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Foreign Trade, Competitiveness and the Balance of Payments

TONY HAWKINS AND DANIEL NDLELA

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Foreign Trade, Competitiveness and the Balance of Payments

TONY HAWKINS AND DANIEL NDLELA
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Dr Mark Simpson completed his B.Sc (Econ) and Ph.D at the London School of Economics, and his Masters at the School of Oriental and African Studies, University of London. Prior to his posting to UNDP Zimbabwe, Dr. Simpson served with the UN’s Department of Peace-Keeping Operations in missions in Angola and East Timor, and with UNDP in Mozambique.
This working paper on Zimbabwe’s past track record and future prospects in the area of foreign trade fills a gap in UNDPs Comprehensive Economic Recovery in Zimbabwe – A Discussion Document launched in 2008. The need for additional work in this area was recognized by the UNDP team of researchers itself, and also prompted by a number of requests from readers of the 2008 document that policy-relevant analysis on trade issues be carried out by the team.

The authors have sought to both disentangle the various constraints that have impacted negatively on Zimbabwe’s past export performance, and presented a menu of policy options that it is believed will enhance Zimbabwe’s international competitiveness in the context of economic recovery, thereby contributing both directly and indirectly to the country’s employment creation and poverty reduction efforts. The authors have not shied away from pointing out the extremely challenging global economic environment in which such recovery will have to take place, and the circumscribed room for maneuver that the country will have as it seeks to compete in international markets. It is against this backdrop that the UNDP Country Office feels that the options put forward in this working paper should be the subject of a vigorous debate between both national actors as well as international agencies interested in supporting Zimbabwe’s recovery.

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Executive Summary

For the foreseeable future Zimbabwe’s economic development will be constrained by low levels of domestic savings as well as by an inadequate supply of foreign exchange from exports and capital inflows. Furthermore because during the crisis phase since 2000 the domestic market contracted by two thirds (in US dollar terms) economic recovery will have to be export-driven since domestic expenditure will remain well below the levels of the 1990s. The impact of this market contraction will be magnified by a very large trade deficit, Since imports (2009–2013) are projected to average 65 percent of GDP, while the export share will be close to 40 percent, a very substantial trade deficit of nearly a quarter of GDP will be a major drag on the speed of economic recovery. As a result, the multiplier effects of domestic expenditure will be much diluted by the visible trade deficit.

This paper explores the implications of this scenario for economic policy and future development concluding that going forward Zimbabwe has no choice other than to seek growth through enhanced integration with the regional and global economies via strong export growth and an investment-friendly business climate to attract foreign capital, especially foreign direct investment (FDI). From a policy viewpoint, fixation with trade liberalization, trade preferences and access to industrialized country markets should be replaced by a much tighter focus on domestic – behind-the-border – obstacles to export growth in the form of malfunctioning domestic institutions and markets, especially labour markets, weak infrastructure and low levels of productivity and competitiveness. Government needs to adopt and implement strategies designed to boost productivity and competitiveness by lowering transaction costs and reducing, if not eliminating, obstacles to foreign investment.

The success of any development strategy depends ultimately on the response of private sector players – entrepreneurs, investors, lenders and corporate strategists. If they are unconvinced, the strategy will not work. Because they are a heterogeneous group, it is simply impossible for the state to devise a ‘one-size-fits-all’ strategy. Some investors may be attracted by outsourcing opportunities while others will see clusters or participation in Global Value Chains (GVC) as profitable. The optimal way out of such a policy dilemma is a level playing field approach, leaving entrepreneurs and investors to ‘discover’ what they can and cannot do.
# Acronyms

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
</tr>
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<tbody>
<tr>
<td>AGOA</td>
<td>African Growth and Opportunity Act</td>
</tr>
<tr>
<td>BOP</td>
<td>Balance-of-payments</td>
</tr>
<tr>
<td>COMESA</td>
<td>Common Market for Eastern and Southern Africa</td>
</tr>
<tr>
<td>CD1</td>
<td>Customs Declaration Form No.1</td>
</tr>
<tr>
<td>CZI</td>
<td>Confederation of Zimbabwe Industries</td>
</tr>
<tr>
<td>DAC</td>
<td>Development Assistance Committee</td>
</tr>
<tr>
<td>ESAP</td>
<td>Economic Structural Adjustment Programme</td>
</tr>
<tr>
<td>EU</td>
<td>European Union</td>
</tr>
<tr>
<td>FDI</td>
<td>Foreign Direct Investment</td>
</tr>
<tr>
<td>FOLIWars</td>
<td>Foreign Licenced Warehouses and Retail Shops</td>
</tr>
<tr>
<td>GCI</td>
<td>Global Competitive Index</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
</tr>
<tr>
<td>GNU</td>
<td>Government of National Unity</td>
</tr>
<tr>
<td>GVCs</td>
<td>Global Value Chains</td>
</tr>
<tr>
<td>IIF</td>
<td>Institute for International Finance</td>
</tr>
<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
</tr>
<tr>
<td>MFN</td>
<td>Most Favoured Nation</td>
</tr>
<tr>
<td>NAFTA</td>
<td>North American Free Trade Agreement</td>
</tr>
<tr>
<td>NTBs</td>
<td>Non-tariff Barriers</td>
</tr>
<tr>
<td>ODA</td>
<td>Official Development Assistance</td>
</tr>
<tr>
<td>OECD</td>
<td>Organization for Economic Co-operation and Development</td>
</tr>
<tr>
<td>PPG</td>
<td>Public and Publicly Guaranteed External Debt</td>
</tr>
<tr>
<td>SADC</td>
<td>Southern African Development Community</td>
</tr>
<tr>
<td>TFP</td>
<td>Total Factor Productivity</td>
</tr>
<tr>
<td>TNCs</td>
<td>Transnational Corporations</td>
</tr>
<tr>
<td>RBZ</td>
<td>Reserve Bank of Zimbabwe</td>
</tr>
<tr>
<td>UNCTAD</td>
<td>United Nations Conference for Trade and Development</td>
</tr>
<tr>
<td>UNECA</td>
<td>United Nations Economic Commission for Africa</td>
</tr>
<tr>
<td>UNIDO</td>
<td>United Nations Industrial Development Organisation</td>
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<tr>
<td>WEF</td>
<td>World Economic Forum</td>
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Section 1
Introduction

Zimbabwe’s independence in 1980 coincided with a marked acceleration in the pace of globalization that lasted through until the global financial crisis of 2007. Because the country’s new government was committed to a strategy of ‘Marxist-Socialist Transformation’ it paid scant attention to the growing tempo of international trade and investment integration. Instead, the authorities opted for increased government intervention, the launch of a plethora of new state-owned enterprises and continued reliance on the inherited inward-looking strategy of import-substitution.

Consequently, for much of the 1980s capital inflows were mostly restricted to aid disbursements and offshore borrowing by the state. As a result the country, which had been import-constrained for much of the pre-independence era when the former Rhodesia was subjected to mandatory UN economic sanctions, continued to be starved of foreign currency and forced to maintain the system of foreign-exchange rationing inherited from the colonial administration.

Towards the end of the 1980s, a number of tentative liberalization measures were adopted culminating in the Economic Structural Adjustment Programme (ESAP) from 1991 to 1995 during which import and current account currency controls were progressively dismantled, fuelling a strong surge in industrial exports and a short-lived inflow of foreign direct investment, mostly to the mining industry.

The government, however, seemed not to have been fully committed to the necessary far-reaching policy and structural reforms, and from the onset of the crisis in 1997 there was a gradual return to dirigisme, during which period GDP growth and exports declined and the foreign-exchange shortage intensified.

For most of the period of accelerating globalization and, post-2003, booming commodity prices, Zimbabwe was sidelined. Neither did it share in the rapid expansion of FDI flows to sub-Saharan Africa. Instead the government again turned inwards and sought solace in rampant domestic credit creation that resulted in the most pronounced bout of hyperinflation in modern history, with disastrous consequences for output, exports, jobs, savings and investment.

There is an extensive literature on the recent export performance of African economies that attributes the region’s loss of global market share to tariff and non-tariff protectionism, especially in industrialized economies. While such influences may well have inhibited export growth in Zimbabwe, there can be little doubt that the prime causes were self-inflicted. Mistaken policy choices rather than a hostile global economic environment better explain the stagnation, decline and growing concentration of exports.

In 2009, the trade openness versus protection debate has little relevance for a small African economy like Zimbabwe with a GDP of $3 billion to $4 billion and per capita incomes in the region of $350 year. The market is just too small to protect and there is limited scope for investment in output and job creation merely to serve the domestic market. Accordingly, whatever the lessons of theory and experience, the practicalities are self-evident. In a post-crisis environment, growth in Zimbabwe must not only be export-driven, but heavily reliant on foreign capital inflows because domestic capital and banking markets have been decimated by hyperinflation. In a word, Zimbabwe must globalize – there is no alternative – difficult though this may well prove to be, especially if the current trend towards deglobalization accelerates.

That Zimbabwe should find itself in this situation at precisely the time when globalization is in retreat and as world trade declines by the largest margin since the Great Depression of the 1930s, while net private global capital flows to emerging markets are forecast to collapse from a peak of $888 billion in 2007 to $141 billion (a decline of 84 percent) in 2009 (Institute of International Finance, 2009), is doubly unfortunate. World trade volumes are forecast to decline 9 percent in 2009 (WTO, 2009)
– the first such fall since 1982. Whatever the depth and duration of the global recession, Zimbabwe will be disadvantaged both in terms of export opportunities and access to capital flows, with the possible and temporary exception of foreign aid.

Zimbabwe’s situation has changed dramatically in one other crucial respect. Dollarization of the economy in the closing months of 2008 and the start of 2009 has removed two crucial elements from the economic policy debate. There is no longer a role for exchange-rate management, other than the choice between the US dollar and the South African rand as the country’s reference currency. Monetary policy, and especially interest rate decisions, have effectively been taken out of the hands of the Zimbabwe authorities with the net result that after years of negative real interest rates, borrowers will have to pay high real interest rates which, while they could have the beneficial effect of encouraging increased domestic household and institutional savings, will slow the pace of economic recovery while heightening dependence on foreign capital.
Section 2

The Context: Globalization and Economic Growth

Over the past 50 years, world trade has grown much faster than output while most of the countries that achieved the fastest growth did so by increasing their participation in world trade (Martin, 2003). This trend accelerated in the 1990s when world trade volumes grew 2.5 times faster than GDP compared with a historical average of 1.5 times faster. Exports grew faster than output in every region – with the fastest growth in East Asia (13.4 percent annually) and by the end of the 1990s exports as a percentage of GDP in developing countries had grown to 25 percent from 15 percent. This reflected not just the opening up of economies in the developing world but sweeping changes in the structure of their exports as they diversified first into manufactured goods and subsequently into services.

In 1980 developing countries earned 70 percent of export revenues from primary products – mostly agriculture and oil – but by 2007 90 percent of their export revenues were from manufactures, though in sub-Saharan Africa this share fell to 19 percent from 26 percent during the commodity price boom (2003–2008), compared with 80 to 90 percent in Asia and over 60 percent in Latin America.

Trade and GDP growth are closely related. Exports are very often the main source of the foreign exchange that a developing economy needs to finance essential imports of food, fuel, intermediate products, manufactures and capital equipment, without which economic growth would be stifled.

Too often, unless growth is export-driven, rapid and sustained economic growth gives rise to trade deficits that must be financed by net capital inflows in the form of offshore borrowing, Foreign Direct Investment (FDI) or foreign aid. In the long run, however, few developing economies can afford a growth model dependent on foreign capital to finance trade deficits, without running the risk of falling into a debt trap because export growth is insufficient to cover debt-service costs.

Since the developing world debt crisis of the 1970s and 1980s, there has been a marked shift in the trade and industrial policies of developing countries away from direct intervention and inward-looking industrialization strategies, towards less controlled and more export-oriented regimes. As emerging markets embraced real globalization in the form of trade liberalization, so they also benefited from financial globalization – a huge increase in foreign capital inflows, especially private flows of foreign direct investment (FDI), bank loans and, in a limited number of cases, portfolio finance. Between 2003 and 2007 net private capital flows to the emerging markets increased 40 percent annually from $229 billion to $888 billion with the fastest growing segments being bank lending, bond finance and FDI (Institute of International Finance, 2009).

In stark contrast, net lending by official creditors – IMF, World Bank and donors – was negative while net Official Development Assistance (ODA) in 2007 totalled $104 billion or just ten percent of the net private capital flows. Indeed, in the seven years to 2007, cumulative ODA of $670 billion was only 65 percent of the net private capital inflow in a single year, 2007 (World Bank, 2008b).

Table 1: Global merchandise exports by sector

<table>
<thead>
<tr>
<th>Sector</th>
<th>1990 (% of Total exports)</th>
<th>2007 (% of Total exports)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>12.2</td>
<td>8.3</td>
</tr>
<tr>
<td>Minerals</td>
<td>10.5</td>
<td>15.0</td>
</tr>
<tr>
<td>Fuels</td>
<td>3.7</td>
<td>4.5</td>
</tr>
<tr>
<td>Manufactures</td>
<td>70.5</td>
<td>69.8</td>
</tr>
</tbody>
</table>

Source: World Trade Organisation International Trade Statistics (various editions)
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sub-Saharan Africa failed to exploit these trends to the same extent as most other developing regions. Net private flows to the region of $57 billion in 2007 – 62 percent of it in equity, predominantly FDI and 38 percent of debt, mostly bank loans – represented a mere 5.5 percent of the global total. To make matters worse, inflows were concentrated in a relatively small number of countries, chiefly South Africa, especially for portfolio capital and the oil exporters.

Indeed, the striking feature of the pre-recession (2008) global economy was the growing reliance of developing countries on export revenues and private foreign capital inflows. In Sub-Saharan Africa’s case, the current account of the balance of payments swung from an average deficit of 4.5 percent of GDP (1999–2002) to a surplus of 3.6 percent of GDP (2003–2006). Booming commodity prices contributed substantially to this turnaround but over the same period net private capital inflows more than trebled underlining the shift in development strategy from reliance on official funding to greater self-sufficiency in the form of increased export revenues and autonomous private capital inflows.

2.1 FOREIGN TRADE AND ECONOMIC GROWTH

There are few instances in recent economic history of countries achieving sustained output and employment growth purely on the basis of domestic market demand. The World Bank Growth Commission Report (2008c) concluded that: ‘All of the sustained, high-growth cases prospered by serving global markets. The crucial role of exports in their success is not much disputed’ (World Bank, 2008c: 48).

But there are numerous assertions to the contrary. Much of the criticism of the trade openness as a pathway to growth however, focuses on interpretations of data that have more to do with econometricians scoring points off one another than with pragmatic advice for policy-makers. Data and interpretation disagreements notwithstanding, however, there is general agreement on two key findings:

(i) That trade protection is not good for economic growth, and

(ii) Secondly that, on its own, trade openness does not guarantee growth.

Openness may be a necessary condition for growth but it is not a sufficient one. Trade openness works to accelerate growth when other conditions are in place – secure property rights, the rule of law, strong financial markets, sound physical infrastructure, open access to international markets and competitive domestic markets for goods, services and labour. Where these conditions do not apply the impact of trade liberalization may be harmful.

The lesson of recent episodes of trade liberalization around the world is that it is the macroeconomic and firm-level conditions that accompany the process of opening up economies that determine whether the process will succeed or not. Trade liberalization is usually interpreted to mean the abolition of non-tariff measures that restrict trade – import controls, quotas, rules-of-origin, health and safety requirements – allied with policies that shift the trade regime towards neutrality. This means eliminating any bias towards domestically-produced import substitutes.

Neutrality is usually defined as a situation in which the effective exchange rate for a country’s exports – that is the nominal exchange rate adjusted for export taxes, export subsidies or trade credits – is equal to the effective exchange rate for imports. This is the nominal exchange rate, adjusted for duties and premia resulting from quantitative restrictions (Bhagwati, 1988). A neutral incentive system is desirable because it fosters the most efficient utilization of a country’s resources.

There is no shortage of evidence of the failure or adverse repercussions of this search for neutrality in incentive systems. In Latin America – notably Argentina and Chile in the 1980s and 1990s – trade liberalization was accompanied by an appreciating real exchange rate which undermined the competitiveness of domestic exports with adverse consequences for the economy. In many transition economies in Eastern Europe in the 1990s, although trade was liberalized, other necessary prior conditions – secure property rights and a
functioning market economy – were not in place. Consequently trade reforms retarded economic performance (Bolaky and Freund, 2004).

The above examples notwithstanding, cross-country regressions suggest that during the 1990s real export growth was higher in those countries that reduced tariffs more but that also enjoyed greater macroeconomic stability and more effective government. In the 1990s, tariff reductions were ‘positively and significantly associated with developing countries’ export shares’ (World Bank, 2005: 138). Trade liberalization, on its own, is not a development strategy for an emerging economy, though in all probability, it is a necessary, though certainly not a sufficient condition.

Indeed, country experience provides convincing evidence of the role of a dynamic export sector in propelling developing country growth. ‘On average, the fast-growing countries of the past two decades have seen their share of global exports rise rapidly (a three-fold increase over the past 25 years), fuelling the sustained growth that these countries have enjoyed’. By comparison countries in Eastern and Southern Africa, including Zimbabwe, have performed very poorly with their global export market share halving (Brenton, Hoppe and Newfarmer, 2008: 4).

Brenton et al., (2008) point out that African countries performed poorly in global export markets despite preferential access to the EU and other markets. They highlight the weakness of the argument that developing countries grow strongly where they have preferential access to protected industrialized country markets. In fact, preferences did not help African countries to integrate with the global economy and, as preference margins decrease with continuing multilateral trade liberalization, the probability is that preferences will be even less effective in the future.

Preferences have failed on three main counts: First, they have detracted from the vital importance of tackling supplyside constraints to export growth. Governments and policy-makers devote months, even years, of work to negotiating preferential trade agreements, while ignoring serious domestic behind-the-border obstacles to export expansion. Secondly, preferences are small; the value of all preferences under Africa, Caribbean and Pacific and General System of Preferences agreements for all African countries, excluding South Africa, is only 2.6 percent of the value of their exports (Brenton, et al., 2008). Third, even where preference margins are substantial, market access is limited by rules of origin and other regulations.

2.2 TARIFF STRUCTURES

Most Favoured Nation (MFN)\(^1\) average tariffs have fallen from 14.1 percent (1995–1999) to 11.7 percent (2000–2004) and 9.4 percent in 2007 – a decline of more than one-third. In addition, a substantial volume of trade is conducted at zero MFN tariff rates or through preferential trade agreements. Concurrent with this steep reduction in protection all regions and income groups have enjoyed substantial real growth in trade with global export growth averaging between 7 and 9 percent over the decade to 2007. At the same time, all regions have become more integrated with the world economy as measured by their trade-to-GDP ratios with the global average rising to 97 percent (2006) from 86 percent (1995). The average for sub-Saharan Africa is 89 percent.

The World Bank’s trade policy indicators (2008d) show a strong negative correlation between a country’s income level and the restrictiveness of its trade regime. The lower the per capita income is, the more restrictive is its trade regime. Only one African country, Mauritius ranked 6th, is in the top 20 least restrictive trade regime economies globally, while 12 are ranked in the bottom 20 out of a total of 125 countries for which data are available.

Trade integration, measured by the trade share in GDP, is negatively and significantly correlated with trade restrictiveness – the more restrictive the foreign trade regime the lower the share of trade in GDP. The data show also that market access is positively and significantly correlated with export

\(^{1}\) The most favoured nation clause in international trading agreements requires that any tariff concession made by one country to another must be immediately extended to all other members, so that it is, in effect, multilateral and not bilateral.
performance, meaning that exports grow more rapidly in those countries with the best access to foreign markets. Ironically oil and commodity exporters, along with high-income countries, enjoy the best market access conditions. There are eight African countries in the top 14 in terms of market access, dominated by mineral exporters (Botswana and Namibia) and oil exporters (Nigeria, Gabon, Algeria and Sudan).

Despite the progress of trade liberalization, high-income countries maintain higher non-tariff barriers and have greater escalation and dispersion in their tariff structures than low-income countries. In effect this means that they protect certain sectors of their economy more robustly than emerging economies, especially those sectors of special interest to developing country exporters. For example, in low-income countries the import average weighted tariff on agricultural products, including preferences, is 1.4 times that of other goods. In high-income OECD countries it is nine times greater.

Developing country exporters also face higher import barriers at the upper end of the value-added spectrum than the lower end. Most countries escalate tariffs as value-added increases so that higher-value products pay higher import duties, but this trend is more pronounced in high-income OECD countries than in developing markets.

On average, sub-Saharan countries rank poorly on most trade policy indicators. The region has the second-highest degree of trade restrictiveness after South Asia with an applied tariff-weighted average of 11 percent (down from 15 percent in 1995–1999). Zimbabwe ranks alongside Sudan, the Seychelles and Comoros as amongst the region’s most closed economies having the highest restrictiveness indices.

The sub-Saharan region also has the worst rankings for governance, business environment and trade logistic and facilitation indicators. It also has the highest degree of export concentration of all the regions with a concentration index of 52.7, while the cumulative average country share of the top five export products approximates 80 percent. Revenues from import duties account for a quarter of fiscal revenues in low-income countries compared with 7 percent in high-income economies.

Sub-Saharan countries rely on trade taxes for 23 percent of their total revenue.

2.3 TRADE LIBERALIZATION IN SUB-SAHARAN AFRICA

Prior to independence in the 1960s and beyond, sub-Saharan Africa’s trade was primarily a two-way relationship with European colonial powers whereby primary products were exported and manufactures imported. From the 1960s to the 1980s, many sub-Saharan governments pursued import-substitution strategies designed to diversify and broaden their economies. During this period, state involvement in the economy was extensive and domestic firms were shielded from international competition by tariffs and import licensing. Tariff structures were extremely complex with large numbers of tariffs, very high tariffs and a high degree of dispersion between different tariffs. Exports were restricted by strict regulation, export taxes and overvalued exchange rates.

During the 1980s, most sub-Saharan countries adopted trade liberalization strategies usually under the tutelage of the IMF and World Bank. By the mid 1990s most African countries had adopted or were implementing IMF/World Bank Structural Adjustment Programmes that placed trade liberalization at the heart of the economic reform process.

Measures to liberalize imports focused on:

- Exchange rate devaluation;
- Reforming the tariff structure by lowering the overall level of tariffs and reducing tariff dispersion; and
- Dismantling non-tariff barriers (NTBs) by reducing the list of products subject to import licensing procedures.

On the export front, four main measures were adopted:

- Exchange rate devaluation;
- The reduction or abolition of export taxes;
- Removal of export licensing procedures; and
• The abolition or privatization of state-owned agricultural marketing boards for export crops.

Some countries went further, seeking to promote non-traditional (new) exports by establishing export processing zones, introducing a variety of export incentives, such as tax-breaks, duty-drawback systems and manufacturing-under-bond arrangements. Other policies included investment in export infrastructure – roads, railways and ports – and the liberalization of investment codes. Trade liberalization protagonists argued that trade openness would boost long-term growth performance in five main ways:

(i) Increased competitiveness in the export sector would attract higher levels of investment resulting in output and employment growth;

(ii) Trade liberalization would have a positive ‘substitution effect’, reducing prices of imported inputs and thereby enhancing export competitiveness and profitability, shifting the incentive structure from production of non-tradables to that of tradable products;

(iii) Exposure to increased competition would foster greater specialization and ‘learning by doing’, as a result of which there would be an increased contribution to the growth process from gains in total factor productivity (TFP);

(iv) The export baskets of primary product economies would be upgraded and diversified; and

(v) Increased foreign trade would accelerate the pace of technology transfer, also giving rise to gains in total factor productivity.

Tariffs were reformed in three stages:

(a) The first was tariff rationalization – reducing the number of tariff rates and of ad hoc rules and regulations;

(b) Tariff dispersion was reduced by lowering top tariff rates and increasing the lowest ones; and

(c) The overall level of tariffs was reduced, so that between 1995 and 2006 average (unweighted) tariffs in Africa were cut to 13.1 percent from 21.7 percent, though by the end of the period African tariffs were higher than in other emerging market regions, except South Asia (Figure 1).

On average, tariffs were reduced by 40 percent and by the end of the period the number of African countries with average unweighted tariffs of more than 15 percent had fallen to 15 while three other countries had average tariffs in excess of 20 percent.

2.4 TRADE LIBERALIZATION AND EXPORTS

One measure of the success of trade liberalization is the increase in the level of imports as a percentage of GDP. This was expected to follow tariff reform and the reduction or elimination of non-tariff barriers.

*Figure 1: Unweighted average tariffs (1995 and 2006)*

Source: UNCTAD (2008)
In the event, the median ratio of imports to GDP in Africa increased some 10 percent from 31 percent of GDP before liberalization to 34 percent subsequently. This was much lower than the average for all developing countries where the import ratio rose by a third to 37 percent of GDP, while for non-African developing countries the increase was 62 percent to 38.9 percent of GDP.

Similarly, Africa’s export-to-GDP ratio rose modestly (11 percent) to 25.7 percent of GDP compared with a 32 percent increase to 29.5 percent of GDP in all developing countries and a 50 percent gain to 31.6 percent of GDP in non-African emerging markets. Indeed, Africa’s trade balance actually worsened after liberalization to a trade deficit of 7.7 percent of GDP from 6.6 percent previously, and while the same was true of developing economies as a whole, the actual trade gap in Africa was substantially larger than that for developing countries as a whole. In non-African developing economies the trade deficit rose to 4.9 percent of GDP from 2.7 percent, while in emerging markets as a whole it widened to 5.9 percent of GDP from 4.3 percent.

The main difference between African and Non-African developing countries was that in the latter the 62 percent rise in the import-GDP ratio was substantially offset by a 50 percent increase in the export share of GDP (UNCTAD, 2008). These numbers confirm earlier research which concluded that trade liberalization boosts both imports and exports, as expected, but that imports grow more rapidly as a result of which the trade deficit widens (Santos-Paulino and Thirlwall, 2004).

Closer econometric analysis of the data suggests that although the crude numbers show that non-African countries exploited trade liberalization more effectively than African states, the actual numbers are statistically very similar. UNCTADs interpretation (2008) is that Africa’s export response was constrained by export momentum effects on the one hand and real effective exchange rates on the other.

Export momentum refers to a country’s capacity to maintain the level of its exports over time. The export momentum coefficient for African economies is 0.78 meaning that for every one percentage point of GDP in exports in a given year, African countries retained 0.78 percent of GDP in the subsequent year. This momentum effect is lower than that for non-African developing countries of 0.87.

Despite this relatively weak export momentum effect, and the adverse effect of overvalued real exchange rates, the value of African exports grew faster (12.4 percent annually) between 1995 and 2006 than in developing countries as a whole (11.5 percent). But Africa had the slowest rate of volume growth for developing regions of 5.8 percent compared with 9 percent for emerging markets as a whole and 6.5 percent for overall international trade. Africa’s export growth was driven primarily by higher export prices which increased 6.1 percent annually over the period compared with 1.5 percent for global trade and 2.1 percent for emerging market exports.

The regional figure masks considerable heterogeneity among African countries where the fastest export growth was achieved by oil and metal exporters and post-conflict states. The most important impact by far was the post-2003 commodity price boom as a result of which export prices rose 17 percent annually (2002 to 2006) after having fallen 2 percent a year between 1995 and 2001.

2.5 EXPORT DIVERSIFICATION

Even more disappointing was the failure of trade liberalization to diversify the region’s export base. The data show that the rise in exports as a share of GDP was primarily the result of rising oil volumes and prices, and to a lesser degree increased metal exports. In the period following trade liberalization, the export concentration index for Africa increased by 80 percent from 0.21 in 1995 to 0.38 in 2006. National figures (2006) range from a high of over 0.8 in oil exporting countries – Angola, Equatorial Guinea, Sudan, Congo, Nigeria, Gabon and Libya – to a low of 0.16 in South Africa and Morocco and 0.19 in Kenya and Tunisia.

Table 2 shows that African export destinations have changed radically since 1960 mostly reflecting the loosening of colonial ties, especially with the EU and the switch of destinations to North America and Asia, especially since the early 1990s. By 2006 China, with two way trade of $32 billion, had
emerged as the region’s third largest trading partner after the US ($60.6 billion) and the EU ($56.4 billion).

Table 2: African export destinations (1960 and 2006)

<table>
<thead>
<tr>
<th>Destination</th>
<th>1960</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>EU</td>
<td>66</td>
<td>40</td>
</tr>
<tr>
<td>NAFTA</td>
<td>9</td>
<td>24</td>
</tr>
<tr>
<td>Developing Asia</td>
<td>6</td>
<td>16</td>
</tr>
<tr>
<td>Africa</td>
<td>5</td>
<td>8</td>
</tr>
<tr>
<td>Other</td>
<td>14</td>
<td>12</td>
</tr>
</tbody>
</table>

Source: UNCTAD (2008)

2.6 MANUFACTURED EXPORTS

From an African perspective, the biggest disappointment of trade liberalization has been its failure, to date, to deliver growth in manufactured exports. In the 2003–2006 period Africa accounted for less than 1 percent of world trade in manufactured products. Sub-Saharan Africa accounted for 0.5 percent of world trade in manufactures, but when South Africa is excluded this falls to 0.23 percent.

Recent explanations for the failure of many countries, especially, but not only in Africa, to achieve export diversification focus on three core issues:

- Factor endowment;
- Geography; and
- Institutions.

Factor endowment militates against export diversification, either because the possession of rich oil, gas or mineral deposits skews the structure of incentives (the tax system and the tariff structure) and the pattern of investment in the direction of natural resource exploitation, or because the existence of a large, unskilled low-productivity, low-wage workforce fosters investment in, and production of, low value-added, labour-intensive manufactures. In a famous article – What you Export Matters – Hausmann, Hwang and Rodrik (2007) conclude that: ‘Countries that produce “poor country” goods remain poor… (so) countries become what they produce’.

In other words, so long as policy-makers adhere to static comparative advantage theory – producing and exporting what they can do well today – their countries will remain in the slow lane. In an increasingly-competitive global economy, export growth depends on moving up the value-added ladder in two respects. First, moving out of primary product and labour-intensive manufactures where demand growth is slow, to more dynamic market segments in medium- and especially high-technology industries. Secondly, within industrial sectors and sub-sectors, shifting activity to those links in the value chain where value-added is greatest.

Both prescriptions are extremely difficult to satisfy. Normally, an economy is a prisoner not just of its resource endowment, but also of its history. Path dependency means that a country’s economic development path is a function of its history. Countries like Zimbabwe where manufacturing industry has regressed will experience great difficulty in making the transition from producing ‘poor country’ goods to the kind of product in demand in rich and fast-growth economies.

The role of geography is more straightforward: land-locked economies like Zimbabwe and those distant from large and dynamic markets are disadvantaged because the costs of exporting are greater, as are the costs of importing essential inputs. There is little policy-makers can do to counter these problems other than by investment in infrastructure and logistics accompanied by economy-wide measures to enhance worker and capital productivity.

The third explanation – weak institutions, and by extension, high transaction costs – is where policy-makers really can make a difference by focusing not on market access issues – such as preferences and trade barriers – but on domestic behind-the-border obstacles to trade.

One explanation offered for Africa’s inability to break through into industrial exports is the continent’s very low level of industrialization. This, however, is unconvincing given that small economies with backward industrial sectors like Swaziland (manufactured exports 47 percent of GDP in the 2000–2006 period), Mauritius (26 percent of GDP) and Lesotho (35 percent of
GDP), have far greater manufactured exports to GDP ratios than more industrialized states. The comparable figure for the continent’s most industrialized country, South Africa, is only 13 percent.

2.7 TRADE LIBERALIZATION, POVERTY REDUCTION AND INCOME DISTRIBUTION

If trade liberalization contributes to faster output growth it will also reduce poverty. The strongest evidence of this comes from the two Asian giants – China and India. Between 1980 and 2000, income per head grew 8.3 percent annually in China and 3.6 percent a year in India while trade integration – trade in goods and services as a proportion of GDP – doubled to 46 percent in China and increased from 19 to 30 percent in India. Between 1978 and 1998 the poverty headcount fell from 28 percent to 9 percent of the population in China and from 51 percent to 27 percent in India (World Bank, 2005).

Unfortunately, these experiences cannot readily be generalized. For the China/India experience to be replicated in Africa, structural transformation must accelerate so that unskilled workers move from contracting sectors of the economy (often non-tradables) to expanding sectors (tradables) that benefit from trade liberalization. In Africa, however, this has not happened because, with some exceptions such as Mauritius, trade liberalization has not yet fostered a strong expansion in the tradables sector, with the exception of oil, gas and metals, which are beneficiaries not of trade policy reforms but of the global commodity price boom.

The impact on employment depends on the macroeconomic framework within which trade liberalization occurs. A study of 18 countries in Latin America (1970–1996) concluded that liberalization had a small, negative impact on employment. The impact was even more adverse in those countries where the real exchange rate was allowed to appreciate as a result of capital flows attracted by economic reform (Dutch Disease effects) (Marques and Pages, 1998). In Brazil, however, (1990–1997) trade liberalization had an initial adverse effect on employment but over the entire period the shift to greater labour-intensity in the economy gave rise to increased long-run employment (Moreira and Najberg, 2000). In some African economies, output and employment effects have been significantly negative. One study of Kenya, Tanzania and Zimbabwe found that firms responded to increased competition from imports by contracting rather than by seeking to upgrade and enhance their competitiveness (Lall, 1999).

Latin American experience suggests that trade reform reduced employment in previously protected industries but fostered new job creation elsewhere in the economy. Dislocations of this kind tended to have short-run adverse effects followed by long-term gains. Chile experienced several years of double-digit unemployment rates after trade liberalization but from 1986 to 1997 its unemployment rate was amongst the lowest in the region (De Ferranti, et al., 2001).

Predictions that trade liberalization would reduce government’s fiscal revenues leading to reduced public social spending have not materialized. In the decade to 1999, Kenya radically liberalized its foreign trade environment but import duties as a proportion of GDP actually increased. This reflected expansion of the revenue base, a reduction in the number and extent of exemptions, increased duties on some imports and a shift in the pattern of imports to higher-duty products (Winters, et al., 2004).

The lessons for poverty reduction are similar to those of the openness-growth relationship. The poor are more likely to benefit from globalization where appropriate complementary policies are in place, including labour market deregulation and social safety nets for the vulnerable (Harrison, 2005). Above all, the impact of globalization on the poor cannot be easily generalized. A number of studies – Winters, McCulloch and McKay (2004), Ravaillion and Lokshin (2004) and Harrison (2005) all draw attention to the heterogeneity of outcomes. Trade liberalization may contribute to poverty reduction depending on the environment within which it is implemented including the overall package of reforms. Where these conditions are unfavourable, trade liberalization may well increase rather than reduce poverty.

Evidence on the impact of trade reform on wage inequality is mixed. In some Latin American
countries the industries most exposed to international competition pay the highest wages but in Mexico the trebling of manufactured exports during the 1990s reflected accelerated productivity growth, increased demand for higher paid skilled workers and an increase in wage inequality. Thus, in Mexico, trade integration through NAFTA\textsuperscript{2} reduced poverty but increased income inequality between regions.

**Multilateral Trade Liberalization: Implications for Zimbabwe**

One, possibly the most important, objective of the current long-stalled round of trade liberalization negotiations – the Doha Round – is the acceleration of development in poor countries. For this reason reform of the global agricultural trading system tops the agenda. There are three core issues for agricultural trade reform – market access, domestic support and export competition. As an agricultural exporter Zimbabwe stands to gain from any agreement on these issues, but because its key farm exports other than cotton, sugar and meat, are either regional – in years when the country produces maize surpluses – or non-food (tobacco, horticulture) that are unlikely to be major beneficiaries of a Doha agreement, the impact on agricultural exports is likely to be relatively small.

Anderson, Martin and van der Mensbrugghe (2005) seek to estimate the gains from Doha Round liberalization under different scenario outcomes, but because of the far-reaching changes in the global economy since these estimates were made, allied with the many uncertainties surrounding the progress and eventual outcome to the Doha negotiations, means that such estimates are highly speculative. That said, it is clear that multilateral trade liberalization would boost real incomes in sub-Saharan Africa, especially where it is accompanied by agricultural reform. The Anderson et al., analysis suggests also that the gains from trade would be even greater where countries go beyond the most likely Doha scenarios with unilateral trade reforms.

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\textsuperscript{2} NAFTA (North American Free Trade Agreement), a trading bloc consisting of Canada, Mexico and the USA entered into force on January 1, 1994. NAFTA created the world’s largest free trade area, which now links 444 million people producing $17 trillion worth of goods and services.
AGOA imports totalled $51.1 billion in 2007, more than six times the amount in 2001, the first full year of AGOA. While petroleum products accounted for the largest portion of AGOA imports, non-oil AGOA trade totalled $3.4 billion in 2007, more than double the amount in 2001. Several non-oil sectors experienced sizable increases during this period, including apparel, footwear, vehicles, fruits and nuts, prepared vegetables, leather products, cut flowers, prepared seafood, and essential oils (Office of the USTRade Representative, 2008).

Assuming continued progress in the related fields of political and economic reform, Zimbabwe should qualify for AGOA membership by 2011, possibly sooner. The three main benefits would be enhanced access to the US market for exports at least until 2015 (when AGOA expires in its present form), increased FDI and aid for trade from AGOAs Trade Capacity Building initiative (TCB).

**Aid for Trade**

‘Aid for trade’ comprises technical assistance; capacity building; institutional reform; investments in trade-related infrastructure and assistance to offset adjustment costs, such as fiscal support to help countries make the transition from tariffs to other sources of revenue. This category is becoming increasingly important so that by 2004 some 31 percent of bilateral Official Development Assistance (ODA) was aid for trade while the World Bank and regional development banks allocate about half their sector programmes to trade facilitation (OEC/WTO, 2007).

In its recovery phase Zimbabwe will need all the help it can get in developing modern ‘trade infrastructure’ – especially investment in physical infrastructure, including transport corridors and information systems to connect exporters to world markets as well as modern customs facilities to move products rapidly and efficiently across borders. Vital also will be the development of institutions and expertise to manage a complex global trading system.
Section 3
Financial Globalization and Economic Development

Recent literature makes a careful distinction between financial globalization, defined as growing global linkages in the form of increasing cross-border financial flows of all kinds, including Foreign Direct Investment (FDI), portfolio investment and bank lending, and financial integration which refers to an individual country’s links with international capital markets. Very broadly, emerging market economies are those with strong financial integration links and thereby more likely to attract inflows of portfolio capital and to some extent bank loans, while the broad mass of developing economies participate in the financial globalization process mostly through the attraction of FDI but also through bank loans. Today the two concepts – financial globalization and financial integration are used interchangeably.

During the recent commodity boom (2002–2008) this distinction between emerging and developing economies became increasingly blurred as the latter, especially but not only oil and gas exporters, have become capital exporters to financial markets in OECD and other developed economies. This has increased their financial integration with the global economy, albeit in a paradoxical and non-traditional manner – low-income countries investing capital surpluses in rich economies, thereby turning traditional economic theory on its head.

The increased volume of cross-border financial flows especially since the mid-1980s reflects the combination of both ‘push’ and ‘pull’ factors. Pull factors have resulted from policy reforms in developing countries – trade and capital account liberalization, large-scale privatization programmes, more investor-friendly investment and business codes and the establishment or liberalization of stock exchanges.

Push factors include changing macroeconomic and business cycle conditions in high-income countries along with important institutional changes such as the growth of institutional investors in industrial countries, including mutual funds and hedge funds, as well as the evolutionary impact of ageing in high-income economies with all that that implies for domestic savings levels. These push and pull factors resulted in a steep increase in the volume of capital flowing to developing countries, though in recent years this acquired a new twist as the world’s richest economies – as a group – have become net importers of capital while developing low-income economies, again as a group, have become net capital exporters.

In principle financial globalization should boost a country’s growth rate directly by augmenting domestic savings, reducing the cost of capital transferring technology (FDI) and strengthening the domestic financial sector. Indirect channels include the ‘discipline’ effects of financial globalization in terms of forcing capital-recipient countries to implement appropriate fiscal, monetary and exchange-rate policies.

However, there is little support in the empirical research for the theoretical view that financial globalization boosts economic growth. The IMF (Prasad, et al., 2003) concludes as follows:

‘An objective reading of the vast research effort to date suggests that there is no strong, robust and uniform support for the theoretical argument that financial globalization per se delivers a higher rate of economic growth.’

(2003: 8)

As the Fund notes, this is not surprising since research suggests that the main explanation for different rates of per capita income growth is differences in total factor productivity (TFP) explained by ‘soft’ factors like governance, property rights and the rule of law. Accordingly, while financial globalization may lead to increased capital inflows, these only translate into higher rates of GDP growth where other pieces of the growth puzzle are in place.

In fact, the evidence suggests that financial globalization, in combination with good macroeconomic policies and good governance is
conducive to growth. The research shows that countries with a strong human capital base and good governance do better at attracting FDI, which (usually) boosts growth. Less convincing is the evidence that corruption is strongly negatively correlated with FDI. In Africa a number of countries that are seen to suffer from high levels of corruption have attracted very large inflows of FDI because they are oil-rich – a consideration that outweighs corruption concerns.

Rogoff et al., (2006) stress the crucial contribution of collateral benefits – positive side-effects of financial globalization. Collateral benefits include development of the domestic financial sector, institutional improvements in the fields of governance and the rule of law and better macroeconomic policies. The argument is that the beneficial impact of financial integration on output and employment growth may take time to show up because the process operates through indirect channels rather than just directly through financing domestic investment. Indeed, these ancillary benefits could turn out to be more important in fostering growth than the external financing of domestic investment.

Although the empirical research does not provide robust support for the view that capital inflows will accelerate economic growth, several studies suggest that different types of inflows may have different growth impacts. Reisen and Soto (2001) examine six different types of capital inflow – FDI, portfolio equity, portfolio bonds, short-term bank borrowing, long-term bank borrowing and official (aid) flows. Only two of the six, FDI and portfolio equity are positively associated with highest subsequent growth rates. Bosworth and Collins (1999) found that increased FDI and bank lending were associated with higher levels of domestic investment, a finding confirmed by the World Bank’s Global Development Finance report (2001) leading to the relatively solid conclusion that FDI, in particular, is likely to boost country growth rates.

The contrast between the gains from trade openness and financial openness is significant, with the evidence suggesting that gains from trade are easier to secure than gains from financial globalization where the entry bar is higher. (Prasad, et al., 2003). While, as noted above, it is difficult to find a robust relationship between levels of capital inflows of all kinds and subsequent economic growth rates, there is evidence to suggest that ‘threshold effects’ can be significant. As noted above, the effect of FDI on growth depends, in part, on the size and quality of a country’s human capital stock (Borenzstein, De Gregorio and Lee, 1998). As with foreign aid, the concept of absorptive capacity applies with the evidence suggesting that a country’s capacity to absorb and exploit foreign capital, of all kinds, depends not just on its human capital stock, but also on macroeconomic policies, the strength of institutions, the state of governance and the depth of domestic capital and financial markets.

### 3.1 Domestic Capital Mobilization

A recent IMF study found that in a sample of 51 emerging markets, those that relied less on foreign finance grew faster in the long run. In other words, countries with balance-of-payments surpluses on current account grow faster than those with deficits that rely on capital inflows. This is another paradox because it suggests that if capital flows to countries that have good investment opportunities, there must be a correlation between rapid growth and a current account deficit. In fact, the evidence gives a different correlation – one between national (domestic) savings and GDP growth. Countries that have higher savings ratios for a given level of investment experience higher growth. The evidence shows that countries with higher levels of investment fare better than those with low levels of investment. But countries that had high investment ratios and lower reliance on foreign capital (lower current account deficits) grew faster – on average, by about one percent a year – than those that also had high investment but relied more on foreign capital. One possible explanation is that higher growth is associated with – in fact causes – higher domestic savings. In other words, fast-growing countries may need less foreign capital. The snag with this explanation is that as countries get richer so they spend more on consumption (South Africa) and also invest more, because there are more investment opportunities. Accordingly, they should have a Balance-of-Payments (BOP)
A decade ago the debate on trade policy in Zimbabwe would have been very different, but ten years of accelerating economic decline, and the decimation of firms, jobs and savings, have dramatically narrowed the range of policy options. Dollarization too has narrowed options, forcing the authorities to impose deflationary policies since currency devaluation is no longer on the agenda. In this environment the debate over protection versus openness pales into insignificance. In its place, policy-makers must focus not on whether trade liberalization is desirable, but on the mechanics of its implementation to ensure that the impact is beneficial. The debate is not about whether, nor even when, but how.

3.2 LESSONS FOR ZIMBABWE

Policy-makers in Zimbabwe can glean little from sub-Saharan and developing world experience of trade liberalization, because while it is true that Zimbabwe still maintains very high levels of overall protection at this stage in its development, Zimbabwe has no option other than to seek growth through enhanced integration with regional and global economies, especially in the form of export growth and openness to foreign capital inflows of all kinds.

deficit on current account and need more – not less – foreign capital.
Section 4
Post-Independence Overview

Throughout the post-independence period, foreign currency has been a major constraint on economic growth. Table 3 shows export growth (in US dollars) of 0.4 percent annually for the 1980–2008 period, while imports grew 0.3 percent a year. Both peaked in 1996 and 1997 since then exports have halved while imports have declined 58 percent. Prior to the onset of economic decline, export growth averaged 4.6 percent a year, below the long-run growth rate of world exports (1980–2007) of 7.3 percent annually, while that of imports averaged 5.8 percent. At their peak in 1996, exports of goods and services accounted for 35 percent of GDP, while the import share in its peak year (1997) was 40.5 percent. During the liberalization period, both ratios increased as the economy was opened up, a process that continued after 1997 when the share of foreign trade in GDP rose further. Exports per head of population declined and stagnated during the 1980s before recovering strongly in the ESAP period to peak in 1997, since when they have halved. Figure 2 shows that per capita exports have declined by more a third since 1980. Per capita imports peaked

Table 3: Foreign trade 1980–2008

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<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>Exports (US$ millions)</td>
<td>2.2</td>
<td>6.7</td>
<td>-4.5</td>
<td>0.4</td>
</tr>
<tr>
<td>Imports (US$ millions)</td>
<td>5.2</td>
<td>6.5</td>
<td>-4.0</td>
<td>0.3</td>
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<tr>
<td>Exports/GDP</td>
<td>24.5%</td>
<td>27.4%</td>
<td>32.9%</td>
<td>29.3% (1980-2006)</td>
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<tr>
<td>Imports/GDP</td>
<td>27.4%</td>
<td>35.5%</td>
<td>35.8%</td>
<td>32.8% (1980-2006)</td>
</tr>
<tr>
<td>Current account balance (% of GDP – average)</td>
<td>-3.8</td>
<td>-5.2</td>
<td>-7.0</td>
<td>-6.0 (1997-2005)</td>
</tr>
<tr>
<td>Terms of trade (1980 = 100)</td>
<td>111.0</td>
<td>107.0</td>
<td>116.5</td>
<td>111</td>
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<tr>
<td>Memoranda Item: Growth 1980–1997 (% p.a.)</td>
<td>Exports 4.6</td>
<td>Imports 5.8</td>
<td>–</td>
<td>–</td>
</tr>
</tbody>
</table>

Sources: World Bank: African Development Indicators (various editions), IMF Regional Economic Outlook for sub-Saharan Africa (various editions) and World Economic Outlook Database (2008); Reserve Bank of Zimbabwe: Quarterly Monetary Policy Statements (various editions) and the Central Statistical Office, Harare: Quarterly Digest of Statistics and National Accounts (various editions).
at the start of the period 1981, before falling steeply during the period of import-constrained growth in the 1980s. As with exports there was a strong recovery during the liberalization phase, but by 2007 imports per capita were 35 percent lower than at independence.

Even more striking is the weak performance of export volumes. These peaked in 1987, a 28 percent increase on the figure for 1980. But, as Figure 3 shows, by 1990 volumes had fallen by a third from their record 1987 levels and when exports reached their 1996 high in value terms, volumes were only four percent higher than in 1980. Indeed in only 6 of the 25 years for which volume data are available were exports greater than in 1980. By 2004, export volumes were one-third below 1980 levels.

Figure 3 also shows that export revenues were sustained by strong export prices, which to some extent offset falling volumes, especially during the commodity price supercycle in 2003–2008. At the end of the 25-year period (1980–2004) however, export prices (in US dollars) were only modestly higher (up 9.5 percent) than at the start. Indeed for most of the period export prices were below 1980 levels. Despite this, however, Zimbabwe’s terms of trade (1980=100) averaged 111 over the entire period (1980–2007) reflecting the fact that, although for most of the period export prices were depressed, import prices were even more so.

No single factor explains Zimbabwe’s weak export performance. Figures 2 and 3 suggest that much of the blame rests with a weak supply-side response especially during the crisis period when export volumes and revenues have declined despite buoyant international commodity prices. Three other explanations stand out:

- Deteriorating competitiveness as measured in the World Economic Forum’s Global Competitiveness Index and the World Bank’s Doing Business indicators.
- An overvalued exchange rate during both the control period of the 1980s and the 2000–2007 crisis period (Figure 4), and
- A quality and value-added deterioration in Zimbabwe’s export basket with growing reliance on mining exports and commodity exports generally and the decline in exports of manufactured goods, especially medium and high-tech manufactures.

Table 4 shows that exports of manufactures reached their peak in terms of market share in the late 1990s and have since declined as also has that of agriculture, mostly due to the sharp contraction in the value of tobacco exports. The mining industry now accounts for just over half total exports, reflecting the combination of the metals price boom and the expansion of platinum.

**Figure 3: Index of export volumes and prices**

![Figure 3: Index of export volumes and prices](source: Central Statistical Office, Harare and the International Monetary Fund)
### Direction of Trade

Recent direction of trade data are not available except on an incomplete basis which precludes ready comparisons with previous years. Over time, South Africa has become the country’s dominant trading partner by far, accounting for 43 percent of imports (Table 5) and 19.4 percent of exports. In the two most recent years for which data are available (2003/04), South Africa’s import share exceeded 50 percent while its export share averaged more than 25 percent.

As South Africa’s import share has grown from 38 percent in the mid-1990s to 50.5 percent in 2004, so the EU share has shrunk from a quarter to 9 percent (Central Statistical Office, Harare, 2008). Similarly, the share of Zimbabwe’s exports going to industrialized countries fell to less than 30 percent in 2004 from over 52 percent in 1995, while South Africa bought 30 percent of Zimbabwe’s exports in 2004, up from only 12.5 percent in 1995. The figures do not reflect a major boom in trade with China. Indeed in 1995/06 China bought 3.25 percent of the country’s exports and by 2003/04 this had risen to 4 percent — in US dollar terms an increase of less than $10 million.

### Exports and Imports in the Context of Regional Trade

As shown in section 4.1 above, South Africa is by far the most important export and import destination of Zimbabwean products in the region. Once South Africa is removed from SADC, trade with the non-COMESA SADC countries becomes insignificant. The remaining SADC member states (DRC, TANZANIA)

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**Table 4: Structure of exports (1981–2008)**

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<td>Agriculture</td>
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<td>46.1</td>
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<td>Manufacturing</td>
<td>9.9</td>
<td>14.1</td>
<td>21.0</td>
<td>15.5</td>
<td>11.3</td>
</tr>
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</table>

**Main Exports**

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<tbody>
<tr>
<td>Tobacco</td>
<td>22.0</td>
<td>20.1</td>
<td>30.5</td>
<td>30.6</td>
<td>13.9</td>
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<td>Gold</td>
<td>7.5</td>
<td>13.8</td>
<td>12.3</td>
<td>12.1</td>
<td>5.7</td>
</tr>
<tr>
<td>Ferrochrome</td>
<td>7.8</td>
<td>9.0</td>
<td>7.0</td>
<td>8.6</td>
<td>9.2</td>
</tr>
<tr>
<td>Cotton</td>
<td>6.3</td>
<td>6.5</td>
<td>4.7</td>
<td>7.4</td>
<td>6.9</td>
</tr>
<tr>
<td>Platinum</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>0.5</td>
<td>29.1</td>
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</tbody>
</table>

**Sources:** Central Statistical Office, Harare and the Reserve Bank of Zimbabwe

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**Table 5: Zimbabwe’s main trading partners (2000–2004) (Percent of total trade, exports and imports)**

<table>
<thead>
<tr>
<th>Country</th>
<th>Rank</th>
<th>Total trade</th>
<th>Exports</th>
<th>Imports</th>
</tr>
</thead>
<tbody>
<tr>
<td>South Africa</td>
<td>1</td>
<td>31.1</td>
<td>19.4</td>
<td>43.0</td>
</tr>
<tr>
<td>UK</td>
<td>2</td>
<td>5.5</td>
<td>7.7</td>
<td>3.2</td>
</tr>
<tr>
<td>Germany</td>
<td>3</td>
<td>4.3</td>
<td>6.2</td>
<td>2.4</td>
</tr>
<tr>
<td>Japan</td>
<td>4</td>
<td>4.0</td>
<td>6.0</td>
<td>2.0</td>
</tr>
<tr>
<td>Switzerland</td>
<td>5</td>
<td>–</td>
<td>4.4</td>
<td>–</td>
</tr>
<tr>
<td>China</td>
<td>6</td>
<td>–</td>
<td>4.2</td>
<td>–</td>
</tr>
<tr>
<td>US</td>
<td>7</td>
<td>3.3</td>
<td>3.7</td>
<td>2.7</td>
</tr>
<tr>
<td>Botswana</td>
<td>2.6</td>
<td>2.4</td>
<td>2.8</td>
<td></td>
</tr>
<tr>
<td>Zambia</td>
<td>2.2</td>
<td>3.1</td>
<td>1.4</td>
<td></td>
</tr>
<tr>
<td>EU (other)</td>
<td>11.5</td>
<td>4.2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>SADC (other)</td>
<td>4.6</td>
<td>n.a</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Source:** Central Statistical Office, Harare

---

3 The only SADC countries which are not also members of COMESA are Angola, Botswana, Lesotho, Mozambique, Namibia and Tanzania.
Madagascar, Malawi, Mauritius, Swaziland, Zambia and Zimbabwe) are also members of the COMESA, with a current membership of 19 countries.

Overall, intra-COMESA trade has grown from a total of $3 billion in 1997 to a figure of $9 billion in 2007 (Figure 4). This high percentage of intra-regional trade growth is partly attributed to the increased demand of intra regional products in recent years. Intra-COMESA trade grew by 35 percent in 2007 over 2006 levels, which was above the 8 percent increase recorded in 2006 over 2005 (COMESA Merchandize Trade Statistics 2008: Bulletin 7). In 2007, Zimbabwe imported maize worth $32 million from Malawi, which was 42 percent of her COMESA imports. DRCs major intra-COMESA import in 2007 was tobacco from Zimbabwe worth $50 million (Ibid).
As argued in Section 2.6, one explanation offered for Africa’s inability to break through into industrial exports is the continent’s very low level of industrialization. In the case of the African region, this translates into low or poor quality of these countries’ manufactured products. In a recent survey of manufactured firms in Zimbabwe, 65 percent of the companies mentioned finance and quality of products as their main problem followed by human resources (51 percent), infrastructure (44 percent) and government policy (37 percent) (COMESA, 2009). Only a year ago in 2008, 90 percent of the same companies perceived their number one problem as government (price controls), followed by foreign currency (80 percent), and raw materials (64 percent). Thus until all the poor policy indicators discussed in Section 4.4 are attended to and corrected, Zimbabwe is unlikely to improve her export performance at both the regional and international levels.

4.3 OVERALL EXPORT PERFORMANCE

Both agricultural and manufactured exports declined steeply over the period (Figure 5). Most of the decline in agricultural exports was attributable to the collapse of tobacco production, partly offset by firmer prices as part of the global commodity price boom. Tobacco export volumes fell from a peak of 195 million kilograms in 2001 to 71 million by the end of the period, while horticulture exports also fell sharply – by almost three-quarters to $33 million in 2008 from over $125 million in 2000. Citrus volumes declined 90 percent and flower volumes 70 percent.

Cotton exports were highly volatile, ranging between a peak of $156 million in 2000 and a low point of $53 million in 2002 – a reflection both of climatic conditions and fluctuating global prices as well as of the general dislocation of agriculture. By 2008 they had recovered to $114 million. Exports of ‘pure manufactures’ – defined to exclude semi-processed raw materials like ferrochrome and cotton lint – fell 80 percent with both clothing and engineering exports recording steep declines.

Exports were sustained, however, in the latter years by the commodity price boom and the expansion of platinum production. From a low of $380 million in 2002 prior to the commodity price upswing, mining exports more than doubled to $865 million in 2008. Given that gold earnings more than halved to less than $100 million in 2008 while asbestos exports were down 90 percent over the period to a mere $6 million, this was a remarkable performance primarily attributable to the doubling of prices for ferrochrome and nickel, a three-fold rise in the price of gold and a 67 percent increase in platinum prices. Volume growth in platinum, was dramatic – from a mere 12,000 ounces in 2002 to 580,000 ounces by 2008.

4.3.1 Imports

The most striking aspect of the structure of imports was the six-fold increase in food imports from 3.2 percent to 17.5 percent of total imports. Fuel imports peaked to $447 million in 2006 (23 percent of total imports) before declining to $290 million in 2008 (15 percent of total imports).
Section 4 – Post-Independence Overview

Table 7: Imports 2000 and 2008

<table>
<thead>
<tr>
<th>Item</th>
<th>2000 (% of total)</th>
<th>2008 (% of total)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Food</td>
<td>3.2</td>
<td>17.5</td>
</tr>
<tr>
<td>Fuels</td>
<td>16.3</td>
<td>15.0</td>
</tr>
<tr>
<td>Electricity</td>
<td>3.2</td>
<td>2.7</td>
</tr>
<tr>
<td>Chemicals</td>
<td>16.3</td>
<td>21.0</td>
</tr>
<tr>
<td>Capital goods</td>
<td>18.6</td>
<td>11.9</td>
</tr>
<tr>
<td>Transport equipment</td>
<td>7.2</td>
<td>6.7</td>
</tr>
<tr>
<td>Manufactures</td>
<td>22.2</td>
<td>16.4</td>
</tr>
<tr>
<td>Raw materials</td>
<td>6.6</td>
<td>4.1</td>
</tr>
<tr>
<td>Other</td>
<td>6.4</td>
<td>4.7</td>
</tr>
</tbody>
</table>

Source: Reserve Bank of Zimbabwe

The decline in capital goods and transport equipment reflect the shrinkage of the economy as well as the lower volumes of manufactured goods and raw materials. Aside from rising food imports the standout item is the increase in chemical imports.

4.4 TRADE POLICY INDICATORS

Table 8 illustrates Zimbabwe’s poor trade policy ratings relative to the region as a whole, which is the second most restrictive in the world. Zimbabwe’s applied trade-weighted average tariff

Table 9 and 10 underscore the necessity for the combination of strong export growth and substantially higher net capital inflows. In the light of gloomy IMF forecasts (IMF, 2009) of a lengthy recession and a weak recovery, the challenges facing Zimbabwe are formidable. The signs are that post-recession export growth will be sluggish and that the combination of the worst global financial crisis since the 1930s and uncertainties regarding foreign aid inflows will constrain the country’s capacity to finance the imports necessary for recovery and recapitalization.

Table 8: Trade policy indicators: Zimbabwe and comparators

<table>
<thead>
<tr>
<th>Country</th>
<th>TTRI</th>
<th>Applied tariff trade-weighted</th>
<th>Rest of the world applied tariff</th>
<th>Ease of Doing Business</th>
<th>LPI</th>
<th>Market access index</th>
<th>Export concentration index</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sub-Saharan Africa</td>
<td>11.8</td>
<td>11.0</td>
<td>3.0</td>
<td>135.8</td>
<td>2.3</td>
<td>5.4</td>
<td>52.7</td>
</tr>
<tr>
<td>Zimbabwe</td>
<td>n.a</td>
<td>14.3</td>
<td>2.7</td>
<td>152.0</td>
<td>2.3</td>
<td>n.a</td>
<td>22.3</td>
</tr>
<tr>
<td>SACU</td>
<td>8.3</td>
<td>8.8</td>
<td>4.0</td>
<td>69.6</td>
<td>2.7</td>
<td>1.2</td>
<td>41.2</td>
</tr>
<tr>
<td>South Africa</td>
<td>5.7</td>
<td>4.9</td>
<td>1.9</td>
<td>35.0</td>
<td>3.0</td>
<td>15.6</td>
<td></td>
</tr>
<tr>
<td>Botswana</td>
<td>9.0</td>
<td>9.4</td>
<td>0.1</td>
<td>51.0</td>
<td>n.a</td>
<td>0.1</td>
<td>72.5</td>
</tr>
<tr>
<td>Zambia</td>
<td>8.5</td>
<td>n.a</td>
<td>2.5</td>
<td>116.0</td>
<td>2.4</td>
<td>3.7</td>
<td>68.4</td>
</tr>
<tr>
<td>Kenya</td>
<td>8.1</td>
<td>9.9</td>
<td>2.6</td>
<td>72.0</td>
<td>2.3</td>
<td>5.1</td>
<td>18.8</td>
</tr>
<tr>
<td>Tanzania</td>
<td>9.0</td>
<td>8.1</td>
<td>2.4</td>
<td>130.0</td>
<td>2.1</td>
<td>6.0</td>
<td>35.3</td>
</tr>
<tr>
<td>Comesa*</td>
<td>12.6</td>
<td>12.1</td>
<td>2.1</td>
<td>130.8</td>
<td>2.4</td>
<td>5.4</td>
<td>49.3</td>
</tr>
</tbody>
</table>

* Excluding East African Community countries

Notes:

TTRI – Trade Tariff Restrictiveness Index summarises the trade restrictiveness of a country. It is expressed as a percent as if it were a tariff rate, meaning that the higher the rate the more restrictive the tariff structure.

Applied tariff (Trade weighted) is the average of most-favoured-nation tariff rates applied by each country, including preferential rates.

The rest-of-the-world applied tariff is the average of applied tariff rates imposed by a country’s export partners, including preferential rates, expressed as a percent.

The Ease of Doing Business ranking represents a broad measure of a country’s business environment. The countries and regions are ranked out of a total of 178 countries – the higher the ranking score, the worse the business environment.

LPI is the country’s Logistics Performance Index. It measures the overall perception of a country’s key seven logistics based on over 1000 surveys of logistics information. The categories include the efficiency of customs and border procedures, the quality of transport and technology infrastructures.

The market access index summarizes the trade restrictiveness of a country’s trading partners. It is expressed as a percent as if it were a tariff rate.

The export concentration index measures the degree to which a country’s export trade is concentrated in a relatively few products. The higher the index the greater the degree of concentration.
Foreign Trade, Competitiveness and the Balance of Payments

is higher than the regional average for sub-Saharan Africa for COMESA, of which it is a member, and for leading regional trading partners such as South Africa, Botswana, Zambia and Tanzania. It has the worst score in respect of Doing Business indicators, but along with Kenya and South Africa has a much more diversified export basket than the regional average and those of most of its regional trading partners.

Zimbabwe is also one of a relatively small number of countries to have increased its trade restrictiveness in recent years. Zimbabwe’s simple average Most Favoured Nation (MFN) tariff was reduced from 27.4 percent (1995–1999) to 17.4 percent (2000–2004), but subsequently increased to 20.1 percent in 2007.

Using 2006/07 data, Zimbabwe ranks as the world’s worst performer (number 170) in terms of expanding its share of global exports. The country’s share of the global export market is estimated to have declined some 96.6 percent, meaning that during a period when global trade expanded very rapidly Zimbabwe lost ground in both absolute terms (falling export volumes and values) and relative terms (the 96.6 percent decline in the country’s share of the world export market).

In the World Trade Organisation’s data base, Zimbabwe’s average tariff (unweighted) for all products in 2007 was 20 percent, 25.4 percent for agricultural products and 19.2 percent for non-agricultural items. The country was ranked 121 out of 184 countries in terms of exports and 139 for imports. Its share of global exports was 0.01 percent and imports 0.02 percent.

4.5 EXCHANGE-RATE POLICY

Figure 6 shows that the real effective exchange rate (REER) for the Zimbabwe dollar depreciated from 158 at independence in 1980 to 100 ten years later. During the 1990s, the REER depreciated further to average 84 over the decade, suggesting that Zimbabwe’s exporters were considerably more competitive during this reform decade than under the control regime of the 1980s – the more so given the fact that Zimbabwe’s export prices were more favourable than the sub-Saharan average over the decade.

The REER was massively overvalued during the 2001–2003 period and while it returned to competitiveness in 2004/05 as hyperinflation took hold, the real rate escalated alarmingly to reach an estimated 1,074 in 2007 (IMF, 2008).

Figure 6: Zimbabwe Real Effective Exchange Rate (1980–2006) (1990=100)

Source: World Bank: African Economic Indicators (various editions) and the International Monetary Fund Regional Outlook for sub-Saharan Africa (various editions)

4 The Real Effective Exchange Rate measures movements in a country’s real exchange rate (adjusted for inflation) in terms of a weighted average of the exchange rates of trading partners.
4.6 BALANCE OF PAYMENTS

For most of the pre-crisis period, Zimbabwe ran a visible trade surplus that was more than offset by the deficit on invisible transactions, leaving a current account deficit averaging some 5 percent of GDP in the first half of the 1980s, which subsequently narrowed to 0.8 percent in the latter half of the decade. During the 1990s, the current-account deficit averaged 6 percent of GDP, narrowing to 3 percent in the 2000 to 2005 period.

On their own such figures are largely meaningless to the extent that they disguise the underlying macroeconomic and institutional factors at work. In the early 1980s imports were constrained by limited access to foreign currency and highly bureaucratic import licensing and allocation systems. Liberalization after 1990 led to a short-term surge in imports (1991–1997) followed by the transformation in the structure of imports as the demand for capital goods and intermediates fell away during the crisis period to be partially replaced by increased food, electricity, fuel and most recently, consumer imports.

The current account figures also camouflage changing capital account profiles. Throughout the period, Zimbabwe attracted very little Foreign Direct Investment (FDI), especially when the $450 million Hartley Platinum project is excluded. Bank lending was negative while foreign aid disbursements were volatile, partly reflecting food crises (1982/83, 1992/94 and 2002 onwards) and since 1997, deepening donor unhappiness with the policies of the Zimbabwe government (Table 9). Since independence in 1980 there has been a small net inflow of private sector finance of $269 million, mostly in the form of Foreign Direct Investment (FDI) of $688 million, which partly offset banking and trade finance outflows of $548 million. RBZ data has been used to calculate the reported net inflow of bank and trade credit in the 2006–2008 period – a marked reversal of the previous outflows reported by the World Bank.

Arguably, the most remarkable feature of the RBZ figures is the dominance of aid. During the post-2000 period, the net inflow of aid funding averaging $250 million annually exceeded the $195 million annually received during the 1980s underlining the degree to which aid flows and dependence have in fact increased during the period of deepening crisis.

Table 9 shows that over the entire post-independence period foreign aid accounted for some 97 percent of the net inflows meaning that since 1980 Zimbabwe has been almost wholly reliant on official inflows of some $8.1 billion. With the drying up of capital flows since 1997, Zimbabwe’s external debt profile deteriorated rapidly, and the country ran up arrears in excess of $3 billion, including the ‘pipeline’ of current transfer payments for the year 2007 alone of $450 million. In fact the real extent of external indebtedness is unknown, partly because of the contingency liabilities of the government and the central bank in respect of offshore loans for which they have provided guarantee as well as the full extent of the current payments pipeline, and also because details of loans from non-OECD and non-DAC (Development Assistance Committee) countries such as China, India, Iran and Venezuela have not been released.

Table 9: Aggregate net resource flows

<table>
<thead>
<tr>
<th>US$ millions</th>
<th>FDI</th>
<th>Portfolio</th>
<th>Bonds, bank &amp; trade finance</th>
<th>Foreign aid</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980-1989</td>
<td>-115</td>
<td>0</td>
<td>-115</td>
<td>1,950</td>
<td>1,720</td>
</tr>
<tr>
<td>1990-1999</td>
<td>420</td>
<td>100</td>
<td>-610</td>
<td>3,950</td>
<td>3,860</td>
</tr>
<tr>
<td>2000-2005</td>
<td>226</td>
<td>1</td>
<td>-112</td>
<td>935</td>
<td>1,050</td>
</tr>
<tr>
<td>2006-2008</td>
<td>157</td>
<td>-62</td>
<td>379</td>
<td>1,309</td>
<td>1,783</td>
</tr>
<tr>
<td>Total</td>
<td>688</td>
<td>39</td>
<td>-458</td>
<td>8,144</td>
<td>8,413</td>
</tr>
<tr>
<td>% Shares</td>
<td>8.2%</td>
<td>0.5%</td>
<td>-5.5%</td>
<td>96.8%</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: World Bank Debt Tables and Global Development Finance (various editions), the Reserve Bank of Zimbabwe and OECD (Development Co-operation Report, 2009)

Zimbabwe’s balance of payments during the deepening crisis period since 2000 make grim reading. Over the 9-year period (Table 10) the country was living beyond its means to the tune of $2.65 billion – the accumulated current account deficit between 2000 and 2008. Approximately $900 million of this was the trade gap, while the net deficit on invisibles (non-factor payments and investment account) contributed a further $3.4 billion, partially offset by positive net private transfers, dominated by diaspora remittances of $1.65 billion.

The RBZ shows official grants (foreign aid) as a below-the-line item on capital account rather than current account, which is unusual. The cumulative figure shown of some $400 million is way below the actual donor estimate of $600 million in 2008 alone.

The capital account numbers defy interpretation in the sense that, as the situation worsened, so Zimbabwe moved from an accumulated capital account deficit of $1.4 billion (2000–2004) to a capital account surplus of $400 million between 2005 and 2008. In particular, the RBZ figures show that foreign direct investment of $10 million a year between 2000 and 2004 increased sixfold to $65 million annually in the 2005–2008 period. It seems unlikely that the accelerating pace of economic decline would have translated into increased inflows both of FDI and long-term loans.

Interpretation is further bedevilled by the very large figures for errors and omissions totalling $1.3 billion over the period. This too is difficult to believe since normally in an economy coping with the twin problems of hyperinflation and collapsing output, capital flight is much more likely than unrecorded net capital inflows. It is, however, possible that unrecorded diaspora inflows account for a large element of this inflow, though it is not at all clear just why it should have turned hugely negative in 2008, unless this is simply attributable to the provisional nature of the figures for that year. Of concern too is the fact that the gaps in, and the opaque nature of, the official balance-of-payments figures conceal even greater offshore obligations in terms of loan obligations and arrears than those made public previously.

Balance-of-Payments: Prospects

Forecasts made in the first quarter of 2009 suggest that the economy will be import- and foreign-currency constrained over the medium term (2009–2013). The current account deficit is projected to average $1.1 billion annually or 23 percent of GDP, while the visible trade deficit is estimated at almost


<table>
<thead>
<tr>
<th>Item</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008p</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exports</td>
<td>2,192</td>
<td>2,108</td>
<td>1,794</td>
<td>1,662</td>
<td>1,671</td>
<td>1,588</td>
<td>1,721</td>
<td>1,803</td>
<td>1,652</td>
</tr>
<tr>
<td>Imports</td>
<td>1,907</td>
<td>1,791</td>
<td>1,821</td>
<td>1,778</td>
<td>1,989</td>
<td>1,994</td>
<td>1,966</td>
<td>1,899</td>
<td>1,941</td>
</tr>
<tr>
<td>Trade balance</td>
<td>284</td>
<td>317</td>
<td>-26</td>
<td>-117</td>
<td>-318</td>
<td>-406</td>
<td>-244</td>
<td>-95</td>
<td>-289</td>
</tr>
<tr>
<td>Income (net)</td>
<td>-404</td>
<td>-337</td>
<td>-246</td>
<td>-191</td>
<td>-208</td>
<td>-197</td>
<td>-209</td>
<td>-245</td>
<td>-202</td>
</tr>
<tr>
<td>Private transfers (net)</td>
<td>137</td>
<td>114</td>
<td>228</td>
<td>169</td>
<td>204</td>
<td>163</td>
<td>115</td>
<td>154</td>
<td>363</td>
</tr>
<tr>
<td>Current account (Excl official transfers)</td>
<td>-147</td>
<td>-93</td>
<td>-225</td>
<td>-355</td>
<td>-430</td>
<td>-549</td>
<td>-367</td>
<td>-258</td>
<td>-222</td>
</tr>
<tr>
<td>Grants</td>
<td>53</td>
<td>40</td>
<td>38</td>
<td>38</td>
<td>24</td>
<td>27</td>
<td>57</td>
<td>42</td>
<td>73</td>
</tr>
<tr>
<td>FDI</td>
<td>16</td>
<td>0</td>
<td>23</td>
<td>4</td>
<td>9</td>
<td>102</td>
<td>40</td>
<td>66</td>
<td>52</td>
</tr>
<tr>
<td>Portfolio</td>
<td>-1</td>
<td>-68</td>
<td>-2</td>
<td>4</td>
<td>2</td>
<td>-12</td>
<td>-34</td>
<td>-28</td>
<td>0</td>
</tr>
<tr>
<td>Long-term capital (net)</td>
<td>-256</td>
<td>-285</td>
<td>-281</td>
<td>-228</td>
<td>-211</td>
<td>-204</td>
<td>-121</td>
<td>12</td>
<td>-145</td>
</tr>
<tr>
<td>Short-term capital (net)</td>
<td>-126</td>
<td>-90</td>
<td>-10</td>
<td>-39</td>
<td>-57</td>
<td>90</td>
<td>145</td>
<td>53</td>
<td>181</td>
</tr>
<tr>
<td>Capital account</td>
<td>-313</td>
<td>-403</td>
<td>-233</td>
<td>-221</td>
<td>-234</td>
<td>3</td>
<td>88</td>
<td>146</td>
<td>161</td>
</tr>
<tr>
<td>Errors &amp; omissions</td>
<td>290</td>
<td>302</td>
<td>78</td>
<td>79</td>
<td>432</td>
<td>342</td>
<td>88</td>
<td>80</td>
<td>-381</td>
</tr>
<tr>
<td>Overall balance</td>
<td>-171</td>
<td>-194</td>
<td>-380</td>
<td>-497</td>
<td>-219</td>
<td>-205</td>
<td>-191</td>
<td>-33</td>
<td>-441</td>
</tr>
</tbody>
</table>

Source: Reserve Bank of Zimbabwe
Section 4 – Post-Independence Overview

24 percent of GDP. The IMF projects a funding gap of 20.6 percent of GDP after allowing for a modest increase in FDI and the quadrupling of portfolio investment inflows.

No provision is made for debt forgiveness, as a result of which net interest payments average 7.5 percent of GDP. Arrears in respect of external debt are projected to increase from $3.77 billion at the end of 2008 to $6.58 billion by end-2013. The clear message from Table 11 is that as well as robust export growth, Zimbabwe needs debt forgiveness along with a substantial increase in net capital inflows, both on private and public account.

**Table 11: Balance-of-payments outlook (2009–2013)**

<table>
<thead>
<tr>
<th>Item</th>
<th>$ millions</th>
<th>% of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current account deficit</td>
<td>5,555</td>
<td>22.3</td>
</tr>
<tr>
<td>Trade deficit</td>
<td>5,638</td>
<td>23.7</td>
</tr>
<tr>
<td>Exports</td>
<td>9,795</td>
<td>41.1</td>
</tr>
<tr>
<td>Imports</td>
<td>15,410</td>
<td>64.8</td>
</tr>
<tr>
<td>Non-factor services (net)</td>
<td>-477</td>
<td>-2.0</td>
</tr>
<tr>
<td>Investment income (net)</td>
<td>-2,337</td>
<td>-9.8</td>
</tr>
<tr>
<td>Private Transfers – including transfers to NGOs</td>
<td>2,952</td>
<td>12.4</td>
</tr>
<tr>
<td>Net capital</td>
<td>-587</td>
<td>-2.5</td>
</tr>
<tr>
<td>Financing gap</td>
<td>4,911</td>
<td>20.6</td>
</tr>
<tr>
<td>Export growth ($)</td>
<td>8.3 percent per annum</td>
<td>n.a.</td>
</tr>
<tr>
<td>Import growth ($)</td>
<td>5.4 percent per annum</td>
<td>n.a.</td>
</tr>
</tbody>
</table>

Source: IMF: Zimbabwe- Staff Report for the 2009 Article IV Consultation

**Foreign Debt**

The IMF describes Zimbabwe as a country in ‘debt distress’ (IMF, 2009). On the basis of relatively optimistic assumptions on policies and the external environment, the present value of the external-debt-to-exports ratio is expected to persist above 250 percent for almost a decade. Under the Debt Sustainability Analysis, carried out by the IMF and World Bank, the baseline scenario projects public and publicly-guaranteed external debt (PPG) indicators to ‘remain far in excess of the corresponding thresholds for a low-income country’ (IMF, 2009). Debt ratios begin at levels three to five times above the threshold and would decline to threshold levels only after 20 or even 30 years. Public debt is projected to decline gradually from more than 200 percent of GDP in 2010 to about 150 percent in 2020. This is an unsustainable situation, meaning that debt-forgiveness will have to be an essential component of any medium-term recovery strategy.

Figure 7: Foreign debt and arrears (2000–2013 projected)
Section 5

International Experience and Lessons for Recovery

Recent research highlights three critical inter-related pre-requisites for successful export-driven growth:

(i) Macroeconomic stability;

(ii) Competitiveness; and

(iii) Supportive infrastructure and institutions – which overlap with competitiveness to the extent that it is extremely difficult for individual enterprises to be internationally competitive where these supportive facilities are weak.

Global recession, domestic market shrinkage, investment and infrastructure deficits and the destruction of the domestic-savings base by a decade of chronic inflation and hyperinflation will dictate the future growth of the Zimbabwe economy. In terms of traditional two-gap analysis, Zimbabwe will have to close a domestic-savings gap – the consequence of hyperinflation and the steep fall in disposable incomes – as well as an over-stretched public sector, while also running a substantial surplus on capital account of the balance of payments to accommodate the necessary surge in import spending.

Strong export expansion is essential in part to absorb existing excess capacity in the economy, while providing market scope for output and employment growth and to help provide the foreign currency required to finance substantial new investment in infrastructure and industrial, mining and agricultural investment.

Over the long haul both import and, to a lesser extent, export volumes have expanded faster than GDP. In the pre-crisis period (1980–1997), when GDP (in US dollars) grew 1.8 percent annually, exports, also in US dollars, increased 3.1 percent annually while imports rose 4.1 percent a year. In effect this meant that every $1 million increase in GDP was associated with a $1.24 million rise in exports and a $1.45 million increase in imports.

Going forward the import coefficient of growth can be expected to rise sharply over the medium term, reflecting high levels of import-intensive investment in infrastructure and in the rehabilitation, upgrading and expansion of productive capacity. This significant increase in the import-to-GDP ratio will have to be funded in part from export expansion along with capital inflows of Foreign Direct Investment (FDI), offshore borrowing and foreign aid.

The savings drought in the economy will necessarily impact on wider economic policy issues than just the management of the balance of payments. Private-public partnerships, commercialization and privatization will have to be part of the policy agenda along with far closer attention to broad Investment Climate and Doing Business concerns that have been neglected in the past. It will be essential too to revisit existing foreign investment legislation, specifically those aspects relating to indigenization and foreign ownership.

During the crisis period Zimbabwe not only failed to capitalize on the commodity price boom but also on the global surge in FDI. In the decade to 2007, FDI flows to emerging markets more than trebled from $150 billion in 1997 to $500 billion ten years later. Over the same period, FDI inflows to sub-Saharan Africa increased seven-fold to $33 billion.

Figure 8 shows that over the entire post-independence period Zimbabwe attracted only $800 million of FDI, half of that for one project, the Chegutu platinum mine. The country’s share of FDI flows to sub-Saharan Africa was a mere 1.1 percent.

The three main explanations for this poor performance are firstly, government ambivalence towards FDI captured in the conflict between its oft-expressed enthusiasm for foreign investment especially recently from Asia, notably China, and its active promotion of indigenization, which requires that Zimbabwe nationals own at least 50.1 percent of the equity in any business.
Secondly, the hostile policy environment as measured by investment climate yardsticks such as the World Bank’s Governance and Doing Business indicators and the World Economic Forum’s Global Competitiveness Index. Third, during the period of deepening crisis, the combination of market shrinkage and escalating political risk dampened the animal spirits of even the most sanguine foreign investor.

In the post-crisis environment, it is imperative that this post-independence trend be reversed. Because the domestic savings base was destroyed by hyperinflation and because the country experienced a decade of very low levels of investment to the point where, during the period of deepening crisis, the national capital stock actually shrunk, Zimbabwe will become more foreign capital reliant probably than at any time in its history. Furthermore the strong probability is that export growth, especially during a global recession and post-recession period, will not be rapid enough to generate the foreign currency needed to finance an essential, but ambitious, national investment and recapitalization programme.

### 5.1 BALANCE-OF-PAYMENTS ADJUSTMENT UNDER DOLLARIZATION

With dollarization, Zimbabwe’s policy options for balance-of-payments adjustment have narrowed. Devaluation is no longer a policy option, though devaluation and revaluation effects will be felt when the two currencies in use – the US dollar and the South African rand – appreciate or depreciate. However, from a Zimbabwe policy viewpoint such effects will be exogenous in the sense that the only choice open to policy-makers is whether to dollarize or randize.

Similarly, there is little scope to use monetary policy to facilitate balance-of-payments adjustment. As foreign-currency deposits build up in the Zimbabwe banks, so there will be scope for the Reserve Bank of Zimbabwe to adjust statutory reserve ratios to influence money supply growth and, indirectly, interest rates. But in the near-to-medium-term such scope will likely be limited by the low levels of bank deposits and the absence of a lender of last resort capable of bailing out banks that make bad loans. Banks are likely to operate with significant, possibly substantial, ‘excess reserves’ over and above the 10 percent of liabilities statutory reserve ratio imposed in February 2009.

Under the existing policy regime (April 2009), the RBZ has set a maximum margin above the London Interbank Offered Rate (Libor) of 6 percent. At a time of deflation – prices falling some 2 to 3 percent monthly in the first quarter of 2009 – such a margin points to positive real interest rates in US dollar terms in excess of 10 percent and in rand terms of more than 17 percent. This will impose a heavy burden on firms accustomed to borrowing at massively negative real rates of interest. The RBZ could vary this 6 percent above Libor maximum rate as part of an adjustment strategy, but its impact would likely be minimal.

In sum, because exchange rates have become an exogenous variable outside the control of the Zimbabwe authorities while monetary policy, at best, might make a marginal contribution to balance-of-payments adjustment, balance-of-payments adjustment must be internalized, best analysed in terms of the Absorption approach to adjustment.

**Figure 8: Zimbabwe: Net inflow of FDI**

![Graph showing net inflow of FDI in Zimbabwe from 1980-1989, 1990-1999, and 2000-2008 with values in millions](image)
This is written as $B = Y - A$, where $B$ refers to the balance of payments on current account, $Y$ denotes output and $A$ absorption or expenditure. It follows that where, as in Zimbabwe, a country has a continuing and unsustainable current account external payments deficit averaging some $300 million a year (2000–2008) that is likely to widen as the economy recovers, it is necessary to increase output or reduce expenditure, or both.

If monetary policy is unable to make much more than a marginal contribution to adjustment, as is likely to be the case in a dollarized economy, the burden of adjustment falls on fiscal policy in the form of reduced public spending or higher taxation. Since Zimbabwe’s fiscal space is likely to be tightly constrained for the foreseeable future, in all probability there will be little room for manoeuvre in the fiscal policy field. In Zimbabwe’s case the adjustment task is further complicated on three fronts:

(i) Post-hyperinflation and post-dollarization, the economy was left with an elevated price, wage and cost structure, which may require a combination of real price and wage reductions and increased productivity.

(ii) Furthermore, falling prices (deflation) are normally, though not always, associated with stagnation or recession in respect of both output and employment. Clearly, after a decade of declining output, employment and living standards, such an adjustment path is socially and politically undesirable.

(iii) Because import dependence has grown and because there are substantial investment deficits to be made good, especially in infrastructure and re-equipping the private and parastatal sectors, there must be a strong probability that the trade gap will widen over the next few years, especially given the probability of relatively sluggish global export markets for several of the country’s main exports.

The policy implications are clear:

(a) Growing reliance on capital inflows of all kinds, including foreign aid so that balance-of-payments adjustment can be phased over a number of years in the hope that the medium-term import bulge will be funded by a temporary surge in financial inflows on both current (aid grants and diaspora remittances) and capital accounts (aid, FDI and offshore borrowings).

(b) A focus on productivity and competitiveness reforms designed to gradually eliminate the Zimbabwe export-price and import-parity premia. Realistically, however, this is unlikely to be achieved without further falls in living standards.

(c) Doing business and investment climate reforms aimed at increasing inflows of FDI that would have the beneficial effect of raising output and employment while also helping finance the deficit on current account.

### 5.2 A CENTRAL ROLE FOR COMPETITIVENESS

The concept of competitiveness as an objective of government economic policy, as distinct from a strategy for enhancing corporate performance, has grown dramatically in importance in the last 20 years. Until the 1990s, international financial institutions like the IMF and World Bank used the concept sparingly and then mostly in the context of exchange rate competitiveness. Indeed, even Zimbabwe’s Economic Structural Adjustment Programme (1990), drafted primarily by World Bank officials, makes little mention of competitiveness.

But this has changed. Competitiveness has moved towards the top of the policy agenda for donors and international financial institutions, though seldom yet for African governments. However at two meetings in the course of 2008, a group of development professionals and interest parties developed the ‘Kivu Consensus – An Agenda for a Competitive Africa’ which identifies competitiveness as ‘the critical element in a strategy to increase employment and prosperity’ (Brenthurst Foundation, 2009: 1).

Competitiveness is often measured in terms of a country’s export market share leading critics to complain that this suggests it is a zero-sum game since China’s export market gains have been secured at the expense of other nations like the
US. Such a definition of competitiveness is then used to justify government policy interventions in the form of industrial policies designed to increase the country’s export market share using subsidies, exchange-rate devaluation and lower wages and other input costs, including the rate of interest.

This is a flawed view of competitiveness because it implies that low wages or currency devaluation make a country more competitive, yet the very opposite is true because the need to hold down wages or devalue the currency means that the country’s firms are not competitive. Exports driven by an undervalued currency and low wages depress a country’s standard of living.

Accordingly, competitiveness is better defined in terms of productivity. Although GDP per head is the most widely used indicator of a country’s economic well-being, differences in productivity explain virtually all of the cross-country variations in output per head (Lewis, 2004). ‘Productivity supports high wages, a strong currency and attractive returns to capital — and with them a high standard of living’ (World Economic Forum, 2007: 52). The policy goal is productivity not export competitiveness per se.

The World Economic Forum (WEF) defines competitiveness as ‘the set of institutions, policies and factors that determine the level of productivity of a country’. Productivity levels determine a country’s prosperity as well as the rate of return on investment. Because the return on investment is a fundamental driver of the rate of GDP growth ‘a more competitive economy is one that is likely to grow faster over the medium to long term’ (World Economic Forum, 2008: 3). In the 30 years that it has published its Global Competitiveness reports, the WEF has progressively revised and improved its measurement of competitiveness. Its most recent report (2008) identifies 12 ‘pillars’ of competitiveness that are grouped into three broad categories (Figure 9) which in turn are linked with three stages of economic development.

Figure 9 shows that four basic requirement pillars — institutions, infrastructure, macroeconomic stability and health and primary education — are deemed to be the key drivers of the initial stage of development in factor-driven economies. The vast majority of sub-Saharan economies, including Zimbabwe and half of the members of the Southern African Development Community (SADC) – Lesotho, Madagascar, Malawi, Mozambique, Tanzania and Zambia – fit into this category. One SADC country, Botswana, is classified as ‘in transition’ from the factor-driven development stage to the efficiency-driven stage in which six ‘efficiency enhancers’ are deemed critical to a country’s growth. Three SADC economies – Mauritius, Namibia and South Africa – are classified in this second category of efficiency-driven economies.
In the WEF’s terminology, factor-driven economies, such as Zimbabwe compete on the basis of their factor endowments, primarily natural resources and unskilled labour. Firms in a factor-driven economy compete on the basis of price, rather than quality, style and product differentiation. They sell basic products or commodities and their competitiveness arises from factor-endowment in the form of plentiful cheap labour or rich natural resources. Productivity per worker is low, resulting in low wages. Sustaining competitiveness depends on macroeconomic stability, a sound infrastructure, well-functioning public and private institutions and a healthy, literate workforce. However, at the bottom of the pile, Zimbabwe is unlikely to compete on this basis of price in both the regional and extra regional export markets, because of high cost structure of production environment.

In the 2008/09 report Zimbabwe is ranked second from bottom. Only Chad gets a lower score, while Figure 10, illustrating the rankings of Zimbabwe and three other SADC economies, shows how the country has slipped down the competitiveness ladder, though this reflects the combination of the inclusion of an increased number of countries in the index as well as Zimbabwe’s relative fall from grace.

In the 2008/09 rankings, Zimbabwe scores best (122) on innovation factors and worst (134) on basic requirements. It has the lowest ranking in the world for macroeconomic stability (134) with higher rankings (88) for infrastructure and 113 for health and primary education. In terms of efficiency enhancers, its best ranking is for financial market sophistication and its lowest are for market efficiency and market size (133). For innovation

<table>
<thead>
<tr>
<th>Country</th>
<th>Rank</th>
<th>Score</th>
<th>Basic requirements rank</th>
<th>Score</th>
<th>Efficiency enhancers rank</th>
<th>Score</th>
<th>Innovation factors rank</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>South Africa</td>
<td>45</td>
<td>4.41</td>
<td>69</td>
<td>4.41</td>
<td>35</td>
<td>4.46</td>
<td>36</td>
<td>4.13</td>
</tr>
<tr>
<td>Botswana</td>
<td>56</td>
<td>4.25</td>
<td>53</td>
<td>4.65</td>
<td>82</td>
<td>3.76</td>
<td>98</td>
<td>3.22</td>
</tr>
<tr>
<td>Mauritius</td>
<td>57</td>
<td>4.25</td>
<td>50</td>
<td>4.67</td>
<td>66</td>
<td>4.03</td>
<td>69</td>
<td>3.65</td>
</tr>
<tr>
<td>Namibia</td>
<td>80</td>
<td>3.99</td>
<td>48</td>
<td>4.71</td>
<td>93</td>
<td>3.57</td>
<td>104</td>
<td>3.16</td>
</tr>
<tr>
<td>Kenya</td>
<td>93</td>
<td>3.84</td>
<td>104</td>
<td>3.80</td>
<td>76</td>
<td>3.90</td>
<td>50</td>
<td>3.87</td>
</tr>
<tr>
<td>Zambia</td>
<td>112</td>
<td>3.49</td>
<td>121</td>
<td>3.54</td>
<td>100</td>
<td>3.43</td>
<td>93</td>
<td>3.29</td>
</tr>
<tr>
<td>Tanzania</td>
<td>113</td>
<td>3.49</td>
<td>114</td>
<td>3.61</td>
<td>108</td>
<td>3.34</td>
<td>106</td>
<td>3.12</td>
</tr>
<tr>
<td>Mozambique</td>
<td>130</td>
<td>3.15</td>
<td>131</td>
<td>3.21</td>
<td>132</td>
<td>3.09</td>
<td>127</td>
<td>2.84</td>
</tr>
<tr>
<td>Zimbabwe</td>
<td>133</td>
<td>2.88</td>
<td>134</td>
<td>2.88</td>
<td>131</td>
<td>2.87</td>
<td>122</td>
<td>2.90</td>
</tr>
</tbody>
</table>

Section 5 – International Experience and Lessons for Recovery

The WEF finds that firm, not country, level variables account for 71 percent of variance in GDP per head across countries. Enterprises, not countries, are the source of competitiveness, but that competitiveness depends on the combination of both macroeconomic and national factors, usually designated comparative advantage, and microeconomic or strategic influences, normally called competitive advantage.

Competitive advantage is firm-specific, determined by the activities and technologies and managerial techniques that the firm uses, relative to other firms in the same industry. It may take the form of some proprietary advantage that the firm enjoys – access to a patent, a technology, a brandname – which gives it an advantage that rivals cannot readily match. It is possible to have (some) competitive firms in an uncompetitive economy but without competitive firms economies cannot be competitive. The evidence suggest it is very difficult, if not impossible, to sustain competitive firms in an uncompetitive economy because, in the words of Professor Michael Porter who has played a key role in developing the theory of competitiveness: ‘The sophistication of companies is inextricably intertwined with the quality of the national business environment’ (Porter, 1990).

His argument is that a country’s productivity is determined by the productivity of its firms meaning that a country can only be competitive if its firms – whether they are indigenous or foreign and whether they are in the private or public sector – are competitive. More productive firms have operating practices and strategies that require more highly skilled people, better infrastructure, better information, strong institutions and more efficient government processes.

Porter and the WEF lay considerable emphasis on the contribution of competitive pressure. Firms that are monopolies or members of cartels in their domestic markets are unlikely to develop competitive advantage in the global economy. Accordingly, government policies that seek to foster ‘National Champions’ – in Zimbabwe, e.g., the Zimbabwe Iron and Steel Co (Zisco) has often been accorded that status by successive administrations – are unlikely to succeed because such enterprises are not challenged in their domestic markets where they are accorded preferential treatment.

The lesson of experience, documented in the WEF’s annual Global Competitiveness Reports, is that there is no single step, no grand strategy, that can deliver national competitiveness. There must be a critical mass approach, involving many different improvements in different fields across a broad

<table>
<thead>
<tr>
<th>Category or pillar</th>
<th>Rank (out of 134 countries)</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic requirements</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Institutions</td>
<td>126</td>
<td>3.00</td>
</tr>
<tr>
<td>2. Infrastructure</td>
<td>88</td>
<td>2.90</td>
</tr>
<tr>
<td>3. Macroeconomic stability</td>
<td>134</td>
<td>1.48</td>
</tr>
<tr>
<td>4. Health &amp; primary education</td>
<td>113</td>
<td>4.16</td>
</tr>
<tr>
<td>Efficiency enhancers</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. Higher education and training</td>
<td>107</td>
<td>3.18</td>
</tr>
<tr>
<td>6. Goods market efficiency</td>
<td>133</td>
<td>3.05</td>
</tr>
<tr>
<td>7. Labour market efficiency</td>
<td>127</td>
<td>3.56</td>
</tr>
<tr>
<td>8. Financial market sophistication</td>
<td>90</td>
<td>3.92</td>
</tr>
<tr>
<td>9. Technological readiness</td>
<td>129</td>
<td>2.28</td>
</tr>
<tr>
<td>10. Market size</td>
<td>133</td>
<td>1.25</td>
</tr>
<tr>
<td>Innovation factors</td>
<td></td>
<td></td>
</tr>
<tr>
<td>11. Business sophistication</td>
<td>124</td>
<td>3.26</td>
</tr>
<tr>
<td>12. Innovation</td>
<td>119</td>
<td>2.55</td>
</tr>
</tbody>
</table>

front. Structural reforms designed to improve the efficiency of goods, capital and labour markets are an essential part of the process.

There are roles for both government and the private sector. The contemporary debate focuses on the linkages between enterprise-level competitiveness and national competitiveness, usually analysed in the context of comparative advantage. Government’s role is that of creating the appropriate business and investment climate, which includes investment in infrastructure and human capital, building and sustaining strong institutions and implementing appropriate macroeconomic policies. With that platform in place the role of firms is to build competitive advantage.

Countries can be classified as over-performers or under-performers by comparing actual GDP per capita with that ‘predicted’ by its Global Competitiveness Index (GCI) score. Countries classified as overperformers are those whose GDP per head is greater than their competitiveness score and ranking justifies. This is a warning sign because it suggests that prosperity is not the result of productivity and competitiveness but of the possession of rich natural resources – oil, gas or minerals – or of temporary phenomena such as a shortlived boom in commodity prices of FDI or aid inflows. Over-performer status may also reflect the time-lag between diminishing competitiveness and the subsequent, inevitable, decline in living standards.

Ironically, it is preferable for a country to be an under-performer, reflected in lower per capita incomes than its competitiveness predicts. This may result from a failure to bring people into the formal market from the subsistence sector; it may reflect enclave-type growth as in an oil or mineral-rich economy, or – and this would seem to the explanation in Zimbabwe’s case – it could be a temporary aftermath to protracted socio-economic crisis.

A 1997 report by the World Bank says that if Africa is to reverse its unfavourable export trends, ‘it must quickly adopt trade and structural adjustment policies that enhance its international competitiveness and allow African exporters to capitalize on opportunities in foreign markets’ (Yeats, et al., 1997). ‘In short, the future of African economies will be determined by Africa, not outsiders’.

### 5.3 MAKING ZIMBABWE MORE COMPETITIVE

Competitiveness must be near the top of the policy agenda in Zimbabwe, especially in the wake of a protracted period of chronically-high inflation and hyperinflation. In a dollarized economy currency devaluation is not an option while a ‘Low Road’ growth strategy driven by low wages, low productivity and static or dated technologies is no solution for a country in which living standards have halved in the last decade and where income per head is as low in 2009 as in the 1950s.

Export growth is crucial for a number of reasons. Exports will generate income growth at a time of weak domestic demand. For a small ($3 billion to $4 billion) economy foreign markets are likely to be the main engine of growth or, as in Zimbabwe’s case, recovery. Strong export growth generates more jobs as well as better jobs, while on the whole and especially in manufacturing, export firms create higher-productivity jobs that pay higher wages and offer better working conditions than in import-substitution activities. There is evidence too that export growth helps to build a more efficient production structure as a result of compositional shifts whereby the most productive exporting businesses tend to grow most rapidly (Schank, Schnabel and Wagner, 2007 and Bernard et al., 2007).

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5 ‘Predicted’ levels of GDP per head are obtained by regressing country scores on the competitiveness index against GDP per head. Countries with actual GDP per head above the regression line are then deemed to be over-performers, while those below the line are under-performers. (World Economic Forum: Global Competitiveness Report 2006/07).
Section 5 – International Experience and Lessons for Recovery

Zimbabwe needs therefore to foster an ‘export surge’ defined as a sustained period – 7 to 12 years – of accelerated export expansion associated usually with four main characteristics:

- Export surges are more likely in open economies or economies that are liberalizing;
- Surges are preceded by a large depreciation in the real exchange rate;
- In developing countries, the real depreciation is large enough to leave the exchange rate undervalued by a 20 percent margin (on average); and
- The discovery of new products and new markets by developing country exporters is dependent on this substantial undervaluation of the exchange rate.

‘Undervaluation – or, put another way, a competitive currency – is the big push that encourages both more entries and more successes. It performs like a “grand opening sale” and once customers start coming many of the new relationships are maintained even after the sale is over’. (Freund and Pierola, 2008: 6)

These Freund/Pierola findings make disconcerting reading for Zimbabwe policy-makers in a post-dollarization economy, because their research suggests that real exchange-rate depreciation is more likely to foster the export surge that Zimbabwe needs than trade liberalization. They find that: ‘A real exchange-rate depreciation of 20 percent gives a large and immediate boost to exporters. Trade liberalization tends to be variable across products and takes place in smaller steps of 2 or 3 percentage points in a year.’ (Freund and Pierola, 2008: 27).

Furthermore, although trade liberalization supports exporters, it does not discriminate in favour of tradables relative to non-tradable sectors of the economy. In contrast real exchange-rate depreciation shifts resources from the import-competing sector into both export and non-tradable sectors.

5.4 STRUCTURAL COMPETITIVENESS AND ‘BEHIND-THE-BORDER’ BARRIERS TO TRADE

The real exchange rate is defined as the, ‘domestic relative price of non-tradable goods to tradable goods’. Prices of non-tradables are partly determined by domestic factors while in a small and dollarized economy like Zimbabwe the prices of tradable goods are set by international prices for exports and imports and by the nominal exchange rate. This means that an increase in the relative price of a non-tradable good reflects increased domestic production costs and, other things being equal, a reduction in the profitability of tradable sectors, especially exports.

In effect this means that where the nominal exchange rate – US dollar or rand – is exogenously determined, as it is under dollarization – misalignment (overvaluation) of the real exchange rate can only be addressed by measures designed to exert downward pressure on domestic costs, wages and prices, or by exogenously-driven depreciation of the nominal exchange rate for the US dollar or rand.

Although dollarization may inhibit exchange-rate competitiveness, Zimbabwe can become more competitive if productivity (output per worker, usually proxied as GDP per capita) grows more rapidly than in its main trading partners. Positive terms-of-trade effects – export prices rising relative to import prices – will have the same effect, while greater openness should also enhance competitiveness because increased exposure to international markets should reduce domestic prices. Provided new investment eases infrastructure bottlenecks and boosts productivity, this too will enhance competitiveness.

Accordingly, in a policy environment where there is little, if any, scope for direct manipulation of the real exchange rate, the focus of competitiveness analysis shifts from the exchange rate to other yardsticks. These include the country’s export-market – are its export volumes growing faster than the global average? How profitable is the

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Foreign Trade, Competitiveness and the Balance of Payments

What is the state of the export sector and what is the state of the balance of payments on current account? Is it in structural deficit measured by a steady rise in net indebtedness? To what extent is a structural deficit the result of depressed export markets and prices for the country’s main exports or the consequence of inappropriate macroeconomic and microeconomic policies that retard export growth? Is weak export performance explained by ‘behind-the-border’ institutional, infrastructural or policy shortcomings? How can the balance of payment on current account and the structural deficit be influenced to increase productivity?

Behind-the-border assessment criteria focus on high transaction costs – the difficulties and cost of doing business. Survey-based indices of the quality of the business climate are available for a large number of countries, and allow for easy multi-criteria competitiveness assessments. The three indices with the largest country coverage are the World Bank’s annual *Doing Business Surveys*, the World Economic Forum’s *Global Competitiveness Index* and the *Index of Economic Freedom* compiled by the Heritage Foundation. These surveys based on objective criteria such as a country’s macroeconomic indicators and questionnaire data are used to assess the effectiveness of institutions, including regulatory bodies, governance and security considerations and macroeconomic and microeconomic conditions and policies.

In 2008, Zimbabwe was ranked 152 out of 176 countries in the World Bank’s Doing Business Survey. It ranks 123 in respect of conditions for employing workers, it is placed 97 for access to credit and 107 for investor protection. The country has the world’s highest labour dismissal costs – 446 weeks of salary – the second highest being Sierra Leone with 189 weeks.

Not only does Zimbabwe have a very poor ranking for Doing Business conditions but it is well behind its main competitors in the regional Doing Business league table (Table 15).

**Table 14: Zimbabwe: Doing Business rankings**

<table>
<thead>
<tr>
<th>Item</th>
<th>Ranking</th>
<th>Procedures</th>
<th>Time</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Starting a business</td>
<td>143</td>
<td>10</td>
<td>96 days</td>
<td>21.6%</td>
</tr>
<tr>
<td>Dealing with licences</td>
<td>172</td>
<td>19</td>
<td>952 days</td>
<td>11,799.0</td>
</tr>
<tr>
<td>Registering property</td>
<td>79</td>
<td>4</td>
<td>30 days</td>
<td>25% of property value</td>
</tr>
<tr>
<td>Enforcing contracts</td>
<td>74</td>
<td>38</td>
<td>410 days</td>
<td>32% of claim</td>
</tr>
<tr>
<td>Closing a business</td>
<td>151</td>
<td>–</td>
<td>3.3 years</td>
<td>22% of estate</td>
</tr>
<tr>
<td>Paying taxes</td>
<td>144</td>
<td>52 payments per year</td>
<td>256 hours</td>
<td>Tax rate 53% of profits</td>
</tr>
<tr>
<td>Trading across borders</td>
<td>169</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Export</td>
<td>144</td>
<td>9 documents</td>
<td>52 Days</td>
<td>$1,879 per container</td>
</tr>
<tr>
<td>Import</td>
<td>144</td>
<td>13 documents</td>
<td>67 Days</td>
<td>$2,429 per container</td>
</tr>
</tbody>
</table>


**Table 15: Doing Business rankings 2008 (178 countries) Zimbabwe and regional competitors**

<table>
<thead>
<tr>
<th>Country</th>
<th>Ranking</th>
<th>Country</th>
<th>Ranking</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mauritius</td>
<td>27</td>
<td>Lesotho</td>
<td>124</td>
</tr>
<tr>
<td>South Africa</td>
<td>35</td>
<td>Malawi</td>
<td>127</td>
</tr>
<tr>
<td>Namibia</td>
<td>43</td>
<td>Tanzania</td>
<td>130</td>
</tr>
<tr>
<td>Botswana</td>
<td>51</td>
<td>Mozambique</td>
<td>134</td>
</tr>
<tr>
<td>Kenya</td>
<td>72</td>
<td>Madagascar</td>
<td>149</td>
</tr>
<tr>
<td>Swaziland</td>
<td>95</td>
<td>Zimbabwe</td>
<td>152</td>
</tr>
<tr>
<td>Zambia</td>
<td>116</td>
<td>Angola</td>
<td>167</td>
</tr>
<tr>
<td>Uganda</td>
<td>118</td>
<td>DRC</td>
<td>178</td>
</tr>
</tbody>
</table>

There are three messages for policy-makers. Doing Business reforms are relatively inexpensive to implement, cost little politically, though there is an administrative burden, and benefit new, small businesses disproportionately relative to their larger well-established rivals (World Bank, 2008a). Secondly, Doing Business reforms make a substantial contribution to enhancing a country’s structural competitiveness by reducing or eliminating barriers to raising productivity, increasing exports and making import substitutes more competitive. Thirdly, they increase a country’s attractiveness for FDI and domestic investment alike.

The main hypothesis of recent investment climate literature is that the business climate affects economic performance across the board and especially the incentive to invest. It is now acknowledged that a number of institutional, behavioural and structural variables drive economic growth. Recent research pinpoints four critical variables that ‘collectively define the so-called business or investment climate’ (Dethier, Hirn and Straub, 2008). These are:

(i) Infrastructure;

(ii) Access to finance;

(iii) Security levels of crime and corruption; and

(iv) The regulatory framework including the protection of property rights and competition policies.

**Trade Logistics**

Only relatively recently have policy-makers started to pay attention to trade logistics with the publication by the World Bank in 2007 of the first comprehensive cross-country study of logistics performance. The Bank’s Logistics Performance Index (LPI) provides a comprehensive picture of supply chain performance – from customs procedures, logistics costs, and infrastructure quality timeliness in reaching destination, and the competence of the domestic logistics industry. (World Bank, 2007). The report says that those at the bottom of the LPI are ‘often trapped in a vicious circle of overregulation, poor quality services, and underinvestment’. Importantly too it finds that countries with strong logistics performance rankings are also those experiencing economic growth led by manufactured exports.

**Table 16: The first Logistics Performance Index: Selected southern and east African economies**

<table>
<thead>
<tr>
<th>Country</th>
<th>Score (out of 5.0)</th>
<th>Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>South Africa</td>
<td>3.53</td>
<td>24</td>
</tr>
<tr>
<td>Kenya</td>
<td>2.52</td>
<td>76</td>
</tr>
<tr>
<td>Uganda</td>
<td>2.49</td>
<td>83</td>
</tr>
<tr>
<td>Angola</td>
<td>2.48</td>
<td>86</td>
</tr>
<tr>
<td>Malawi</td>
<td>2.42</td>
<td>91</td>
</tr>
<tr>
<td>Zambia</td>
<td>2.37</td>
<td>100</td>
</tr>
<tr>
<td>Lesotho</td>
<td>2.30</td>
<td>108</td>
</tr>
<tr>
<td>Mozambique</td>
<td>2.29</td>
<td>110</td>
</tr>
<tr>
<td>Zimbabwe</td>
<td>2.29</td>
<td>114</td>
</tr>
<tr>
<td>Namibia</td>
<td>2.16</td>
<td>126</td>
</tr>
<tr>
<td>Mauritius</td>
<td>2.13</td>
<td>132</td>
</tr>
<tr>
<td>Tanzania</td>
<td>2.08</td>
<td>137</td>
</tr>
</tbody>
</table>


Zimbabwe ranks 114th out of a total of 150 countries assessed, falling behind most of its regional comparators (Table 16) Zimbabwe’s worst rankings – of the 7 yardsticks used – were for Customs procedures and operations (138), infrastructure (136) and domestic logistics (134).

While landlocked countries, such as Zimbabwe, are at a clear disadvantage, the report notes that three landlocked economies – Uganda, Malawi and Zambia – are in the top 15 of the 39 sub-Saharan countries assessed. It says that:

‘Logistically friendly countries are more likely to have better global value chain integration and attract export-oriented FDI. Since trade and FDI are the key channels for the international diffusion of knowledge, poor logistics may impede access to new technology and know-how and slow the rate of productivity growth.’ (2007: 12)

The report’s findings reinforce the evidence that there is a great deal that the Zimbabwe authorities can – and should – do both to improve export performance and lower operational costs that does not require market access concessions or preferences on the part of trading partners.
The Enabling Trade Index

The Enabling Trade Index, compiled by the World Economic Forum, first published in 2008 measures ‘the factors, policies and services facilitating the free flow of goods over borders and to destinations’ (World Economic Forum, 2009) The index is based on four sub indexes covering market access, border administration, transport and communications, infrastructure and the business environment.

Table 17: Enabling trade index: Selected African countries, 2008

<table>
<thead>
<tr>
<th>Country</th>
<th>African ranking (25 countries)</th>
<th>Global ranking (118 countries)</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mauritius</td>
<td>1</td>
<td>40</td>
<td>4.50</td>
</tr>
<tr>
<td>Tunisia</td>
<td>2</td>
<td>49</td>
<td>4.23</td>
</tr>
<tr>
<td>South Africa</td>
<td>3</td>
<td>59</td>
<td>3.98</td>
</tr>
<tr>
<td>Namibia</td>
<td>5</td>
<td>77</td>
<td>3.66</td>
</tr>
<tr>
<td>Uganda</td>
<td>6</td>
<td>79</td>
<td>3.69</td>
</tr>
<tr>
<td>Zambia</td>
<td>7</td>
<td>85</td>
<td>3.52</td>
</tr>
<tr>
<td>Kenya</td>
<td>8</td>
<td>86</td>
<td>3.51</td>
</tr>
<tr>
<td>Lesotho</td>
<td>13</td>
<td>95</td>
<td>3.36</td>
</tr>
<tr>
<td>Mozambique</td>
<td>18</td>
<td>101</td>
<td>3.30</td>
</tr>
<tr>
<td>Tanzania</td>
<td>19</td>
<td>102</td>
<td>3.27</td>
</tr>
<tr>
<td>Nigeria</td>
<td>22</td>
<td>111</td>
<td>3.02</td>
</tr>
<tr>
<td>Zimbabwe</td>
<td>23</td>
<td>112</td>
<td>2.98</td>
</tr>
<tr>
<td>Chad</td>
<td>25</td>
<td>118</td>
<td>2.60</td>
</tr>
<tr>
<td>Sub-Saharan Africa</td>
<td></td>
<td></td>
<td>3.90</td>
</tr>
</tbody>
</table>


Table 17 shows that Zimbabwe ranks third from bottom in the list of 25 African countries and is sixth from bottom in the global index. The country ranks bottom in Africa for business environment, the regulatory environment and import and export procedures, once again highlighting the potential for substantial improvements in the country’s competitiveness were Doing Business reforms to be implemented. The country scores very poorly too for border administration and physical security.

5.5 FIRM COMPETITIVENESS AND MANUFACTURED EXPORTS

Just seven industries account for over three-quarters of sub-Saharan Africa’s manufactured exports and when resource-based semi-processed items are excluded there are only two – motor vehicles from South Africa and clothing that count for Africa’s exports. Why has the region lagged behind its peers especially in Asia, but also in Latin America?

Obviously there are powerful macroeconomic as well as microeconomic explanations why African manufacturing is under-developed. On the macro side, market size is crucial along with poor infrastructure and a range of policy shortcomings, from cumbersome bureaucratic and corrupt customs and tax systems to unattractive investment climates.

Over time there has been a discernible shift from broad macroeconomic and trade liberalization strategies designed to tackle these problems by creating an enabling environment for robust export growth, to targeted microeconomic policies aimed at helping firms to exploit export opportunities. Firm-level evidence explains why some enterprises succeed in export markets while others fail.

Research studies pinpoint low productivity as a major – perhaps the major – obstacle to growth in manufactured exports in Africa (Bigsten and Soderbom, 2006). Teal (1999a) shows that following trade liberalization, manufacturing output grew 4 percent annually in Ghana in the first half of the 1990s, but this was entirely attributable to labour and capital accumulation, not to technical progress and productivity growth.

Technical inefficiencies, often the result of decades of protectionism and very high levels of market concentration in small markets, are partly to blame. Comparisons between a highly successful clothing exporter, Bangladesh, and an unsuccessful African one, Kenya, are instructive. Bangladesh is one of the world’s largest clothing exporters, while Kenya, despite some recent penetration of the US market thanks largely to the Africa Growth and Opportunity Act (AGOA), has failed to break through into global markets. The most important single explanation appears to be production costs, which are three times higher in Kenya than in Bangladesh, primarily, but not only, due to wages which were 138 percent higher in Kenya.

High costs extend beyond wages however, to include finance costs. In Kenya and Madagascar export finance costs borne by clothing exporters
were 136 percent and 227 percent respectively of those in China (Kaplinksy and Morris, 2007). The high costs of African manufactured exports appears to be a structural problem rather than one related purely to labour productivity (UNCTAD, 2008).

Evidence from Ethiopia, Ghana and Kenya show that there is a positive correlation between manufacturing firm productivity and export success (Mengistae and Pattillo, 2004) leading UNCTAD to conclude that whether or not a firm will export depends on production costs on the one hand and the level of entry barriers to foreign markets on the other. Exporting depends on costs being contained below a certain threshold, with the result that firms whose costs are above that threshold concentrate on domestic market sales (UNCTAD, 2008).

Empirical evidence also suggests that firms learn by exporting as a result of which their productivity rises. In other words, it is not highly productive firms that export, but firms that ‘learn productivity’ through exporting that are successful. Bigsten and Soderbom (2006) calculate that learning from exporting can generate productivity gains amounting to 50 percent of value-added which explains how firms and countries develop ‘momentum’ in exporting. Past exports lead to faster future export expansion.

Two types of learning are crucial to export success:

(a) Productivity learning, where exporters learn to produce better quality at lower costs; and

(b) Market learning whereby firms exposed to foreign consumers’ demands discover how to design and produce items that foreign buyers want. Moroccan manufacturers that concentrate on consumer items, attribute their success to export market learning. Because African consumer markets and product characteristics differ so greatly from those in export markets, success in the domestic market is no guarantee of export growth, other than in neighbouring markets with similar per capita incomes and consumer tastes. Three-quarters of manufacturing firms in Morocco that export do so within the first three years of their existence underlining the fact that successful exporters are those set up with the aim of serving foreign markets (Fafchamps, et al., 2008).

UNCTAD cites evidence to show that the size distribution of African firms in the manufacturing sector is skewed towards smaller firms and this is a ‘serious handicap to export performance’ (2008: 72). In the Kenyan manufacturing sector, the probability of firm failure decreases with size while Bigsten, et al., (2004) found that exporting firms in Cameroon, Ghana, Kenya and Zimbabwe are larger than non-exporters. Generally, a firm in Africa exports only if it reaches a minimum of 100 employees (Teal, 1999b) and the fact that there are relatively few firms of this size helps to explain why so few sub-Saharan firms export.

UNCTAD (2008) concludes also that the high costs of African manufactured exports relative to those of competitors in Asia and elsewhere appear to be a structural problem, not just one of labour productivity and relative wages, thereby strengthening the policy case for across-the-board Investment Climate and Doing Business reforms designed to reduce transaction costs, eradicate behind-the-border constraints and improve competitiveness.

5.6 THE MACROECONOMIC CHALLENGES FACING ZIMBABWE’S EXPORTING SECTOR

Research carried out on the impact of macroeconomic policies on local firms shows that the inward-looking strategies of the 1980s were not compatible with an industrial strategy that emphasized growth, resulting in a failure to spur growth, to diversify the country’s manufacturing base and to resolve the problem of weak competition (Bjurek, et al., 2002, Ndlela and Robinson, 1995). The mainstay of the Zimbabwe government strategies during the control period (1980–1990) encompassed:

1. Foreign-exchange allocation system – which became the most important policy instrument that affected short- and long-term decisions of enterprises in both the private and public sectors;
2. Investment policies – also intertwined with the foreign-exchange allocation system implied that investment was controlled through an administrative approval of all new investment or expansions, the main criteria for approval being that, ex ante, the project should not be a net user of foreign exchange during any twelve month period of its expected life and that it should not compete with local production unless it also produces for export;

3. Price controls – where the government determined a maximum selling price for most basic commodities, while other commodity groups required government approval before price increases could be initiated;

4. Local market regulations – instituted through the statutory minimum wage legislation of 1980, under which the government set up minimum wage and salary increments for various income brackets;

5. Trade policy and export incentives – in addition to foreign-exchange controls, stringent import restrictions were set by government, with only a limited number of incentives aimed at boosting the country’s manufacturing sector, with little change in the tariff structure inherited from the colonial government – imports of raw materials were subject to 10 percent or less while the average rate of capital goods was about 20 percent.

The adoption of outward oriented industrial policies of the 1990s failed to live up to expectations, as this was followed by a lackluster performance of the manufacturing sector. The disappearance of the chronic shortages of imported inputs and capital goods, the removal of foreign-exchange allocation system, price controls and several regulations in the labour market, the slight increase in the domestic and international competition, should all have contributed to a substantial increase in productivity, but this did not happen. The total factor productivity (TFP) growth rates, estimated for 31 manufacturing sub-sectors over the period 1980 to 1995 showed no clear tendency to increase during the ESAP period. On the contrary more than half of the sub-sectors experienced declines in TFP during 1991 to 1995, with some improvement of performance during 1994–1995 (Bjurek, et al., 2002: 275)\(^7\). During the later period productivity increased for approximately two-thirds of the sub-sectors, but the time span for this was short-lived.

The overall impression is that TFP growth was lower during ESAP than during the period 1986–1990, even though during the last two years of the programme more sub-sectors experienced higher productivity growth than during 1986–1990. Bjurek, et al., observed that the;

‘differences between periods could well be the result of liberalization, but they could also be due to changes in exogenous factors such as changes in demand, foreign aid and weather conditions.’ (Ibid)

The main econometric test analysis was performed through setting up one dummy to zero in 1993, and to unity in 1994–1995, when the administrative allocation system of foreign-exchange system, the direct local market allocation (DLMA) had been abolished and a unified exchange rate established. The econometric tests results ‘do suggest that the increase in the growth of imports and foreign aid that occurred during ESAP raised TFP. An increase by one percentage point in imports or foreign aid raises TFP growth by 0.2 and 0.1 percentage points, respectively.’ (Ibid: 278).

The above result is in line with other estimates of the exchange-rate liberalization whose most positive result was the unification of the exchange rate in the second quarter of 1994. The liberalization of trade and exchange-rate policy reforms meant that economic agents could import as per their requirements. Firms and individuals could go to the market and source their foreign exchange. The role of the Central Bank was only to ensure that the market operates efficiently, subsequently it would intervene, whenever there was a mismatch between supply and demand of foreign exchange in the market implying that the RBZ would buy or sell foreign currency to maintain stability in the market.

\(^7\) Since the growth rate performance of the TFP is determined by different factors. not just market reforms, the authors estimated a panel data model to control for exogenous variables. They then tested formally to see if TFP was higher after the implementation of ESAP than before. Though none of the measures turned out to be significant, two variables related to ESAP had an impact on TFP growth – the growth rate of imports and foreign aid.
In line with regional developments, foreign-exchange bureaux were allowed to operate in Zimbabwe. Furthermore, the private sector was allowed offshore borrowing up to US$5 million without the approval of the External Loans Coordinating Committee. The Central Bank transferred the responsibility of arranging forward cover to commercial banks. By July, 1994 further improvements were implemented in the exchange controls and exporters were allowed to retain 100 percent of their export earnings and the holiday allowances for individuals was further increased to US$5,000 by January 1995.

The reforms in the trade and exchange rates allowed business and individuals to source foreign exchange in the market. However, in view of the thinness of the market and lack of the appropriate institutional prudence to manage the new system, exchange-rate management problems were experienced. Beginning from 1994, the real exchange rate remained continuously appreciated for more than two years, leading up to the 1997 correction. This experience epitomizes an inflexible approach to exchange-rate management, which results in the persistence over time of an appreciated real exchange rate. During the lead-up to the crisis, there was a tendency to confuse the appreciated exchange rate with exchange-rate stability. This perception continued even after the level of gross foreign reserves fell sharply during the six-months to the end the first quarter of 1997. The appropriate response to this fall in reserves would have been to encourage a more flexible adjustment of the exchange rate while tightening monetary policy. Neither of these two remedies was adopted when reserves began to fall, possibly because the authorities believed that the fall in reserves was temporary. However, monetary policy was progressively tightened since mid-1997, after it became obvious that reserves would not recover.

On 14 November 1997 the Zimbabwe dollar crashed by almost a fourth of its value in local currency terms and continued to slide until the end of that year. This currency crisis had suddenly surfaced against the background of relatively optimistic and confident mood that had prevailed in the economy during the first and second quarters of the year, bringing into sharp focus the importance of redressing underlying fundamental weaknesses in the economy, as well as fostering confidence in economic management.

The Zimbabwean economy had entered 1997 on the back of a strong rebound in economic growth, declining inflation, a buoyant stock market, a strengthening current account position, and gross official reserves near historically high level of some US$830 million which was three months of imports cover. However, the problem lay in the little progress achieved in fiscal consolidation, which contributed to further erosion in external competitiveness.

It would appear that from 1997 onwards there was increased pressure on foreign-exchange reserves for a number of reasons, including the stability of the exchange rate, whose sustainability is in turn dependent on the country’s macroeconomic fundamentals such as convergence of the inflation with that of its major trading partners. In the case of Zimbabwe there was no occasion to align the local levels of inflation and budget deficits with those of the country’s major trading partners.

5.7 CHALLENGES FACING MANUFACTURING SECTOR FIRMS

Following the onset of Zimbabwe’s deepening crisis that started in 1997, one key feature of the Zimbabwean manufacturing sector has been the extremely low capacity utilization of firms. The capacity utilization of local manufacturing firms stood at 19 percent in 2007 compared to 34 percent in 2006 (CZI Survey, 2007). According to the results of a limited survey of companies undertaken during this study (Table 18), capacity utilization averaged 38 percent in 2007 and 21 percent in 2008.

Due to such low effective capacity utilization rates, many local manufacturing sector enterprises have lost their competitiveness even in the domestic

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8 This committee monitors all external borrowing in Zimbabwe. The limit of US$5 million offshore borrowing has since been abandoned.
market. The extent to which the operational environment has been extremely inimical to the operations of companies can be illustrated by two episodes. The first was the imposition of price controls in July 2007. The price controls were enforced at the end of the production chains, unfortunately with no appreciation of the price structures that normally lead to the final pricing of the products. Particularly for those companies that were mainly supplying the domestic market, production simply ground to a halt as companies ran losses on their order books. Secondly, the RBZ’s registration of the foreign licenced warehouses and retail shops (FOLIWARS) towards the end of 2008 did not recognize the existence of local manufacturers. The entire thrust was based on accommodating importers of groceries and similar items, and no attention was paid to the needs of the already struggling local manufacturers. This initial exclusion of local manufacturers meant a preference for imports. Later, it was clarified that manufacturers not registered under the FOLIWARS could sell to local companies in foreign exchange but subject to raising the central bank’s CD1s as if the transaction was an export. However there was a problem with this arrangement in that the proceeds from the transaction were subject to the central bank’s forex surrender requirement of 15 percent. This effectively meant that transactions by local firms were subjected to an additional tax whereas the imported goods were not, thereby rendering the local manufacturer uncompetitive compared to the foreign supplier.

In terms of competitiveness, because of the anti-export signals from virtually all public institutions and the generally deteriorating economic environment, most companies are currently at best ambivalent about whether to consider production for exports. The majority of them have just crawled back into what they consider as a more secure domestic market, though in essence there is no longer a secure domestic market. The situation is made even more difficult when one considers that structurally most of Zimbabwe’s companies, whether small or large conglomerates, produce in isolation of one another. Quite unlike developments in other regions of the world, which are increasingly being organized in a variety of different business systems and global value chain approaches, building on distinctive institutional contexts and through coordination of economic activities across national boundaries, the majority of Zimbabwean firms are still predominantly producing in isolation of each other even at the domestic level. There has been little effort by companies to concentrate on their core business and sub-contract non-core functions to other companies, both within the country or regionally, as each case may demand.

Under normal conditions, Zimbabwe’s local firms should be aiming at identifying factors that will boost competitiveness in both the domestic, regional and global markets as the main driver of their corporate strategies. As this working paper has argued, Zimbabwe’s domestic market, like that of many countries in the region, is arguably too small to act as an incentive for local companies to operate at the necessary levels of output and economies of scale in order to be competitive at the global level. With the coming into effect of the COMESA Customs Union to be followed soon by that of SADC – both free trade areas with a common external tariff – domestic companies have to be competitive in both the local and regional markets.

<table>
<thead>
<tr>
<th>Sub-Sector</th>
<th>Capacity utilization</th>
<th>2007 (%)</th>
<th>2008 (%)</th>
<th>2009 (%) projected</th>
</tr>
</thead>
<tbody>
<tr>
<td>Food &amp; agro industries</td>
<td></td>
<td>13</td>
<td>6</td>
<td>45</td>
</tr>
<tr>
<td>Text &amp; clothing</td>
<td></td>
<td>47</td>
<td>29</td>
<td>40</td>
</tr>
<tr>
<td>Metal working</td>
<td></td>
<td>47</td>
<td>40</td>
<td>37</td>
</tr>
<tr>
<td>Chemicals-pharmaceuticals</td>
<td></td>
<td>22</td>
<td>19</td>
<td>35</td>
</tr>
<tr>
<td>Chemicals-fertilizer</td>
<td></td>
<td>47</td>
<td>24</td>
<td>70</td>
</tr>
<tr>
<td><strong>Average capacity utilization</strong></td>
<td></td>
<td><strong>38</strong></td>
<td><strong>21</strong></td>
<td><strong>30</strong></td>
</tr>
</tbody>
</table>

Source: Data obtained from survey by COMESA (2009)

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9 This was the effective start of dollarization in the sense that these so called FOLIWARS were allowed to sell their goods to local consumers in foreign currency, initially side by side with local procured products being sold in the local currency.

10 CD1 (Customs Declaration Form No.1) is an exchange control document in terms of the Exchange Control Act [Chapter 22.05] that is processed by authorized dealers (commercial banks, who do it on behalf of the Reserve Bank of Zimbabwe) and is used for the clearance of all exports of a commercial nature, i.e., exports whose value exceeds US$1000.00.
As with other sectors of the economy, the major challenge facing Zimbabwe’s manufacturing sector in the short term is to reconcile the need to maintain viable capacity utilization, adequate employment levels and improve competitiveness. As already discussed above, with the dollarization of the country’s currency – and devaluation no longer being an option – regaining competitiveness will depend on how fast measures will be taken to reduce the current high and uncompetitive pricing and cost structures prevalent in the economy. As local companies move to align their high cost domestic prices with those offered in the region, competitiveness will be achieved through a number of ways, including:

• raising productivity;

• cutting costs – which in the short term may include jobs and wages;

• encouraging greater competition, particularly in domestic and regional markets; and

• alignment of local prices with those offered in the region.

The immediate challenge, therefore, is how to get these firms to raise their capacity utilization levels to supply both the domestic market and regional markets in the face of fierce price competitiveness of regional and international competition. Some would argue that, given their attendant high cost and inefficient production structures, the local manufacturers would have to be protected from what appears to be the more efficient and low cost South African competition in order to avoid any further slide into de-industrialization of the economy. Indeed most of the companies recently interviewed, particularly in the agro and food processing sub-sectors, are lobbying for tariff protection in order to offset foreign competition. However, a mindset of autarky will, as it has repeatedly done in the past, encourage domestic producers to think that there is still an exclusive domestic market, instead of thinking about diversifying and seeking new opportunities and challenges in the regional markets and beyond.

Under normal circumstances, corporate strategies are supposed to be proactive rather reactive. However, analyses of Zimbabwean companies and local support institutions suggests certain common response patterns in the face of the unprecedented anti-export bias created by the macroeconomic environment and ancillary legislation. Of the two main strategies likely to be followed by companies, namely: (i) reactive firm strategies, and (ii) proactive firm strategies, the main response of local firms appears to be the former as firms struggle for survival and shelve any consideration of the latter.11

According to the Zimbabwean companies, the current state of a generalized low-capacity utilization is due to a number of factors, including:

• Non availability of foreign currency to purchase raw materials, spare parts and machinery;

• Lack of normal access to credit lines;

• Exchange control regulations which negatively affected profitability, e.g., the retention and compulsory liquidation of company’s foreign currency balances resulting in lack of viability of exports;

• The demise of the commercial agricultural sector which has led to most agricultural inputs now being imported, depressed demand for industrial products, massive brain drain, demise of the middle class which negatively affected markets for certain high value products;

• The initial exclusion of local manufacturers from supplying local shops thereby giving advantage to imports under the FOLIWARS programme in November 2008; and

• Deterioration of infrastructure: unreliable rail transport, deteriorating road network, erratic supplies of electricity, water and communication systems.

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11 For the reactive firm strategies (retraction to domestic market and Transnational Corporations [TNC]-subsidiaries adjusting to their headquarters directives, and proactive firm strategies (increased efforts to export, upgrading of products through diversification of activities), see Gereffi, 1996; Gereffi & Korzeniewicz, 1994; Ndlela, 2004.
5.7.1 Retraction to the Domestic Market

Virtually all Zimbabwean companies have in the post-2000 period retracted to the domestic market. In the sample of 20 Zimbabwean companies spread through five manufacturing sub-sectors shown in Table 16, 82 percent of them were by March 2009 only producing for the domestic market, with a combined exports to the regional markets shared between SADC (14 percent) and COMESA (4 percent). Exports to the rest of the world are virtually insignificant at 0.25 percent.

According to the CZI Manufacturing Report (2007), the main reasons for industrial firms dropping out of export markets in the order of importance were:

1. A controlled managed (overvalued) exchange rate;
2. Non-availability of foreign currency;
3. Foreign competition; and

Table 19: An analysis of destination and source markets

<table>
<thead>
<tr>
<th>Sub-sector</th>
<th>Domestic</th>
<th>COMESA</th>
<th>SADC</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>Food &amp; agro</td>
<td>86</td>
<td>6</td>
<td>6</td>
<td>0.25</td>
</tr>
<tr>
<td>Text &amp; clothing</td>
<td>80</td>
<td>10</td>
<td>10</td>
<td>0</td>
</tr>
<tr>
<td>Metals</td>
<td>66</td>
<td>3</td>
<td>32</td>
<td>0</td>
</tr>
<tr>
<td>Pharmaceuticals</td>
<td>84</td>
<td>0</td>
<td>16</td>
<td>1</td>
</tr>
<tr>
<td>Fertilizer industry</td>
<td>93</td>
<td>0</td>
<td>8</td>
<td>0</td>
</tr>
<tr>
<td><strong>Simple average</strong></td>
<td><strong>82</strong></td>
<td><strong>4</strong></td>
<td><strong>14</strong></td>
<td><strong>0.25</strong></td>
</tr>
</tbody>
</table>

Source: Data obtained from survey by COMESA (2009)

The majority of companies surveyed cited retention by the RBZ of a large chunk of their export earnings (which varied from between 45 percent to 15 percent towards the end of 2008) as a major disincentive to export, with companies forced to abandon export markets and reduct to a poor and declining domestic market. In addition to the retention schemes, companies were also forced to either utilize their foreign-currency earnings within 30 days or liquidate them at an extremely overvalued exchange rate. Up to the first half of 2004, local exporters were compelled to surrender 25 percent of their export earnings at an official exchange rate which was on average 6 times less than the official auction rate of foreign currency. From 2007 onwards, a number of companies started citing shortages of raw materials as the main reason for their failure to export. Of course, this was strongly linked to foreign currency shortages.

An additional non-tariff constraint on Zimbabwe’s export performance was its growing international isolation over the crisis period. For example, Zimbabwe became ineligible to benefit from the USs African Growth and Opportunity Act (AGOA) with the loss of a significant export market. Those neighbouring countries that became eligible for AGOA subsequently became beneficiaries of firms that pulled out of Zimbabwe, e.g., Botswana and South Africa. Zimbabwe thus lost the possibility of technology upgrading, quality and volume production of woven and knitted fabrics, which Zimbabwean based firms would have produced for exports to the AGOA bound manufacturers in the region, as well as exporting directly to the United States.

Finally all companies suffered from acute shortages caused by policy distortions at the centre. The shortages ran to electricity, money, water, and semi-manufactured inputs, e.g., sugar for manufacturers of soft drinks. For example, large companies in the food processing sector were forced to scale down their operations due to lack of raw material and power outages, from the first half of 2008 onwards, such that consumers have been forced to import maize-meal, flour and cooking oil from South Africa and while local capacity utilization plunged to all time lows.

12 While there were no explicit measures that were being imposed by regional partners (SADC, COMESA and AU), the country was effectively isolated from many international regional pacts currently enjoyed by other countries of the region, e.g., AGOA facility, in the European Union (EU) assistance rendered during the implementation of the Cotonou Agreement and Economic Partnerships Agreements (EPAs).
Up to 2006, the most important constraint facing local firms had been foreign exchange, followed by the availability of raw materials (partial overlap with access to foreign currency) and domestic demand continued to be the next most important constraint (Table 20). However, the situation changed drastically from July 2007 when the government suddenly introduced a price freeze. For the majority of the companies this was the turning point, and capacity utilization dropped by between 60 to 80 percent between July and August 2007 due to the price freeze. As noted above, the government imposed the prize freeze at the end of the production chain, i.e., at the retail level of the product, with absolutely no regard to the cost structure of the whole production chain.

However, following the installation of the Government of National Unity (GNU) in February 2009, the constraints facing the companies have again changed. As shown in Table 20, whereas, government policy and exchange rate had occupied first and second positions just before the installation of the GNU, these no longer loom so large in the concerns of companies.

Table 20: Major constraints on industrial production

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Finance</td>
<td>100</td>
<td>90</td>
<td>90.0</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>Quality</td>
<td>65</td>
<td>80</td>
<td>74.0</td>
<td>69.4</td>
<td>79.7</td>
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<tr>
<td>Human resources</td>
<td>38</td>
<td>68</td>
<td>64.5</td>
<td>58.9</td>
<td>70.9</td>
</tr>
<tr>
<td>Government policy</td>
<td>38</td>
<td>45</td>
<td>12.0</td>
<td>9.7</td>
<td>8.9</td>
</tr>
<tr>
<td>Infrastructure</td>
<td>33</td>
<td>n/a</td>
<td>30.0</td>
<td>26.4</td>
<td>41.9</td>
</tr>
<tr>
<td>Price control</td>
<td>n/a</td>
<td>20</td>
<td>20.0</td>
<td>8.3</td>
<td>6.3</td>
</tr>
<tr>
<td>Exchange rate</td>
<td>n/a</td>
<td>4.5</td>
<td>70.0</td>
<td>6.9</td>
<td>8.9</td>
</tr>
</tbody>
</table>

Source: Confederation of Zimbabwe Industries: Survey of Manufacturing Industry 2006 up to 2007. Estimates for 2007/08 and 2009 have been obtained from interviews with companies in the survey.
1. In post-crisis Zimbabwe, investment and infrastructure deficits in both the private and public sectors, at a time when the domestic savings base is negligible and when the banking sector is unlikely to be in a position to satisfy the working capital demands of businesses, mean that for the foreseeable future Zimbabwe will be a substantial net importer of capital – foreign aid, FDI, offshore bank borrowing and limited portfolio inflows. This will almost certainly result in some, possibly substantial, dilution of domestic ownership of the capital stock.

2. Closing the infrastructure deficit at a time when Zimbabwe’s public sector finances will be seriously constrained is likely to mean increased reliance on private sector funding, including public-private partnerships, commercialization and privatization.

3. Although – in the medium term – the main burden of balance-of-payments adjustment and the financing of investment will have to be borne by the capital account of the balance of payments, this carries a risk of excessive dependence on foreign funding along with the possible emergence of an unsustainable burden of foreign debt.

4. Accordingly export promotion and diversification must be at the top of the policy agenda, though given that in a dollarized economy Zimbabwe will be unable to pursue the kind of competitive currency export growth strategy proposed by Freund and Pierola (above), other options will have to be pursued.

5. However, when it comes to the choice of a currency peg – dollar or rand – policy-makers should take note of the benefits of a competitive currency. If, over time, the rand is deemed likely to depreciate relative to the US dollar then this is a strong argument for Zimbabwe to opt for the South African currency as its reference currency, especially in the light of the country’s tighter trade and financial integration with other SADC states, especially South Africa.

6. Arguably the most likely medium-term export growth path is not that of export diversification but of continuing high concentration in a limited range of primary product exports – platinum, ferrochrome, gold, cotton, tobacco and nickel. Such a growth path is sub-optimal to the extent that there is no broadening of the country’s export portfolio, and the bulk of the export products, though not tobacco and cotton, are capital-intensive, thereby limiting the extent of new employment creation. Export growth in the mining sector will depend on substantial FDI and recruitment from abroad of expensive skills, while such a growth path implies little export market discovery and learning as well as limited scope for participation in, and exploitation of, Global Value Chain (GVC) opportunities. For these reasons this growth path while feasible, and indeed probable, would make only a limited contribution in terms of reviving manufacturing, enhancing competitiveness and diversifying Zimbabwe’s export basket.

7. Prior to the onset of the crisis, Zimbabwe did have competitive advantage in the field of service exports, especially tourism, which could be revived though this would involve a changed business model for tourist operators along with substantial infrastructure and capacity investment by both the state and the operators allied with more tourist-friendly policies. The latter includes streamlined customs and immigration formalities, an open-skies policy to attract greater international airline participation and, possibly, privatization of the national airline. Finance and banking is a second industry in which Zimbabwe has traditionally enjoyed competitive advantage and in which it could become a regional player.

8. An immediate policy priority should be tackling high transaction costs since, in the wake of
decades of above-average inflation, culminating in ten years of chronically-high inflation and hyperinflation, Zimbabwe’s cost, wage and price structure is out of sync with those in regional and global competing countries.

9. There is no evidence of sustained success in the export of manufactures by a landlocked country, though some cite the recent, but seemingly temporary, surge in Lesotho’s clothing exports. Geography – being land-locked — works against exporters of manufactures in two main ways: firstly by increasing the cost of penetrating wealthier or denser foreign markets although Zimbabwe does have a relative competitive advantage in the form of the proximity of the large Gauteng market in South Africa. Secondly, firms in landlocked countries encounter higher input costs because they are further away from cheaper foreign suppliers and because domestic substitutes are more expensive (Elbadawi et al., 2006). This too underlines the necessity of measures to enhance structural competitiveness by reducing or eliminating behind-the-border obstacles to foreign trade.

10. High transaction costs that inhibit exports must be tackled. It is simply impossible for exporters to expand where they are hamstrung by higher transport, energy, finance and logistics costs than their competitors. Transaction costs can be lowered by fostering domestic competition in the services sector and by the use of regulators where natural monopolies exist as in electricity, water and rail transport. Hoekman and Nicita (2008) conclude that policies to reduce transaction costs at or behind-the-border will have a greater payoff than further reductions in tariffs and non-tariff barriers.

11. Domestic resources must be channelled where they are most productive. This is not a matter of picking winners and then using industrial policy to promote these industries or enterprises, but of eliminating existing distortions in the structure of incentives so that resources flow to those firms and industries in which the country has long-term competitive advantage or has the capability to develop competitiveness. This is then a ‘Discovery’ issue.

6.1 THE CORPORATE STRATEGY DIMENSION

Invariably, policy debates overlook the role of firms and managers because the focus is on what governments can and should do. But because ultimately a country’s competitiveness is determined by the productive efficiency of its enterprises, corporate strategy plays a critical role in the process of export growth and export diversification. With the explosive growth of global production sharing in the last 20 years a country’s export success depends increasingly on the location decisions of multinational companies. Few today deny that foreign direct investment is a major driver of technology transfer and improvements, job and skills creation and export expansion.

The criteria on which location decisions are made are part industry-specific, part location-specific and part task-specific, which means that there is no simple means of assessing how policy might influence the FDI decision. Most investment intentions surveys highlight the crucial roles of market size and projected future market growth, though these may assume less significance where investment is resource-seeking in nature – oil, gas, minerals and tourism – and where it is motivated by cost reduction considerations or so-called efficiency-seeking investment. Some FDI is export platform in nature whereby the multinational invests to exploit cheap labour or more likely preferential access to the EU and US markets. Frequently, motivations overlap so that an investment in China might be driven by the size and growth potential of the domestic market, low production costs and attractive regional or global export opportunities.

Given these criteria, the scope for public policy interventions to attract FDI is limited. Almost all the survey evidence casts doubt on the efficacy of targeted interventions such as special tax-breaks, wage subsidies or subsidized utility tariffs. From these surveys, however, there is support for general investment climate and doing business reforms that lower transaction costs and market uncertainty. Such reforms make sense from an industrial policy viewpoint too because there is no need for the authorities to try and pick winners but rather to focus on eradicating or minimizing obstacles to doing business and administrative or bureaucratic conditions likely to reduce the rate of return on
investment. In contrast, interventions that seek to raise the rate of return by limiting competition or granting preferential tax rates are undesirable because they are costly in terms of tax efficiency and because they reduce consumer welfare, even if they do create jobs and generate output and employment.

FDI and trade can seldom be disentangled. Investment in platinum translates into rapid export expansion, as well as the participation in GVCs or offshoring. Accordingly, corporate strategic decisions have a major impact on the structure and growth of foreign trade. Where the firm decides to outsource or seek a foreign input into its worldwide value chain that will impact not just on output and employment in the chosen location but also on its foreign trade. Accordingly the often unpredictable micro- or firm-level response to macroeconomic policies determines whether a given policy initiative will succeed or fail.

6.2 REPLICATING FOREIGN EXPERIENCES

Policy-makers are tempted to seek models or experiences elsewhere that they can replicate in their own economies. What may be appropriate in Kenya with a given resource endowment and institutional, cultural and behavioural variables, may well not suit a different set of conditions in Zambia or Zimbabwe.

Success is location-specific so that even if were possible to identify a unique Asian Model for replication in sub-Saharan Africa, the chances of successfully transplanting an entire system to an alien environment are slim. Obviously countries can learn from each other’s experiences but that is very different from seeking to turn Zimbabwe into a mini-Korea or Taiwan.
Section 7

Conclusion

At this stage in its development, Zimbabwe has no option other than to seek growth through enhanced integration with the regional and global economies, especially in the form of export growth and openness to foreign capital inflows of all kinds. It is unfortunate that this should coincide with the worst global recession for 70 years and at a time when the steep decline in trade and investment flows suggest that the international economy has entered into a phase of de-globalization.

Because during the crisis period the economy downsized, suffered an exodus of skills and endured unprecedented hyperinflation resulting in the destruction of the savings base, there is no alternative to an outward-looking strategy. From a policy viewpoint, this means that fixation with trade liberalization, trade preferences and access to industrialized country markets should be replaced by a much tighter focus on domestic – behind-the-border – obstacles to export growth in the form of malfunctioning domestic institutions and markets, especially labour markets, weak infrastructure and low levels of productivity and competitiveness. Government needs to adopt and implement strategies designed to boost productivity and competitiveness by lowering transaction costs and reducing, if not eliminating, obstacles to foreign investment.

The success of any development strategy depends ultimately on the response of private sector players – entrepreneurs, investors, lenders and corporate strategists. If they are unconvinced, the strategy will not work. Because they are a heterogeneous group, it is simply impossible for the state to devise a ‘one-size-fits-all’ strategy. Some investors may be attracted by outsourcing opportunities while others will see clusters or GVC participation as profitable. The optimal way out of such a policy dilemma is a level playing field approach, leaving entrepreneurs and investors to ‘discover’ what they can and cannot do.
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