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The Social and Economic Impacts of the Tariff Measures Announced in the 2011 and 2012 National Budgets of Zimbabwe:

Focusing on Industry, Informal Economy and the Poor

Edited by:

Judith Kaulem
Denboy Kudejira
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List of Acronyms

CCZ	Consumer Council of Zimbabwe
COMESA	Common Market for Eastern and Southern Africa
CSOs	Civil Society Organisations
CZI	Confederation of Zimbabwe Industries
EAC	Economic Commission for East Africa
ELG	Export Led Growth
EPA	Economic Partnership Agreement
ESA	Eastern and Southern Africa
ESAP	Economic Structural Adjustment Programme
EU	European Union
FPL	Food Poverty Line
FTA	Free Trade Area
GDP	Gross Domestic Product
HDI	Human Development Index
HDR	Human Development Report
HIV/AIDS	Human Immuno-Deficiency Virus/ Acquired Immune Deficiency Syndrome
IDP	Industrial Development Policy Framework
ILO	International Labour Organization
ISI	Import Substitution Industrialisation
LEDRIZ	Labour & Economic Development Research Institute of Zimbabwe
LFS	Labour Force Survey
MTP	Medium Term Plan
NTBs	Non Tariff Barriers

OGIL	Open General Import Licence
PARP	Poverty Alleviation Action Plan
PASS	Poverty Assessment Study Survey
PAYE	Pay as You Earn
PDL	Poverty Datum Line
PRFT	Poverty Reduction Forum Trust
SADC	Southern African Development Community
SADCC	Southern African Development Coordination Conference
SIDA	Swedish International Development Agency
STERP	Short Term Emergency Recovery Programme
TB	Tuberculosis
TCFPL	Total Consumption Food Poverty Line
TI	Transparency International
UDI	Unilateral Declaration of Independence
UNDP	United Nations Development Programme
USAID	United Stated Development Agency
VAT	Value Added Tax
WB	World Bank
WEF	World Economic Forum
WTO	World Trade Organisation
ZETREF	Zimbabwe Economic and Trade Revival Fund

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CHAPTER 1: INTRODUCTION AND BACKGROUND

The Poverty Reduction Forum Trust (PRFT) has initiated a scoping study to gauge the social and economic impacts of recent tariff measures pronounced in the 2011 and 2012 national budgets. Focus has been limited to the possible impacts of these measures on the informal economy, the poor and vulnerable and the industry so as to guide future public policy interventions in Zimbabwe. The output will also be a vital advocacy instrument for the Forum that will open up social and economic dialogue with key stakeholders in Zimbabwe drawn from the public sector, private sector, academia, development partners and clergy to enrich objective economic policy formulation.

The findings of this study which is a Pilot will be a vital resource for use under a new information dissemination platform, the ***Socio-Economic Justice Dialogue Series*** that the PRFT has created for a broad based, economy – wide and participatory approach towards enhancing objective public policy formulation in Zimbabwe.

Highlights of Tariff measures in the Budget

During the presentation of the 2011 and 2012 the Minister of Finance, Mr. Tendai Biti introduced import duties on a number of commodities including clothing, electrical goods such as fridges and some foodstuffs. He also introduced tariffs on agricultural equipment, as well as reduction of duties on materials used in the agriculture equipment manufacturing subsector. Tariffs can be used to achieve both economic and non economic objectives. In some cases, they can be used to protect local industries, income distribution, revenue collection and for political considerations. Focusing on the use of import tariffs for protection of the domestic economy from foreign competition, what is central is to gauge how this affects the various economic agents.

Likely Impacts of Tariffs

The effect of tariffs on the economy varies from country to country depending on the level of economic development, as well as the structure of the economy. For a large country, theoretically, the overall welfare effect might be positive since it can depress the price of exports, while for a small country it might be negative since it will not have welfare effects on world prices. A small economy like Zimbabwe might suffer a welfare loss when it imposes a tariff. This is premised on the fact that International Trade Theory makes the fundamental observation that in many circumstances, introducing a tariff reduces a country's welfare as it raises the prices of the imported goods. This is normally the case for small importing countries who can not affect the terms of trade, Zimbabwe being no exception.

The reduction in a country's welfare has led to a search for explanations as to why they are prominent. As noted above, import duties may be levied for either revenue or protection, or both, but tariffs are not always a satisfactory means of raising revenue, because they tend to encourage economically inefficient domestic production of the item which is benefiting from tariff insulation (i.e. a tariff hike to limit importation). Even if imports constitute the bulk of the available revenue base, it is better to tax all consumption, rather than only the consumption of imports, to minimize the possibility of the tax regime becoming regressive, and hence avoid uneconomical protection.

For Zimbabwe, tariffs have over the years been used mainly as a revenue device and also for protecting the local industries. These import tariff policies are made on the assumption that through their implementation people will be induced to turn to domestically produced products and the manufacturing industry in particular can be bolstered and become more competitive. However, the import tariffs have both market effects (price and volume) and welfare effects (gainers and losers) on the Zimbabwe producers and consumers.

Tariffs that increase prices of commodities are regressive to consumers: the poorest consumers are the first to be "priced out of the market" by high prices. The import of clothing for resale has contributed immensely towards restoring the livelihoods of many people in Zimbabwe given the unprecedented unemployment levels. Hence, the introduction of import duties on clothing as well as foodstuffs has the potential to worsen the livelihoods of many people especially women who constitutes the majority of cross border traders.

However, this general result might not be substantiated without having a proper empirical study. What henceforth governs the effectiveness of tariff imposition is producer production reaction, import and export demand elasticity, import substitutability, competitiveness and export stimulation possibility. The decision to protect the domestic industry should depend on the industry's learning, potential, the shape of the learning curve and the degree of substitutability between domestic and foreign goods (Melitz, 1999).

This research seeks to provide an objective analysis of the impact of imposition of import duties on regional positioning, producers, consumers, the poor and various economic impacts. The research is focused on isolating the social and economic impacts of the tariff measures that have been implemented by government through the 2011 and 2012 National Budgets on the informal economy, the poor segments of society, and industry. On that basis, the major output of the research would be to generate objective conclusions that would guide policy interventions in Zimbabwe.

Study Focus

Objectives of the Study

The broad objective of this study is to evaluate the social and economic impact of the tariff measures that were introduced through the 2011 and 2012 national budgets. The research seeks to isolate the specific impacts on the ***informal sector, the poor and industry and commerce***. The overall purpose of this intervention is threefold, namely to come up with viable policy options for legislators; to provide information to civil society organizations for planning and as a tool for engaging with policy makers as well as to unravel possible areas for further research for academics and research institutions. The following is the Scope of the Study:-

i. What is the likely impact of the import duties on Producers?
ii. What is the likely impact of the import duties on Consumers?
iii. What are other likely economic impacts?
iv. How the various groups are affected especially the poor, in terms of consumption, production, prices, expenditures, incomes and asset accumulation as a result of the import duties?

v. Looking at the SADC Trade Protocol Roadmap, the EPAs dialogue, COMESA initiative and other related trade platforms, critically assess the implications of these measures on the country's position in regional and global trade issues?
i. Look critically at the sectors affected by the measures, and proffer the likely economy – wide impacts of the measures;,
ii. Make policy recommendations to address the problems referenced here.

Methodology

The research employed both **qualitative** and **quantitative** analysis. The former technique was used to capture and analyse specific the behaviour of the target economic agents after the policy pronouncements as a basis to gauge the initial impacts of the measures. Quantitative Techniques were employed to measure specific impacts of the tariff changes on specific target segments of the economy as defined in the Terms of Reference.

Secondary data collection: The first stage of the assignment was committed to the generation of secondary data through desk review of published literature on the subject. The key sources of secondary data were publications by Treasury, Economic Journals, and National Press documents, and any other resource materials that were deemed to be of relevance to the subject matter such as those published by key stakeholders (e.g. Cross Border Traders Association, Informal Traders Association, Zimbabwe National Chamber of Commerce (ZNCC), Consumer Council of Zimbabwe (CCZ) and Confederation of Zimbabwe Industries (CZI).

Primary Data Collection: The major source of primary data for the study was a Focus Group Model that revolved around two Workshops that were hosted in Harare, and Bulawayo. To ensure a broad based approach to generating primary data for the study, participants at these Workshops were randomly pooled from a diversity of stakeholders that included legislators, public sector, private sector, banking, Civil Society Organisations (CSOs), Development Partners, and Informal Traders. The Budget, Finance and Investment Promotion Committee of Parliament that attended the Workshops provided a strategic economics policy oversight reference Group, given that their mandate is to overshadow the Ministry of Finance.

Their involvement also provided a broad based engagement of the policy review process given that they represent political constituencies. They therefore, save as proxies for the citizenry in their constituencies. A list of the participants during these Focus Group Sessions is attached as **Annex 1** for ease of reference.

Data Collection Problems: The study could have benefitted from a balanced mix of data collection tools that could have included the use of questionnaires and one-on-one interviews. This was not feasible due to time and resource constraints, and hence remains a major weakness of the research methodology. The timing of the study, post tariff measures implementation could not provide for an objective trend and historical analysis of the possible impacts of the policy changes, hence limiting focus to first round, and rather marginal short term movements in business, and consumer decisions owing to the tariff changes.

The longer the period beyond the implementation of tariffs, (with 5 years as a benchmark), the more revealing the impacts of the tariff measures would be. In this regard, the findings of the study should be treated as an assessment of the possible first round impacts of the tariff related measures. A much more informative study could be pitched, if the new measures are allowed sufficient time to influence the production, and consumption function in the country.

The ***Study Findings*** are presented as follows: ***Chapter 2*** looks at the impacts of the Tariffs on Industry, whilst ***Chapter 3*** looks at the impacts as they manifest themselves in the Informal Sector. The last part is ***Chapter 4*** that pitches a conclusion and recommendations.

CHAPTER 2: STUDY FINDINGS: SOCIAL AND ECONOMIC IMPACTS OF TARIFFS ON THE INDUSTRY AND THE POOR

By
Rongai Chizema

Introduction and Background

During the presentation of the 2011 and 2012 National Budgets, the Minister of Finance, Tendai Biti introduced import duties on a number of commodities including clothing, electrical goods such as fridges and some foodstuffs. These import tariff policies are made on the assumption that through their implementation people will be induced to turn to domestically produced products and the manufacturing industry in particular can be bolstered and become more competitive. However, the import tariffs have both market effects (price and volume) and welfare effects (gainers and losers) on the Zimbabwe producers and consumers.

Tariffs that increase prices of commodities are regressive to consumers: the poorest consumers are the first to be "priced out of the market" by high prices. The import of clothing for re-sale has contributed immensely towards restoring the livelihoods of many people in Zimbabwe given the unprecedented unemployment levels. Hence, the introduction of import duties on clothing as well as foodstuffs has the potential to worsen the livelihoods of many people especially women who constitutes the majority of cross border traders. In addition, the adoption of trade protectionist policies is in contrast to trade liberalisation agreements to which Zimbabwe is a signatory to. In the region, Zimbabwe is participating in the Common Market for Eastern and Southern Africa (COMESA) Customs Union which is expected to be implemented in 2012 and is also participating in the Southern Africa Development Community (SADC) Free Area Trade (FTA) where it is expected to liberalise 100% of its trade by 2012. In addition, there are the COMESA-EAC-SADC Tripartite FTA negotiations currently underway where again member states will be expected to liberalise their trade. At the January 2011 African Union Commission Summit, proposals for the formation of a Grand FTA in Africa were also made which might result in the formation of an all Africa FTA.

On the international arena, Zimbabwe has also been involved in the ESA-EU Economic partnership Agreement (EPA) negotiations and it is one of the countries that signed the interim EPAs in 2008. If the full EPAs are signed, Zimbabwe is expected to liberalise most of its trade with the EU. Furthermore, Zimbabwe is a member of the World Trade Organisation (WTO) where again it has obligations to remove all impediments to trade. This WTO membership creates a binding constraint on Zimbabwe's ability to implement protectionist trade policies.

Role of Tariffs in Public Finance

A fundamental result of International Trade Theory is that in many circumstances, introducing a tariff reduces a country's welfare as it raises the prices of the imported goods. This is normally the case for small importing countries who can not affect the terms of trade.

The reduction in a country's welfare has led to a search for explanations as to why they are prominent. Tariffs can be used to achieve both economic and non economic objectives. In some cases, they can be used to protect local industries, income distribution, revenue collection and for political considerations. For Zimbabwe, tariffs have been used mainly as a revenue device and also for protecting the local industries.

As noted above, import duties may be levied for either revenue or protection, or both, but tariffs are not a satisfactory means of raising revenue, because they tend to encourage economically inefficient domestic production of the taxed item. Even if imports constitute the bulk of the available revenue base, it is better to tax all consumption, rather than only the consumption of imports, in order to avoid uneconomical protection.

Protection of domestic industry

Probably the most common argument for tariff imposition is that particular domestic industries need tariff protection for survival during their infancy. Comparative-advantage theorists will naturally argue that the industry in need of such protection ought not to survive and that the resources so employed ought to be transferred to occupations having greater comparative efficiency. The welfare gain of citizens taken as a whole would more than offset the welfare loss of those groups affected by import competition; that is, total real national income would increase. An opposing argument would be, however, that this welfare gain would be widely diffused, so that the individual beneficiaries might not be conscious of any great improvement. The welfare loss, in contrast, would be narrowly and acutely felt. Although resources can be transferred to other occupations, just as comparative-advantage theory says, the transfer process is sometimes slow and painful for those being transferred. For such reasons, comparative-advantage theorists rarely advocate the immediate removal of all existing tariffs. They argue instead against further tariff increases—since increases, if effective, attract still more resources into the wrong occupation—and they press for gradual reduction of import barriers.

The infant-industry argument

Advocates of protection often argue that new and growing industries, particularly in less-developed countries, need to be shielded from foreign competition. They contend that costs decline with growth and that some industries must reach a minimum size before they are able to compete with well established industries abroad. Tariffs can protect the domestic market until the industry becomes internationally competitive and, it is often argued, the costs of protection can be recouped after the industry has reached maturity. In short, the infant industry argument is premised on the idea that there are economies of large scale production in many industries, and that developing countries have difficulty in establishing such industries.

Infant industry tariffs have been disappointing in other ways; the infant-industry argument is often abused in practice. In many developing countries, industries have failed to attain international competitiveness even after 15 or 20 years of operation and might not survive if protective tariffs were removed. The infant industry is probably better aided by production subsidies than by tariffs. Production subsidies do not raise prices and therefore, do not curtail domestic demand, and the cost of the protection is not concealed in higher prices to consumers. Production subsidies, however, have the disadvantage of drawing government revenue, rather than providing for its accumulation, which may be a serious consideration in countries at lower levels of development

Tariffs and Modern Trade

The role tariffs play in international trade has declined in modern times and one of the primary reasons for the decline is regional integration initiatives aimed towards reducing all impediments to trade. The introduction of regional and international organizations such as COMESA, SADC and the World Trade Organisation (WTO) is designed to improve free trade. Such organizations make it more difficult for a country to levy tariffs and taxes on imported goods, and can reduce the likelihood of retaliatory taxes. Because of this, countries have shifted to Non Tariff Barriers (NTBs) such as quotas and export restraints. The policy thrust of the WTO to which Zimbabwe is a signatory, is to foster the evolution of free global trade through the continuous elimination of production and consumption distortions, in member countries.

Protectionism in the less-developed countries

Much of the industrialization that took place in the late 20th century in some less-developed countries was characterized by the expansion of import-competing industries protected by high tariff walls. In many of those countries, tariffs and various quantitative restrictions on manufactured goods were high, but the effective rates of protection were often even higher, because the goods tended to be highly fabricated, and the proportion of value added in production after importation was low. While countries such as Taiwan, Hong Kong, and South Korea oriented their manufacturing industries mainly toward export trade, they tended to be exceptional cases. More commonly, developing nations have mistakenly sought to compete with foreign made goods for the domestic market. High protection in these countries has often contributed to a slowdown in production, while the export of primary commodities has discouraged expansion of exports of the more valuable manufactured goods. Although domestic production of nondurable consumer goods fosters rapid economic growth at an early stage, less-developed countries have encountered considerable difficulties in producing more-sophisticated, value-added commodities. They suffer all the disadvantages of small domestic markets, in addition to a lack of incentives for technological improvement.

Relative Importance of Customs Revenues in Zimbabwe

Governments, the world over, use taxation as a fiscal tool to attain its economic growth and development goals. Government has been using import duties to fulfil the following objectives:-

- Improving supply of goods and services to augment local production;,
- addressing shortages of locally produced goods / Capacity utilisation levels;,
- Levelling the playing field between imported and locally produced basic commodities;, and
- Price stabilisation.

During the past years, Government has progressively reduced its dependence on trade taxes to finance Budget expenditure, with significant steps having been taken to reduce customs duty on inputs. In 2011, customs duty was 12% of total revenue, representing a 3.2% decline from the 2010 contribution of 15.2%. Of the total revenue collections to September, major contributors were VAT (31%), PAYE (20%), customs duty (12%) and excise duty (11%), as indicated in **Figure 2.1** below:-

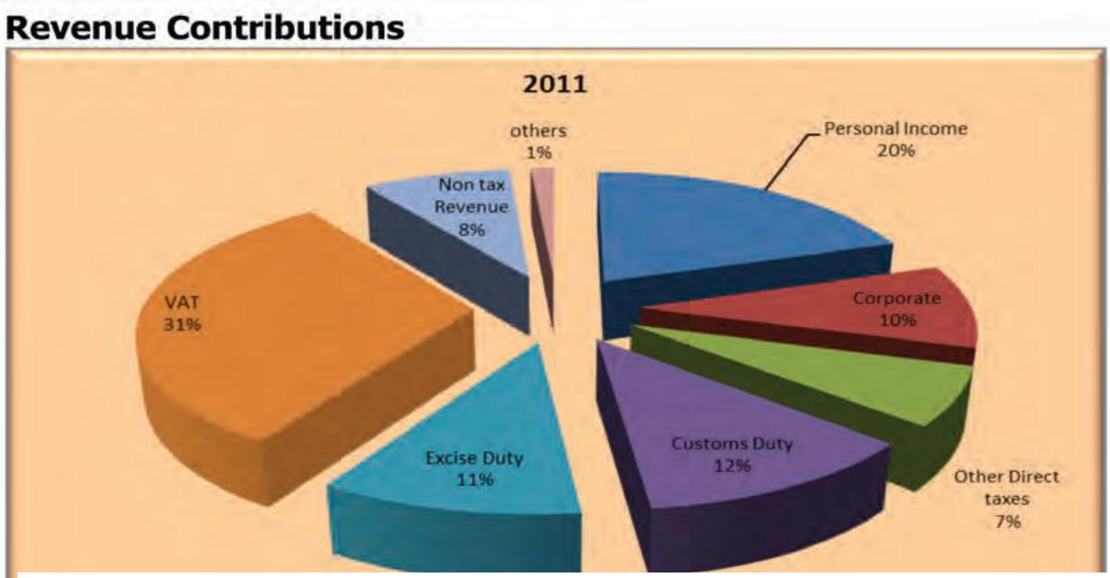


Figure 2.1: Revenue Collection composition (*Source*: 2012 Budget Statement)

Evolution of Zimbabwe's Import and Tariff Regime

For very long periods, Zimbabwe has used trade and domestic policies to protect domestic industries as well as a way of raising government revenue. These policies consisted of administrative setting of the exchange rate, government control of imports through near-universal, non-automatic import licensing requirements, tight restrictions on the repatriation of dividends for foreign investors, internal price controls, government control of agricultural marketing, and a complex web of related programmes and exemptions. While insufficient data imposed limitations towards drawing clear conclusions, it appears that these measures have compromised Zimbabwe's actual export capacity.

Around the early 1940s, Zimbabwe had managed to build a relatively sophisticated industrial base achieved largely under import substitution industrialisation (ISI) strategy (Riddell, 1988). According to Riddell, around 10 per cent of Gross Domestic product (GDP) and 8 per cent of exports were derived from the manufacturing sector. As a measure to counter international trade sanctions that were imposed between 1965 and 1979, the country developed a highly protected system including the creation of an extensive set of controls to ration foreign exchange, and the adoption of restrictive trade policies. The escalating war of independence further disrupted economic activity and trade. This resulted in a limited development of exports especially in the manufacturing sector. The ratio of manufactured exports to gross output dropped from about 27 per cent in 1965 to 15 per cent in 1980 (Ndlela and Robinson, 1992).

At independence, the country continued with the highly restrictive trade and domestic policies that were developed in the former Rhodesia during the period of the Unilateral

Declaration of Independence (UDI), and even introduced new measures. The liberalisation of the economy in the early 1990s under the Economic Structural Adjustment Programmes (ESAP) resulted in the removal of most restrictive trade policies. A notable one was the placing of most goods under the Open General Import License (OGIL) where imports and exports are exempted from licenses. Certain products, however, require import licenses which are administered by the Ministry of Industry and Commerce, through the Control of Goods Act. Zimbabwe requires permits for selected agricultural imports and these are granted by the Ministry of Agriculture, Mechanisation and Irrigation Development. Some animal products require a separate permit under the Animal Health (Import) Regulations to comply with Sanitary and Phytosanitary regulations. The purpose of licensing is for Sanitary and Phytosanitary requirements and statistical purposes.

The trade liberalisation measures that were adopted in 1990 were aimed to gradually dismantle the import substitution industrialisation (ISI) policies inherited from the previous regime and implement market driven policies. The adoption of trade liberalisation policy under ESAP in 1990 was tantamount to the government's re-focusing of policy from ISI to Export Led Growth (ELG). The argument was that, openness to trade and free market policies are fundamental in promoting exports (World Bank, 1987). Trade liberalisation and market deregulation were, thus, used as the principal drivers towards the implementation of ELG. The main focus of trade liberalisation was to achieve an expansion of exports through diversion of resources from the domestic to the export sector. Such orientation would in turn lead to faster growth of GDP (Balassa, 1982).

Zimbabwe's Tariff Bands

"In 1997 the Government launched a new tariff structure, which brought about a reduction in the rates and rationalisation of the band structures of as shown in **Table 2.1.** Despite this move, in 1998 the Government increased tariffs on goods considered luxuries to rates of between 70 – 100% in order to reduce import demand. In 2001 Government also increased tariffs on certain processed items that have domestically produced substitutes, such as food"[3]. This narrative provides an empirical scenario of the evolution of Zimbabwe's tariff policy, which has tended to change in the short to medium term to suit specific discretionary government objectives. Currently the Zimbabwe tariff structure consists of 9 bands namely; 0%, 5%, 10%, 15%, 20%, 25%, 40% and 60%. The tariff regime also consists of specific duty and a combination rate of duty on products such as clothing, footwear and travel bags.

Table 2.1: Tariff Bands for Zimbabwe Pre and Post 1997

Goods	Rates of Duty before 1997 %	Rates of Duty after 1997 %
Raw materials	0 - 40	5
Merit Goods		

[3] Hurungo, J. T; 2010, "Trade Policy Review: Zimbabwe", Stellenbosch, tralac, 2010;, page 24.

• *Education*	0 - 40	5
• *Medical*	0 - 20	0 - 20
• *Goods of the Blind*	0 - 10	0
Intermediate goods	0 - 35	5 - 25
Capital goods	0 - 25	0 - 5
• *Tools*	0 - 20	5 - 15
• *Spares*	0 - 56	15
• *Partly processed inputs*	0 - 55	15
Finished goods	0 - 85	40 - 85
Sensitive goods	-	>40%

Source: Hurungo, 2010; Zimbabwe Revenue Authority (ZIMRA)

The country's successive tariff rationalisation over the years has produced a cascading tariff structure categorized into raw materials and capital goods with low duties, intermediate goods with moderate duties and final goods with relatively high duty rates. The adopted tariff structure takes into consideration the value addition processes obtaining in the economy. Whilst the principle of import substitution is sometimes viewed in a retrogressive manner in that it is seen as being counter to the central tenets of global liberalisation, the situation in Zimbabwe demands that we rely on it to offer temporary protection for our industry to counter the surge in the disruptive imports of cheap and dumped goods which can easily be produced locally[4]. Despite this positive dimension to the Industrial Development Policy Framework thrust, the challenge with the current tariff regime is that contrary to policy pronouncements that advocate for a system that fosters a relative degree of protection, (whilst promoting competitiveness through rationalisation, and tariff alignment), in practice tariffs have been adjusted at the discretion of the Treasury without due regard to the possible medium to long - term implications on industry development.

Macroeconomic Context Setting:
Key highlights of recent policy thrusts: Medium Term Plan [MTP], Short Term Emergency Recovery Programme [STERP], and Industry Development Policy [2012 – 2016].

The Zimbabwean economic crisis, 2003 – 2008

The period 2000 - 2008, has seen all the economic gains of the post – independence era being compromised, and thus a reversal of the economy's growth peak of 12.6% of GDP in 1996 to a cumulative decline in GDP of 48% by 2008 and a virtual collapse of the political and

[4] GoZ, 2012;, "Industrial Development Policy, (IDP), Framework", Ministry of Industry and Commerce, February, 2012;, page 11.

economic governance[5]. The last decade has witnessed the engine for economic growth and development that is anchored in Zimbabwe's manufacturing sector declining in its contribution to GDP from averages of 20% to below 10% by 2008.[6] Apart from the agricultural sector that has had the most pronounced degree of contraction, over the last 30 years the manufacturing sector has not been spared either, given its direct linkages with agriculture. For example, between 1980 and 1990 the manufacturing sector accounted for 15% of formal employment and was contributing up to 25% to GDP. This robust performance was reversed from 2000 onwards in correlation with the slide in agriculture production, since implementation of the land reforms (during that period), resulting in the sector shedding more than 50% growth between 2000 and 2008.

Apart from the agricultural sector induced downturn in the sector, its woes were compounded by acute foreign currency shortages, lack of funding for capitalization purposes, price distortions arising from price controls and hyperinflation, influx of cheaper imported goods, unreliable utility and energy supplies (electricity, water, fuel, coal) and recurrent droughts. Capacity utilization fell dramatically reaching 10% in 2008. This lost decade is traced by **Figure 2.2** below that shows a reversal of the hyperinflationary induced and unsustainable profits that lasted until 2008, and began dipping as the economy retreated into self correction mode with the implementation of price stabilisation measures[7]. At the epicentre of the economic crisis, were unprecedented levels of hyperinflation, sustained periods of negative GDP growth rates, massive devaluation of the currency on parallel markets, low productive capacity of most industries that compounded de-industrialisation, loss of jobs, and food shortages.

[5] Chizema, R; 2011, "Impact of the Global Financial Crisis on Diaspora Remittances and its Implications for MDG Achievement in Zimbabwe", UNDP Poverty Reduction WPS 3, November, 2011;, page 9.

[6] GoZ, 2012: "Industrial Development Policy Framework, 2012 – 2016", Minsitry of Industry and Commerce;, February 2012; page vii.

[7] This Graph has been extracted from a presentation by Zhou. N,[former Chief Executive Officer of PG Industries], at an Investment Conference hosted by Deat Capital in Victoria Falls, in August, 2009.

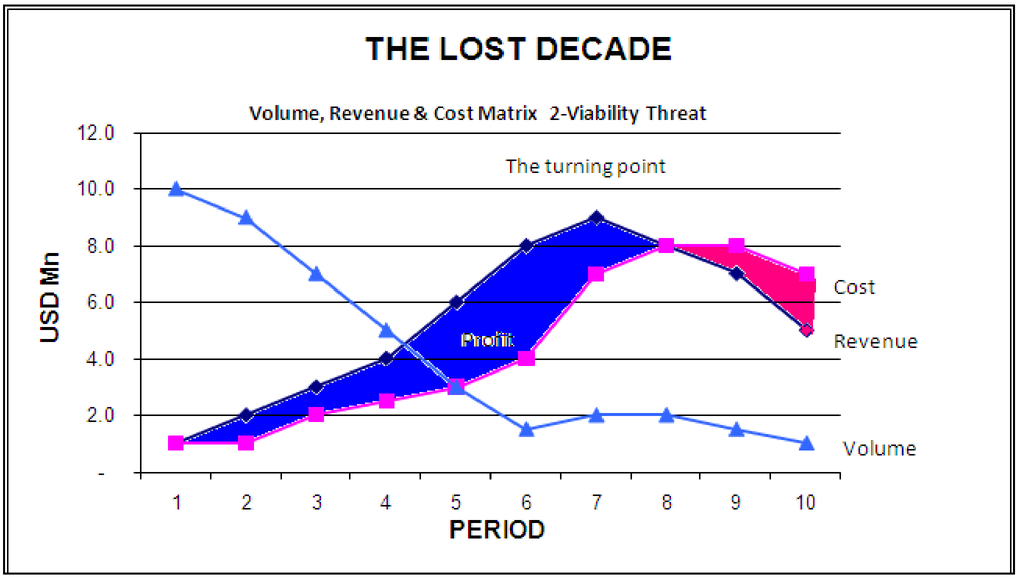


Figure 1.2: The Lost Decade

The Short Term Emergency Recovery Programme (STERP)

The adoption of a multicurrency regime through the 2009 National Budget and the launch of the Short Term Emergency Recovery Programme (STERP) in March 2009, has by and large stabilised the domestic economy. These positive economic policy interventions have accounted for a significant thawing in inflationary pressures from peaks of 128 million percent in August 2008, to below 5% by end of 2009.

Capacity utilization in the manufacturing sector has also significantly improved from about 5% at the height of economic instability in 2008 to 40% in 2010. Societal welfare has improved, with GDP per capita increasing from US$403 in 2007 to US$499 in 2010, given the positive economic outlook since the implementation of STERP. Implementation of an austerity budget premised on the principle of cash budgeting principle, "*you eat what you kill*[8]", and monetary policies through the multi – currency regime has stabilised the macro - economy, and improved the socio – economic and political system. These positive policy developments have been buoyed by the Global Political Agreement (GPA), which was signed on 18th September, 2008, leading to the appointment of a transitional Government of National Unit (GNU), in February, 2009, that ushered in a stable political and economic governance framework in Zimbabwe.

The Medium Term Plan (2011 – 2015)

In July 2011, the government launched the Medium Term Plan (MTP): 2011-2015, a successor to STERP. The MTP provides a compendium of the policy framework, projects, investment opportunities and programmes designed to create an economic environment that enables the participation of all players in the economy, with a view to contribute to the

[8] This principle of you eat what you kill was coined by the Minister of Finance T. Biti (MP), emphasizing that for Treasury to spent they should have collected revenues first. It fosters to aim for a balanced budget.

achievement of the goals and objectives set out in the plan. The plan, among other objectives, seeks to achieve broad based economic growth, increase economic empowerment, create decent jobs and improve the economic and social well-being of the Zimbabwean people. The Government is exploring avenues aimed at facilitating the resuscitation of the private sector by way of securing injections of fresh working and medium to long term capital. As part of assistance in the revival of the manufacturing sector, Government established the Zimbabwe Economic and Trade Revival Fund (ZETREF) with the support of the African Export- Import Bank (Afrexim Bank) in August 2010 to help companies finance the acquisition of equipment, raw materials and spare parts in order to enhance output and quality of goods and services.

The Industrial Development Policy (IDP) Framework (2012 – 2016)

In February 2012 the Government launched the Industrial Development Policy (IDP) Framework [2012 – 2016], that seeks to address the challenges facing the manufacturing sector. The overall objective of the policy is to restore the manufacturing sector's contribution to the GDP of Zimbabwe from the current 15% to 30% and its contribution to exports from 26% to 50% by 2016[9]. The Policy Framework identifies four priority sectors namely agro-processing (food and beverages, clothing and textiles, wood and furniture), fertilizer industry, pharmaceuticals and metals & electrical as drivers of the industrial recovery. The policy framework provides for the establishment of a dedicated and well resourced institutional framework in the form of an Industrial Development Bank that will primarily fund the manufacturing sector. The Bank will extend technical, financial and managerial advice to its clients in planning and execution of the industrial projects. The bank will also facilitate transfer of technologies from developed countries to industrial enterprises in Zimbabwe.

Zimbabwe's Global Competitiveness rankings[10]

Economic growth is hinged on a globally competitive private sector, hence obviating the need for a supportive, credible and predictable business operating environment, where production decisions can be made efficiently with little bureaucratic impediments. Business actors and the public want an environment that provides for an unhindered accumulation of capital and wealth, and one that allows private sector initiative and innovation to thrive. The public endeavors to enjoy the right to self determination, whilst at the same time being guaranteed equal access to opportunities and resources. They also expect the existence of economic freedom within constitutional parameters.

[9] GoZ, 2012;, "Industrial Development Policy", Ministry of Industry and Commerce, February, 2012; page viii.

[10] The Economic Freedom Index is calculated every year by the Heritage Foundation, in conjunction with the Wall St Journal. It analyzes the level of free economic enterprise in 183 countries, across the following areas: Business Freedom, Trade Freedom, Fiscal Freedom, Government Size, Monetary Freedom, Investment Freedom, Financial Freedom, Property Rights, Freedom from Corruption, Labor Freedom, Tariff Rate and Tax Burden.

If economic agents are denied freedom to carry out their activities, it therefore affects even investments in the country. Institutional barriers to doing business that include corruption in government, raise the transactions costs of doing business, and hence are critical determinants of private sector development and have the potential to put a check on sustainable human development, and hence the attainment of social and economic justice. According to the Economic Freedom of the World Index, Zimbabwe with a ranking of 141 is among the top 10 countries with the lowest economic freedom ranking based on the EFW Index. The lack of freedom to do business in the country makes the country less competitive on the global rankings as it will not be able to attract investments in the country that will enhance production. Zimbabwe ranks near the bottom of the World Bank's global index of the Ease of Doing Business Even in terms of Ease of Doing Business ranking by the World Bank, overall, Zimbabwe is ranked 36 out of the 46 countries in Sub-Saharan Africa, and 171 out of 183 countries globally as shown under **Box 1**. On the global rankings on the same index the country is far from matching its regional peers, with South Africa, Zambia, Namibia, and Botswana on 35;, 84;, 78;, and 54 respectively.

Box 1: Global Competitiveness Rankings, 2010

Country	Rank	Score
Zimbabwe	141	3.57
Myanmar	140	3.81
Angola	139	3.89
Venezuela	138	4.33
Republic of Congo	137	4.75
Central African Republic	136	4.77
Guniea Bissau	135	4.82
Burundi	134	4.91
DR Congo	133	4.91
Algeria	132	5

The global corruption index pitched by the Transparency International (TI), has an even weaker ranking for the country; Zimbabwe scores 134 against 178 countries, and is far from its regional peers, with South Africa at 54, Namibia 56, Zambia 101, whilst Botswana scores at 33. The cost of doing business in a host country is one of the critical factors that affect investment decisions, and one of the principal drivers of this cost is corruption, hence the significance of the TI index in determining the attractiveness of investment destinations. Such costs include those imposed by the entry and exit requirements, labour regulations, access to credit, and government bureaucracy.

Market Competitiveness

The World competitiveness Report 2010 notes that infrastructure, and more specifically energy and transport, remains a major obstacle to competitiveness in Africa. Well developed infrastructure integrates national markets and an efficient transport network is a prerequisite for entrepreneurs to get their goods to market in a secure and timely manner. Economies also depend on electricity supplies that are free of interruptions and shortages so that businesses and factories can work unimpeded. Finally, a solid and extensive telecommunications network allows for a rapid and free flow of information, which increases overall economic efficiency. The current state of infrastructure development tends to limit the country's competitiveness with regard to the attraction of foreign direct investment. **Table 2.2** shows

SADC countries' Ease of Doing Business rankings, and confirms the weak scoring for Zimbabwe in this regard.

The investment climate has been further dented by negative perceptions around the much touted Indigenisation laws that have been judged to represent an expropriation of foreign capital. "The Indigenization and Economic Empowerment Act of 2007 has negatively impacted investment and most importantly, foreign direct investment (FDI) due to uncertainty on how it is to be implemented. The law restricted the potential of the Zimbabwe stock market to mobilize funding for both public and private institutions".[11]

Table 2.2: Doing Business Rankings[12] (2011) for SADC Countries

Economy	Ease of Doing Business Rank	Starting a Business	Getting Electricity	Registering Property	Getting Credit	Protecting Investors	Paying Taxes	Trading Across Borders
Mauritius	1	2	1	8	10	2	1	1
South Africa	2	5	25	10	1	1	7	23
Rwanda	3	1	2	5	2	3	3	31
Botswana	4	9	10	3	6	5	4	28
Namibia	6	21	15	30	5	13	17	21
Zambia	7	6	21	16	2	13	8	30
Seychelles	8	15	33	7	39	9	2	2
Kenya	9	25	19	27	2	16	36	20
Swaziland	13	36	37	23	6	19	9	26
Tanzania	14	20	8	37	12	16	25	7
Madagascar	17	3	45	31	44	9	11	10
Mozambique	18	7	41	35	33	5	20	18
Lesotho	20	28	31	32	33	28	10	25
Malawi	21	26	44	15	20	13	5	37
Zimbabwe	**36**	**28**	**39**	**12**	**20**	**19**	**24**	**40**
Angola	37	38	23	24	20	9	31	36
Congo, Dem. Rep.	41	30	32	21	43	35	35	39

Source: World Bank, 2010

[11] USAID, 2012, "Zimbabwe Agricultural and Rural Livelihood financial Market Assessment", Volume 1, February, 2012; page 25.

[12] Economies are ranked on their ease of doing business, from 1 – 183. A high ranking on the ease of doing business index means the regulatory environment is more conducive to the starting and operation of a local firm. This index averages the country's percentile rankings on 10 topics, made up of a variety of indicators, giving equal weight to each topic. The rankings for all economies are benchmarked to June 2010.

Recent Economic Trends

Since 2009, the country's economy has been growing due to implementation of credible economic policies, anchored on the continued use of multiple currencies, fiscal prudence through cash budgeting, and the liberalised business environment. In 2011, the country's growth rate was estimated at 9.3%, a 1.2% increase from the 8.1% registered in 2010. According to the 2012 National Budget as detailed under **Table 2.3,** the economy is projected to grow by 9.4%, buoyed by high growth rates in the agriculture sector (11.6%,), finance and insurance (23%), and tourism (13.7%). Despite some challenges which the industries are still facing, the Zimbabwe manufacturing sector is slowly recovering with the sector having grown by 2.7% in 2010 after a decade-long de-industrialization experience. The manufacturing sector is projected to grow from 3.5% in 2011 to 6% in 2012, confirming some modest recovery in the medium term, though it will still take some time for the sector to restore its pre – crisis (year 2000 and before), luster.

Table 2.3: Sectoral growth developments (2009 – 2012)

	2009 (%)	2010 (%)	2011 (%)	2012 projected (%)
Agriculture, Hunting, and Fishing	21.0%	33.9	7.4	11.6
Mining and Quarrying	33.3	47	25.8	15.9
Manufacturing	10	2.7	3.5	6.0
Electricity and Water	1.9	1.5	12.4	4.9
Construction	2.1	1.5	1.0	1.5
Finance and Insurance	4.5	0.5	24	23
Real Estate	2.0	0.9	1.0	1.5
Distribution, Hotels and Restaurants	6.5	0.5	10.3	13.7
Transport and Communication	2.2	0.1	5.5	6.0
GDP at Market Prices	5.4	8.1	9.3	9.4

Source: 2012 National Budget

The erratic power supply, deteriorating road infrastructure and absence of medium to long - term capital continue to adversely impact on the cost structure of domestic industry, hence, compromising competitiveness, as well as denting prospects for an immediate and durable recovery in the manufacturing sector. Due to supply - side challenges that have manifested themselves through a subdued uplift in industry capacity utilisation, the economy has been absorbing disproportionately large amounts of imports of finished goods, further threatening the survival of the local industry. However, with the implementation of the Industrial Development Policy Framework, (2012 - 2016) it is hoped that this will provide a solid anchor for the sector's medium to long term recovery prospects.

Tariff measures in the 2011 and 2012 National Budgets

At the height of the economic crisis in 2008, given the protracted collapse on local production capacity for staples, government suspended duty on maize meal, and cooking oil, margarine, flour, soap among some basics to put a check on food insecurity. Since then these measures have remained intact until recently when signs of recovery in the domestic industrial capacity have become discernible. The duty suspensions were continuously extended until December 2010 when duty was reintroduced through the 2011 National Budget on selected products such as cooking oil, maize meal and other products which the government believed the local production was capable of producing to meet local demand (as shown under Table 2.4).

Table 2.4: Reintroduction of import duties in the 2011 National Budget

Product Description	**MFN rates of duty**	**SADC rates of duty**	**Proposed rates of duty**
Margarine	40	15	15
Washing powder	40	10	10
Petroleum Jelly	40	10	10
Bath soap	40	10	10
Beauty or make up preparations for the care of the skin	40	15	15

Source: 2011 National Budget Statement

In the 2011 Mid Term Fiscal Review, the Minister of Finance further reintroduced duty on a number of basic commodities on the backdrop of improved capacity in the industries to 35% from 10% in 2009. This was followed by further lifting of the duty suspensions on other commodities together with the levying of surtax tax on other commodities as announced in the 2012 National Budget. According to the Minister, the rationale behind the introduction of surtax was to protect the local industry from imports especially from South Africa (see **Box 2**). However, the move has been criticized by many players who are questioning the rationale behind protecting the industry when the world is moving towards opening up their economies. Imports of clothing, footwear, refrigerators, cookers, soaps, light passenger vehicles of heading 87.03 which are more than five years old from date of original manufacture and many agricultural products are now required to pay 25% surtax as shown under **Box 3**. In the 2012 budget, duty on most raw materials used as inputs that are not locally produced and other capital goods were also reduced to ensure that the cost of production is reduced, in an attempt to enhance the competitiveness of local producers. However, imports of raw materials that can be produced locally remain liable for import duty. A controversial decision which was announced in the budget was the adjustment of rate of duty on clothing from 40% plus US$1.50 per kg to 40% plus US$3 per kg and also removal of clothing and footwear from the traveller's rebate which was however, reversed after the Ministry had realised that it had erred. The reason for the adjustment of duty was to curtail incidences of undervaluation at the same time protecting the clothing and textile industry which is facing collapse due to the stiff competition it is facing from cheap imports from South Africa, China and other low cost producing countries.

Box 2: Products that now attract a 25% Surtax

i. Selected Range of motor vehicles;,
ii. Selected electrical goods;,
iii. Soaps and cosmetics;,
iv. Milling products;,
v. Fruits and vegetables (when in season);,
vi. Meat products;,
vii. Beverages;,
viii. Tobacco;,
ix. Sugar;,
x. Dairy products;,
xi. Footwear and textiles.

Box 3: Fresh Farm Produce

Product	MFN Duty (%)	SADC Duty %	Proposed Duty (%)
Potatoes	40	10	25
Tomatoes	40	10	25
Onions and Shallots	40	10	25
Cabbage	40	10	25
Carrots	40	10	25
Peas	40	10	25
Beans	40	10	25
Mushrooms	40	10	25
Spinach	40	10	25

However, in as much as it is prudent to protect our local clothing manufacturers, the government was ill advised to impose such a deterrent duty on clothing and other products. In the past, the country used to export 70% of cotton produced without any value addition but now almost 90% of the cotton is exported. This means that the local ginning industries are left with only 10% of the cotton which is not enough to supply the clothing manufacturers with the cloth. In the end, the local clothing manufacturers end up importing raw materials thereby making the cost of production even higher. Therefore, a good policy would have been to come up with measures or interventions that promote the value addition of cotton locally until the cotton has been processed into a finished product which then can be exported. This is the case in low cost producing countries like China; cotton is brought into the factory and comes out of the factory processed into a finished product. This reduces costs such as transportation, at the same time ensuring production of a product with a high value.

Motivation for the tariff measures

According to the Ministry of Finance, there were a number of reasons to justify the tariff measures adopted. The measures were mainly aimed at supporting the productive sectors, redirecting consumption of resources to the productive sectors as well as enhancing revenue collection. Firstly, for some products, it was argued that the local industries now have capacity to meet local demand and therefore, needed to be protected from cheap imports. The duty on clothing was necessitated by the need to protect the textile industry which for a long time has been negatively affected by an influx of second hand clothing which most of the time is smuggled in the country. The other reason for the tariff measures taken by the government was to curb the growing number of informal, foreign owned clothing retail stores flourishing in most of Zimbabwe's cities, with the bulk selling cheap Chinese imports and blatantly flouting Zimbabwe taxes and labor regulations.

Another observation is that the infant industry argument that drove the government to take all these tariff measures is the oldest argument used to justify the protection of industries from international trade. Most economists would nonetheless agree to a list of specific circumstances that would warrant the temporary and limited protection of an infant industry. However, most industries in most developing countries including Zimbabwe have remained infants for a long time, which is in direct contrast to Mill (1848) who argued that protection must be temporary and that the infant industry must then mature and become viable without protection. According to Bastable (1891), governments should consider protecting local industries if the cumulative net benefits provided by the protected industry exceed the cumulative costs of protection.

Together these conditions are known as the Mill - Bastable test and any trade protectionist measure must try to fulfil this test. Therefore, it was important for the Ministry of Finance to have carried out wide consultations and research so that the potential benefits and costs of the measures would be quantified. The recent acknowledgement by the Ministry that it blundered when it introduced the surtax is a clear indication that no research was carried out to guide these tariff measures.

Impact of the Tariff measures

Tracking what happens/ would happen after imposition of import duties is central to analyse the impact of import duties in the economy. The question that needs to be addressed is whether imposition of import duties will improve the general welfare of the agents in the economy or does it harm them. According to international trade theory, the benefits of tariffs are uneven and shift over time. In the short run, higher prices for goods can reduce consumption by individual consumers and by businesses. If the government hikes duty on flour imports, the production cost goes up immediately, implying a higher cost structure for bakeries, and hence a spike in the price of bread. In this case consumers pay more for bread, as bakeries pass on the extra cost of flour on account of the tariff hike. In short, tariffs and trade barriers tend to be pro -producer and anti - consumer. Although domestic industries also benefit from a reduction in competition, in the long term, businesses may see a decline in efficiency due to a lack of competition, and may also see a reduction in profits due to the emergence of substitutes for their products.

Given that a tariff is a form of tax, the government will see increased revenue as imports enter the domestic market. Generally, there is conflicting hypothesis on the direction and impacts of tariff measures. Proponents of high tariffs for industry support, argue that imposition of high tariff barriers will facilitate growth of infant industries. Some question the effectiveness of tariffs in accomplishing the infant industry protection (Baldwin 1969).

Impact on Producers

Theoretically we expect domestic producers to increase production after imposition of import tariffs on the final product. The infant industry argument has been widely seen as the reason for raising tariffs, so as to render import substitutes uncompetitive, and hence lent domestic suppliers an urge. However, there is controversy in the effectiveness of such a policy. Hurungo (2010), in his paper, "*Trade Policy Review: Zimbabwe*", observes that a significant number of all the previously protected infant industries have closed shop, and further that this policy seems to be increasing the economy's malaise.

Figure 2.3 shows that though there has been some significant uplift in GDP since 2008, despite implementation of short term tariff hikes in 2011 and beyond, the manufacturing output have not yet responded fully, owing to structural changes that constrain speedy supply response. There are various reasons though, that have been pointed out to support infant industry argument (see Baldwin, 1969).

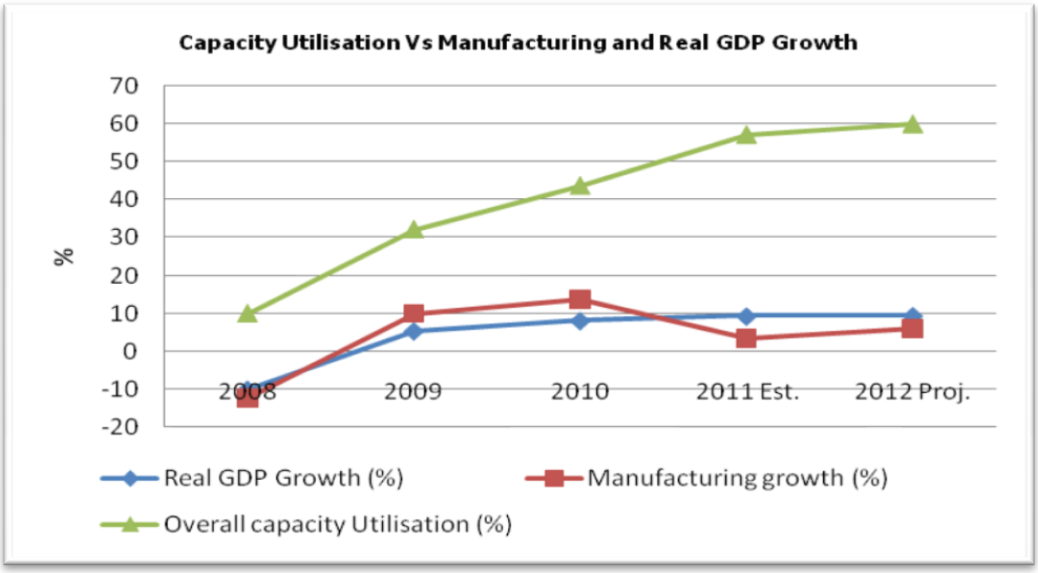


Figure 2.2: Trends in Capacity Utilisation, Manufacturing Sector, GDP Growth (2008 – 2012) *(Source: Author's compilation)*

It has also been shown that the main conditions cited as warranting temporary tariffs, might lead to either decrease in social welfare or at least fail to achieve the socially optimal allocation of resources in new industries (Baldwin, 1969). A tariff hike may boost domestic production because of reduced competition in the home market. The reduced competition will provide domestic producers the leverage to hike the prices of the target goods, hence triggering a spike in production volumes. However, for Zimbabwe the increase in production seems constrained by supply side structural challenges key of which are power supply bottlenecks, credit constraints and general production bottlenecks. It is crucial therefore, to reflect on what has been the response of producers to the imposition of tariffs, though we expect some lags in response to the policy announcement and implementation. The capacity of Zimbabwean producers to produce previously imported goods is doubtful given the aforementioned supply side challenges.

More so, their ability to be competitive in the export market remains constrained by similar challenges, making the infant industry case for Zimbabwe less credible. What might be needed by Zimbabwe producers is not necessarily tariff protection but rather an even playing field, such that they can position themselves to compete regionally. Government 's focus should be to build a supportive infrastructure regime, and a conducive business operating environment, that prepares industry and commerce for the beckoning free trade regime under the SADC Trade Protocol. Survival under such a free trade zone will hinge on industry competitiveness. However, the imposition of duty on some commodities might be a welcome development if they have strong linkage with other sectors. This will be hinged on the hope of strong forward and backward linkages created in the production of such a commodity. The case in point is pre - packed wheat flour, rice and salt.

Some Empirical Evidence; Manufacturing sector – Cooking and Mealie - Meal Production

In previous budgets, for example the 2011 National Budget announced an array of protective measures which were aimed at enhancing local production but to date these measures have failed to improve capacity utilization in the manufacturing sector which still remains subdued. A good example is shown in the **Figure 2.4** for cooking oil producing companies whose production capacity utilization was around 32% in 2011 and only expected to increase to 37% in 2012 despite the reintroduction of duty in August 2011. In fact, the capacity utilization remained stagnant at 32% between 2010 and 2011 despite the reintroduction of duty on imports of the product. It therefore, supports the argument that these protective measures are not what the industry currently needs. Protective measures should only be used as short term measures to protect local industries from competition from foreign producers.

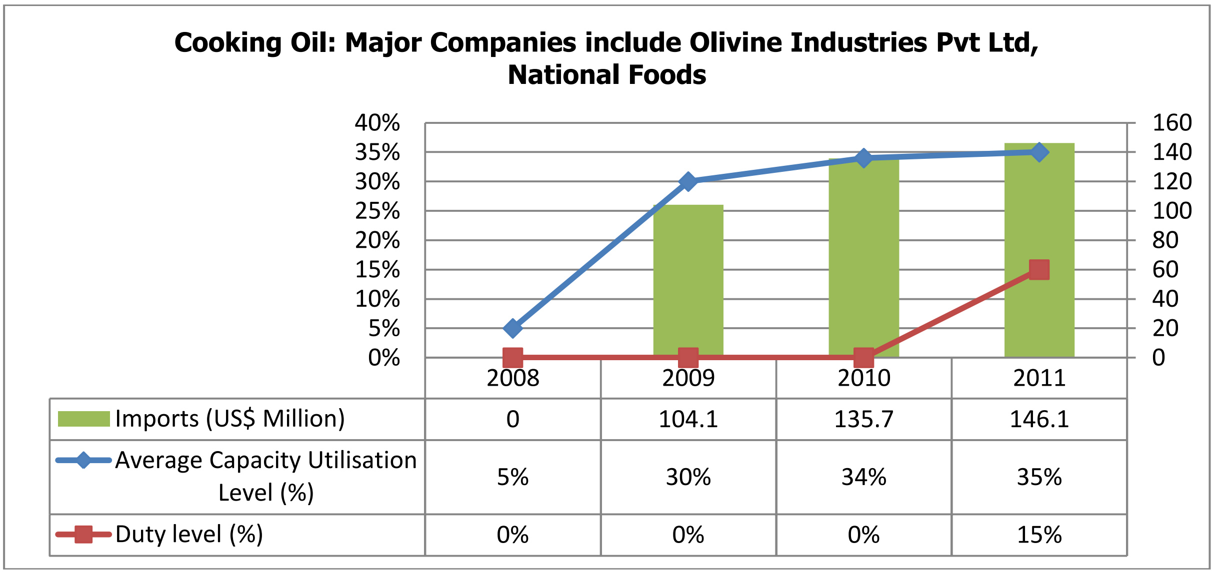


Figure 2.3: Performance in Cooking Oil Production *(Source: Author's compilation from Olivine Industries Statistics)*

Table 2.5: Capacity Utilisation of selected companies

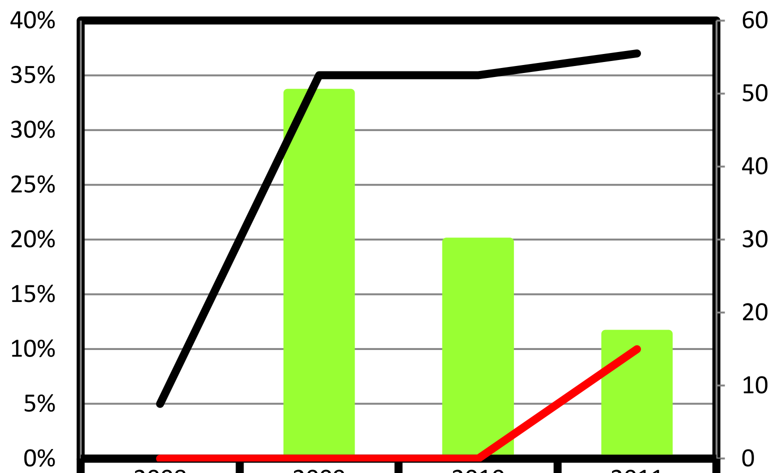
Company	**2008**	**2009**	**2010**	**2011**	**2012 Proj.**
Olivine Industries (Pvt) Ltd	5%	25%	32%	32%	37%
National Foods	5%	35%	35%	37%	45%
Bata Shoe Company	25%	50%	30%	28%	60%
National Blankets Limited	25%	30%	15%	8%	8%

Source: *Author's compilation from listed companies' statistics*

In **Figure 2.4** and **Table 2.5** above it can be noted that despite the implementation of a tariff hike on the importation of cooking oil, consumers are still importing, given the product's affordability when pitted against domestic perfect substitutes. On average, cooking oil imported from South Africa costs between $3.50 and $3.85 for a 2 litre bottle, whilst that from local producers costs between $4.50 and $5.00 per 2litre bottle, implying a 30% net saving on the imported product using the upper price threshold for the product. There are a number of reasons why the local industry cannot produce as efficiently as foreign producers. Local producers face challenges of working capital, under – capitalization that has constrained retooling, electricity outages, high wage rates not matched to production and many other challenges.

All these put local producers at a disadvantage, hence making their products uncompetitive. Under the circumstances, Government should be focusing on measures to strengthen the capacity of domestic industries in order to adequately prepare them for the opportunities abound under regional economic integration (that is through COMESA and SADC).

For some industries like maize meal milling companies, the protective measures have yielded positive results. According to the 2012 budget statement, the tariff measure taken has positively impacted on the operations of some manufacturing companies. The milling industry, for example, has doubled capacity utilization from 21% to 46% and also employed a significant number of people.



	2008	2009	2010	2011
Imports (US$ Million)	0	50.1	29.7	17.1
Average Capacity Utilisation Level (%)	5%	35%	35%	37%
Duty level (%)	0%	0%	0%	10%

Figure 2.4: Performance of Maize Meal Producers[13] (***Source:*** Author's compilation based on National Foods statistics)

[13] Major companies include National Foods, Blue Ribbon

The reintroduction of duty on maize meal has managed to limit the imports of maize meal as well as boosting domestic production.

Table 2.6: Textiles and Clothing and clothing duty structure, (2008 – 2012)

	2008	2009	2010	2011	2012
Duty Level	40% - 60% +[US$10/kg]	40% +[US$5/kg]	40% +[US$2.50/kg]	40% +[US$1.50/kg]	40% +[US$3/kg]
Capacity Utilisation Level (%)	25%	30%	15%	30%	30%

Performance of the textiles and clothing industries have remained subdued despite the protection they have been getting from the government. Given the accelerated decline in the sector on the back of economic liberalism during the ESAP era [1991 – 1995], in the post liberalisation era the government has been trying its best to ensure that the industry is protected from the influx of cheap imports of both new and second hand clothes. Instead many textile companies such as David Whitehead and many others closed shop due to an array of challenges they faced. The clothing industry has been affected by a host of challenges as listed under **Box 4**. As long as these challenges are not addressed, continued increases in tariffs will not help the industry to return to the pre - ESAP production levels. Instead, any further increases in tariffs to protect the sector will discourage competitive production hence accounting for the emergence of a highly inefficient textile production function in Zimbabwe. What can be observed is that the local industry does not have the capacity to meet demand and will resort to overpricing of the goods they produce. Not much can happen in the manufacturing sector if financing remains short – term and expensive and utilities (electricity, water, fuel etc), are unaffordable. The steep cost of credit is confirmed by **Table 2.7** across all forms of available banking classes. The table shows that commercial banks weighted average base lending rates have been trending up since May 2011, and the figure for October was 13.1 percent[14]. Merchant bank weighted average base rates are even higher—19.6 percent in October (AfDB; December 2011). Those rates compared to savings and three-month deposit rates suggest interest rate margins of 10–16

Box 4: Clothing Industry Challenges

- Ageing equipment;,
- Electricity power blackouts and high tariffs;,
- Acute cash flow problems – with Continental Fashions filing for bankruptcy, and 11 other companies under Judicial management;,
- 11 000 job losses in 2011, with an economy – wide contagion effect of knocking off 55 000 more jobs.

[14] USAID, 2012 page 22.

percent[15], which is at least double the average interest rate margin for other regional countries. These wide interest rate spreads discourage savings, and hence are a major impediment towards the build up of available resources for credit creation by banks in the medium to long term, a major threat to the availability of credit to the real sector.

Despite an outcry from local players in the manufacturing sector, the duty - free policy needed to be extended until production levels in industries had significantly improved. Of concern is that the level of value - chains in the sector, that without exception have substantially declined, and in some cases virtually collapsed.

Table 2.7: Interest rate levels, 2011 (Annual percentages)

Month	Commercial Bank Average Base Lending Rate	Commercial Bank Weighted Average Base Lending Rate	Merchant Bank Average Base Lending Rate	Merchant Bank Weighted Average Base Lending Rate	Three - Month Deposit Rate	Savings Deposit Rate
Jan	1.26-28	9.5	11-34	29.5	9.3	1.0
Feb	1.26-28	14.0	15-34	27.1	9.3	1.0
Mar	1.26-28	9.5	16-32	19.9	8.3	1.0
Apr	1.26-28	9.5	16-32	18.3	8.6	3.2
May	8-30	12.8	15-32	18.1	8.6	2.7
Jun	8-30	11.2	16-32	17.3	8.6	2.6
Jul	8-30	11.0	16-32	18.2	11.3	2.7
Aug	8-30	12.1	16-32	18.9	11.9	2.7
Sep	8-30	12.6	16-32	19.6	8.3	1.0
Average			11.4	20.8	9.4	2.0

Source: *USAID, 2012*

For instance, while Zimbabwe exported 80% of its cotton lint, the residual 20% went into local spinning, weaving and other textile manufacturing processes, clearly pointing to subdued value adding capacity in the cotton sector. Currently COTTCO a leading cotton value chain actor in Zimbabwe is exporting 98 percent of its lint, and thus prospects of global value chains [GVCs] in this sub-sector have vanished into thin air (Ndlela, 2012).

Impact on Consumers

Generally, imposition of tariff increases will lead to an increase in the price of commodities. This is because prices faced in the domestic economy from imports will be world price plus the tariff $(P_w + t)$. Johnson (1965) pointed out that infant industry protection like other protective measures designed to correct domestic distortions account for relative welfare loss to consumers by raising the domestic prices of the imported goods above the world price. This logically increases the price of commodities which is harmful to consumers' welfare. The consumer surplus will be reduced. Consumers will face higher prices if they continue importing after the imposition of import tariffs. This largely hinges on the demand elasticity

[15] *Ibid* page 22.

for the imports the consumers prefer. Due to consumers' preference for product variety and diversity, as well as the pursuit of quality products, we foresee consumers not adjusting their import demand for such commodities in the short term, hence the tariff hike might be inflationary (Krugman;1980). More so, the commodities that Zimbabwean consumers are importing are of necessity, so as long as imports are not followed by an increase in domestic production of these importables, we expect an increase in prices. Time lag, implementation lag and impact lag may also lead to increase in prices. So it would not be highly beneficial to consumers for government to adopt protectionist policies.

Imports have not been reduced after imposition of import duties as evidenced by the increase in the volume of imports for August and October 2011 (Zimbabwe Economic Monthly Review, 2012). This has fed into an increase in prices towards the end of the year. The reasons for such spikes of imports have been attributed to fertiliser importation and also pre festive season stocking of commodities (Zimbabwe Economic Monthly Review, 2012). There was sharp increase in prices after the re - introduction of import duties on basic commodities in August 2011 as shown under **Figure 2.6** with notable spikes in August, September and October of 2011.

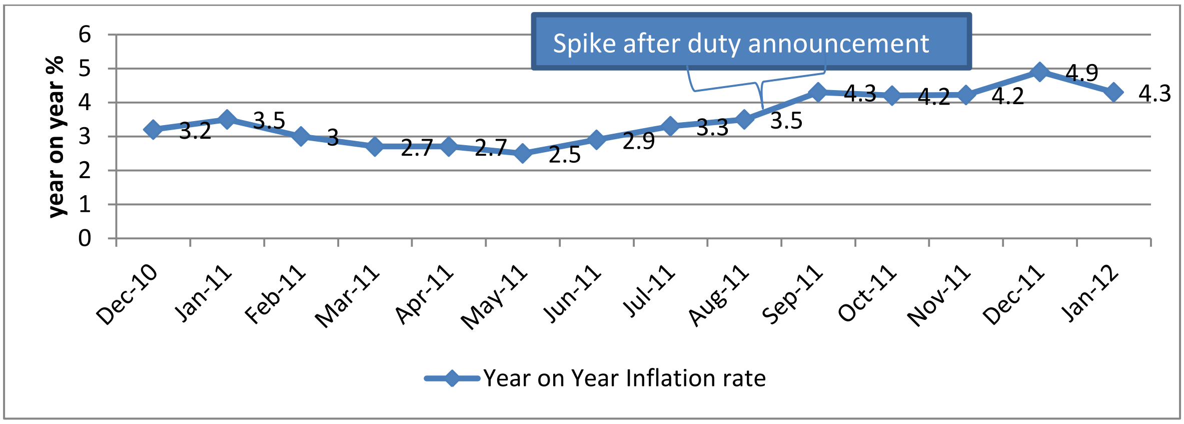


Figure 2.5: Inflationary impact of Tariff hike (Zimstats, 2012)

These measures are therefore expected to have a negative bearing on the inflation outlook in the short to medium term, and hence push average headline inflation for 2012 above 5% from a previous expectation of an average of around 4%. The increasing trend in month - on - month inflation for 2011 is expected to continue in 2012 following the expansion of the list of goods now covered by the tariff hike. The risk for higher inflation in the medium term also prevails, although it is our view that price increases will not be as severe as in the past. Just to emphasize that despite the tariff hike, consumers may find it difficult to shift their preference curve in the short term, particularly for those goods with negative elasticity of demand, such as your luxuries, the level of imports has in essence shown an upward trend during these months. The increase in prices might cause reduced demand which might be detrimental to production in the domestic economy.

Societal welfare

It cannot be denied that there are unique factors affecting new industries which may require market intervention by public authorities if a socially efficient allocation of resources is to be achieved. The question is on the effectiveness of tariffs in accomplishing this result. In particular, it can be argued that for some of the main conditions cited as warranting temporary tariffs, protection may well either decrease social welfare or at least fail to achieve the socially optimal allocation of resources in the industries that are targeted for protection.

The Poor and Marginalized segments of Society: - The poor are the most vulnerable group in any society if there is structural change. The earlier account has objectively documented how the imposition of tariffs is likely to translate into a spike in the prices of domestically produced goods (particularly for those targeted by the protection), thus implying a corresponding erosion of buying power for the general populace. This is harmful to the poor since they will not be able to afford the commodities, and in an attempt to maintain their utility curve, they are forced to consume less of the goods, or in extreme cases resort towards purchasing cheap, unhealthy commodities which might be harmful to their health. For example, they may resort to buying cooking oil that is produced in the backyard which is unhealthy, or in extreme cases purchase used cooking oil. They also tend to buy used clothes like underwear and those used clothes that might not be recommended to wear after they have been used by others. This has, and is being witnessed in the selling of these used clothes in open markets in Zimbabwe. The poor's consumption might be affected negatively in this case, and hence the overall impact is a continuous erosion of societal welfare, and a damper to sustainable human development and the attainment of social and economic justice.

It has been established in many studies that the poor are hurt by protectionism. Protectionism discriminates against the rural poor who are left paying higher prices for often inferior local products. More so, since the markets are small (as is the case in Zimbabwe), protection may mean the promotion of monopolies and an eventual rising prices and costs of production, given the inherent inefficiencies of such entities. What one observes on balance is that a tariff hike is usually associated with a ***regressive tax effect***, hurting the poorest far more than the better off. So far a closer look at the import duty hikes in Zimbabwe, it can be observed that most of them tend to fall on the necessities of life such as food, clothing and footwear. Bhaghwati notes the fact that trade protection hurts the economy of the country that imposes it is one of the oldest but still most startling insights economics has to offer.

However, imposition of tariffs *may* benefit the poor if they are involved in the production of protected commodities. If for example they are labourers in the sector enjoying protection, and productive capacity exists to take advantage of the tariff hike, this might increase real wages and hence reduce poverty. Most poor people are also engaged in small holder agriculture, and the hike in duties for fresh farm produce is likely to benefit those involved in market gardening (producing tomatoes, vegetables, peas, carrots etc), as it will boost their net incomes, wages and return on agricultural investment. In this regard, the organised small holders in Murehwa, Mutoko, Mudzi, Marondera and Domboshawa who have traditionally been supplying fresh vegetables are likely to benefit, if they can expand their production capacity to take advantage of the tariff measures, thus anchoring their meaningful contribution towards agricultural GDP in Zimbabwe.

Tariff hikes and prospects for Smuggling*:* Complex tariff schedules (especially when combined with high average rates) increase both the discretionary authority of customs administrators and the benefits from importers from manipulation of import classifications. Protection is a subsidy to smugglers. **Box 5** details some of the likely negative developments associated with a tariff hike. Importers can become innovative, and engage in *transit diversion* which occurs when importers claim (deliberately) that the goods are destined for another country like Zambia but go on to sell these in Zimbabwe. It is a fact that increases in protection may be a boost for smuggling and corruption, and ZIMRA[16] has confirmed current challenges they are experiencing with their staffers due to corruption. They have even suggested taking new and old Customs officers through a Prison orientation programme just to scare them away from corruption. This will however, not be a durable deterrent, as what's needed is a simplified tariff regime[17], which is easier to implement, less cumbersome, and hence encourages compliance.

Box 5: Costs of Tariff hikes

- Under invoicing
- Transit diversion;,
- Fielding wrong tariff declarations (deliberately);,
- Under statement of the quantities imported;,
- Smuggling

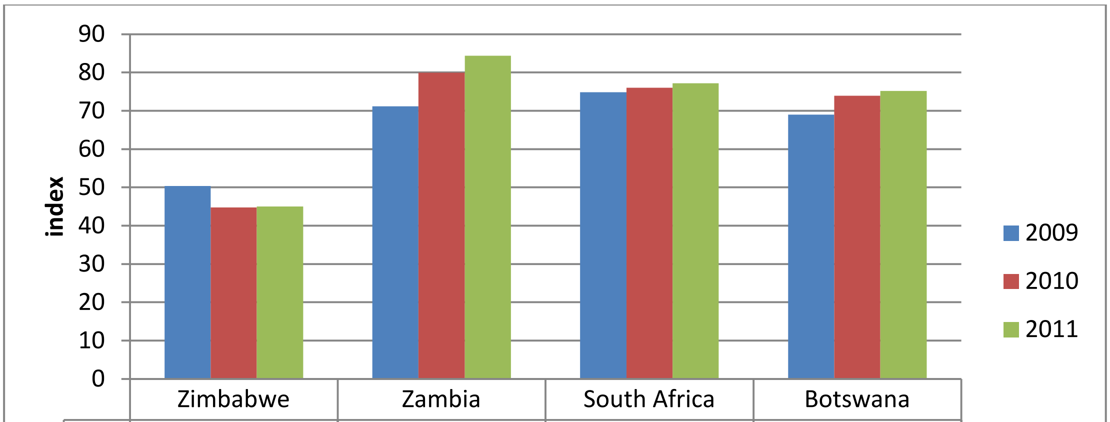
The Bilateral, Regional and Multilateral Dimensions of the measures

The African Union faces a setback in its plan to create a single continental market in the next five years because of a growing number of countries imposing barriers to trade in the form of both tariffs and Non Tariff Barriers (NTBs). The move by Zimbabwe to introduce new tariff measures might derail the efforts to liberalize trade currently being negotiated under various initiatives such as the COMESA-EAC-SADC Tripartite FTA, the African Continental FTA, COMESA Customs Union, the pending SADC Customs Union, ESA-EU EPA negotiations and many other bilateral trade agreements between Zimbabwe and other countries. The restrictions, which defy benefits of economic integration, hamper free movement of goods and services.

In the current conditions facing Zimbabwe and indeed the regional economy, **trade openness or trade liberalisation** is the necessary condition for growth although it is not a sufficient condition until other key conditions are in place.

[16] Herald Newspaper 2 May, 2012.

[17] In many cases it has been proven that lowering tariffs to reasonable levels reduces smuggling, puts competitive pressure on producers, helps users of imported goods, and enhances state revenues.



	Zimbabwe	Zambia	South Africa	Botswana
2009	50.4	71.2	74.8	69
2010	44.8	79.9	76	73.9
2011	45	84.4	77.2	75.2

Figure 2.7: Trade Freedom Index *(Source: Heritage Foundation, 2011)*

Using the Heritage Foundation Trade Freedom Index which is a composite measure of the openness of an economy to trade, as shown through the elimination of barriers to trade such tariff and non tariff barriers that hinder the ease with which economic agents are able to import and export goods and services. The Heritage Foundation tries to provide a ranking on this index to show how open to trade a country is, and **Figure 2.7** gauges the performance of Zimbabwe, South Africa, Botswana and Zambia over the period 2009 – 2011. It is clear from the figure below that Zimbabwe has a lower index than competitive neighbours, implying that the country still exhibits some barriers to trade, tariffs being one example

These other conditions include: secure property markets, the rule of law, strong financial markets, sound physical infrastructure, and open access to international markets and competitive domestic markets for goods, services and labour. The lesson of recent and successful episodes of trade liberalisation 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 liberalisation here is understood to mean the abolition of all 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 includes eliminating bias towards domestically-produced import substitutes.

Zimbabwe is a signatory to a number of bilateral, regional and multilateral trading arrangements. Considering regional integration, it would be to the country's advantage to consider addressing other issues related to capacity utilisation other than the duties for sustainability and competitiveness of our products. Zimbabwe is a member of Common Market for Eastern and Southern Africa (COMESA) and Southern African Development Community (SADC) Free Trade Protocols in support of the regional integration agenda. The FTA Protocols provide for duty-free importation of goods from COMESA and SADC member states, provided such goods meet set criteria on the rules of origin. While the benefits of regional integration are not being questioned, the local industry capacity to face competition following the downward spiral experienced in the last few years has called for the levying of duties on selected strategic/sensitive products to nurture industries under stress.

Furthermore, Zimbabwe is participating in the ESA-EU EPA negotiations which are aimed at liberalising most of the trade between ACP countries and EU countries. It therefore, implies that once the EPA negotiations are concluded and ratified by the signatory parties, ACP countries, Zimbabwe included will have to dismantle some of the barriers in place including some of the recent tariff measures adopted. This situation will even put pressure on the local producers who for a very long time have remained infants. Therefore the truth of the matter is that everywhere in the world, there is no longer any place for all these protective trade measures. Instead, countries should be using the long periods of time taken in negotiation to prepare their industries for competition that comes with globalisation. Zimbabwe will gradually liberalise 80% of its imports from the EU within 15 years after a moratorium (grace period) of 5 years. Zimbabwe's first tranche of liberalization is in 2013 and is mainly for raw materials and capital goods. The next tranche for liberalization will be in 2015 and it covers mainly intermediate and finished products.

Within Africa, there are a number of initiatives aimed at opening up economies to enhance intra Africa trade. Such efforts include COMESA-EAC- SADC Tripartite FTA, the African Continental FTA, COMESA Customs Union, and the pending SADC Customs Union. All these are aimed at promoting free trade within Africa and therefore supporting the notion that tariffs and any other protective measures in the name of protecting domestic industries are no longer options. Countries have to rather face the reality that very soon the whole world will be a global village.

Zimbabwe is a founder member of SADC which was established in 1980 as the Southern African Development Coordination Conference (SADCC). In 1996, the SADC Member States developed and signed a Trade Protocol in order to deepen integration in the area of trade. According to the timelines which were agreed, The Protocol, which came into force in 2000, introduced a trade liberalization programme in which 85% of all intra-SADC trade were expected to be duty-free by 2008. The other remaining 15% was to be liberalised in 2012 but in 2010, the country was granted derogation from implementing tariff phase-down on sensitive products until 2014 under Article 3 of the SADC Trade Protocol order to provide local industry sufficient time to recapitalize and restore its competitive edge. Therefore it means that the duties recently imposed on some products might only remain in place until 2014 but the chances that the industries will be prepared for the full liberalisation are slim as the required capital injections necessary to make them produce competitively have not been forthcoming.

Also of concern, is the level of duty levied on some of the products especially agricultural products which have been set at 25% that is higher than the SADC rates for similar products at 10%. With regards to the WTO, Zimbabwe is lagging behind in its WTO notification obligations due mainly to capacity constraints. The country however, has made notifications to the WTO on Non-Preferential Tariffs, Import Licensing Procedures, State Trading Enterprises and agriculture, among others. Additional technical assistance and capacity building will be required to improve on the level of notifications.

Policy Recommendations

The medium-term outlook for Zimbabwe hinges on the successful implementation of the MTP whose main goal is to transform the economy, reduce poverty, create jobs, maintain macroeconomic stability and restore the economy's capacity to produce goods and services competitively. This builds upon the economic stabilisation gains achieved since the launch of STERP in March 2009 and its subsequent implementation. Key areas for success include infrastructural development, institutional capacity building, review of current and introduction of new regulations and strengthening and establishment of regulatory authorities to improve efficiency and facilitate investment and economic growth. The projected average growth target of 7.1% over the plan period will be realised **through the transformation of the economy from being a producer of primary commodities to value addition, beneficiation and new knowledge based industries.**

Adoption of **tariff regimes that are supportive of industrial growth and export development** while complying with regional and multilateral obligations should be pursued. The government should put in place measures to boost exports which include improving competitiveness by lowering the cost of production and transaction costs, maintaining macroeconomic stability, investing in new technologies, diversification of the export basket and new markets developments.

Recognize and understand the national interest in tariff rationalization: Rationalization of tariffs is an essential element in a strategy to promote sustainable and equitable development. It is open economies that have been the most successful in taking advantage of the opportunities provided by globalization, and this is especially true among developing countries. Tariff rationalization is especially important in promoting the competitiveness of domestic industries.

Governments should avoid yielding to rent seeking behavior: - Over the years industry and commerce has organized itself into strong lobby industrial groups such as the Confederation of Zimbabwe Industries (CZI), the Zimbabwe National Chamber of Commerce (ZNCC), Affirmative Action Group (AAG), and Chamber of Mines, to advance individual member interests. These lobby structures have perfected their act over the years, and some have survived the pre – economic liberalism era, when controls and protection were popular, as the post liberalism era where freer market economics has been a planning template. Government should be wary of the objectivity of some of the lobby agendas as well as the economy wide impacts of some of their proposals. *Decisions in Treasury on tariffs should be backed up by empirical research, to ensure credibility*. All impacts should be mapped, taking into account the incidences of the intended tariff review, that is all key stakeholders including consumers and industrial users of protected goods is necessary to make informed tariff rationalization decisions.

Government should rely on general rules and clear timetables for tariff and more general trade policy reform- Make rules applicable to all sectors and all activities. Otherwise the system will be overwhelmed by pleas for special treatment, and reform will be frustrated.

Shift in Industry development Discourse: The economic development theory has recently changed given the global dynamics in the 20th Century, with the global financial crisis of 2008 being a case in point. The theory of traditional comparative advantage has been put to test by current dynamics, and success now hinges on other parameters dictated by the information age. Growth now revolves around dismantling barriers, working around your binding constraints to development, such as debated by Rodrik. Zimbabwe needs to address head on the structural problems that have accounted for economic dualism 30 years on. Industry protection is not one of the pressing issues for now. Let us focus on those industries where we can do better, and aim to support complimentary industries supporting such growth nodes. In the region Botswana and Lesotho are already doing so.

Areas for further research

This study is the first instalment towards building capacity to objectively engage the Ministry of Finance on key industrial policies, in order to support the economic development thrust, and hence meaningfully impact on poverty alleviation. The study will thus be useful in starting off debate on tariff issues in Zimbabwe. However, going forward, there is need to pitch a more robust economy wide review of the country's tariff system, as well as gauge its alignment towards delivering a competitive industrial base in Zimbabwe. The study will thus serve as an entry point towards more informed research on broader trade related policy issues that the national budget should consider.

Conclusion

Zimbabwe's participation in the regional and multilateral trade negotiations plays a catalytic role in achieving sustainable economic growth and development. Trade plays an important and pivotal role in the attainment of higher efficiency, productivity and international competitiveness of all economic sectors. Therefore this study concludes that **the solution does not lie in further regulation but in the efforts to address the challenges that have relegated the industry to the position it is currently in.**

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CHAPTER 3: SOCIAL AND ECONOMIC IMPACTS OF IMPORT TARIFFS ON THE INFORMAL SECTOR

By
Naome Chakanya

The dual and enclave structure of the Zimbabwean economy

At independence, Zimbabwe inherited a dual and enclave economy which continues to characterize the economy now and explains the continuous problem of underutilization of resources. **Figure 3.1** depicts the dual and enclave structure of the Zimbabwean economy.

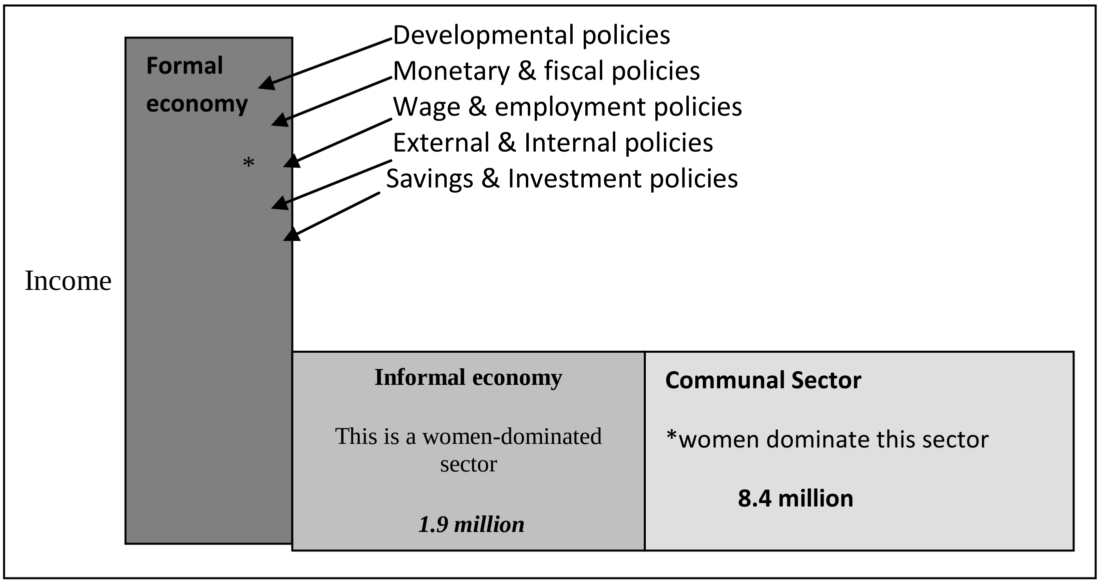


Figure 3.1: Structure of the Zimbabwean economy (*Source: Adopted from LEDRIZ 2011)*

By focusing on the formal sector, which is male-dominated and which has been shrinking drastically since 2000, past policies have neglected the non-formal sectors that accommodate the majority of the population, especially women. They have therefore reinforced the inherited dual (separate) and enclave (isolated) structure of the economy. The formal sector itself is more integrated into the global economy and its relationship with the informal and communal sectors is largely exploitative. In essence therefore, the economy is exogenously oriented and driven by external factors outside national control. The point is that as long as the majority of Zimbabweans do not have entitlement to assets or means of production, whatever growth or recovery is achieved is, to borrow from a renown economist Bhagwati, 'immiserising.' With this structure, the economy cannot rely on the formal economy alone to meet the development needs of the people, implying the need for conscious policies of integrating the non-formal economy into the mainstream of the economy. For too long, the informal economy had been left to pull itself by its bootstrap, without any formal recognition and assistance.

The state of the informal economy in Zimbabwe

At independence in 1980, the informal economy was relatively small, accounting for less than 10 percent of the labour force. The second Poverty Assessment Survey (PASS II) (2003) indicated that the informal economy accounted for 30 percent of those employed, up from 23 percent in 1995[18]. The same study indicated that two thirds (63 percent) of the people employed in the informal economy were in the urban areas[19].

The 2004 Labour Force Survey (LFS) suggests that 53 percent of those employed in the informal economy were females, and 47 percent were males. The distribution of informal economy employees in 2004 by sector shows that about half of the employees were in other services (51 percent) followed by agriculture, hunting and fishing at 18 percent and manufacturing at 13 percent. Using data from the 2004 Labour Force Survey, the international Labour Organization (ILO) applied both the enterprise-based and job-based concepts of informality. The enterprise-based definition suggested that 1.2 million workers were employed in the formal sector and just over 710,000 in the informal economy. When the jobs-based concept was applied, 975,000 workers had formal jobs, more than half of which were professional or skilled and almost 4.1 million had informal jobs, 90.2 percent of which were unskilled. This therefore implies that 4 out of every 5 jobs in Zimbabwe are informalized.

Given the continued collapse of the formal sector due to the politico-socio-economic crisis, the informal economy has expanded. Entry into the informal economy continued as a survival mechanism for many people in response to rising poverty levels with unofficial poverty rates pegged at 80 percent of the population by 2010. This has led to the informal economy being labelled "the survivalist economy".

Most importantly, the informal economy absorbs those who have been retrenched as well as school-leavers who cannot find employment in the shrinking formal economy therefore, reducing the level of high unemployment in the country. In other cases the informal economy has been referred to as "a buffer for cyclical trends in the formal sector by providing a 'dumping ground' for retrenched labour and a waiting station for job seekers[20]."

Whilst its contribution towards employment creation is very much visible, the informal economy supports hundreds of thousands of livelihoods in Zimbabwe. It was the informal economy that helped many Zimbabweans to survive by selling imported foodstuffs and other items such as clothing, textiles and footwear (both new and used) from countries such as South Africa, Zambia and Botswana during the height of the economic crisis. To date, informal retailing has become a dormant feature in the daily and weekly markets in both the city centre and urban suburbs, thereby creating either full-time or part-time employment. Most informal retailers have stands in these markets and specialise in specific products such

[18] This contrasts with a level of 13.4 percent in the LFS of 2004.
[19] Zimbabwe Employment Policy Framework, 2009

[20] Financial Gazette, "Informal sector now Zimbabwe's biggest employer", 12 June 2002, http://www.gdrc.org/informal/6-zimbabwe.html

as men's jeans, ladies wear, including underwear and dresses, blankets and shoes among others.

In addition, the informal economy has become an alternative source of social protection. There are various definitions of social protection but the World Bank defines it as a set of measures that support society's poorest and vulnerable members and helps individuals, households and communities to better manage risks. Social protection plays a key role in improving the quality of life for individuals and societies and it is the role of the state to provide adequate social protection for its citizens as enshrined in the various international instruments that Zimbabwe has signed to.

With the rise of the economic crisis the need for social protection also rises. This has been compounded by the volatile macroeconomic environment (including food and fuel prices), HIV and AIDS and other diseases such as Tuberculosis (TB) and climate change and its impact on food security. In fact, even those in high professions that did not need social protection more than a decade ago, such as doctors and lecturers now require social protection. Unfortunately, the government's allocation of the national budget towards social protection has been miserable. In 2009 the government's share of allocation to the Ministry of Labor and Social Services declined from 2.1 percent to only 1 percent in 2010 and further declined to 0.8 percent in 2012 national budget.

It is therefore the income from the informal economy that has assisted many households to fill in the gap left by formal social protection schemes. Various informal or community-based social protection schemes have emerged over the past years which are supported by income from the informal economy. These include savings clubs, housing schemes, burial societies, grocery schemes and support to people living with HIV and AIDS. Savings clubs amongst women have gained momentum as most people especially women are not employed in the formal sector. The majority of these women generate modest incomes from the informal economy and they have been able to buy assets such as property and vehicles[21]. Therefore, the positive role of the informal economy in contributing to the economy and welfare of the citizenry cannot be left untold.

Unfortunately, despite this large contribution, the informal economy has been a target of government's unfavorable ad hoc policies and policy reversals. It is this same economy that suffered from the government's "Operation Murambatsvina/Restore Order" of 2005 and now again has been hit hard by the introduction of import duties, which have been suspended and reintroduced again, all within a short period of time, a clear sign of lack of proper consultation and lack of proper design of these import duties. The attitude of authorities towards this economy has remained hostile and harsh.

Therefore, the purpose of this Chapter is to discuss in detail the economic and social impact of import tariffs, herein referred to as import duties, on the backbone of the country, the informal economy with specific reference to informal cross boarder traders who have been on the rise since the onset of the economic crisis.

[21] Zimbabwe Broadcasting Cooperation (ZBC), "Savings clubs' concept hailed", 16 December 2011, http://www.zbc.co.zw/news-categories/business/14693-savings-clubs-concept-hailed.html

The theoretical basis of import duties

As highlighted in the previous Chapter, an import duty is a form of tax or levy that is placed by the government on commodities that are brought into the country from a foreign country. Traditionally, most countries have used import duties to protect domestic producers and industries from international competition and in the process increase government revenue. The purpose of placing import duties is therefore to discourage a country's consumers from importing from another country and buy from local industries, thereby supporting domestic products and services. Import duties have both a positive and a negative effect. However, the import duty system has mostly worked in cases where the government and local industries have been able to deal with the supply-side constraints so that industries can quickly adjust their production levels to meet or fill the gap in local demand of the goods.

The state of the manufacturing sector in Zimbabwe and the role of the informal economy

Although the manufacturing sector has continued to improve since the operation of the multi-currency regime in 2009, the 2011 CZI Manufacturing Survey indicated that the manufacturing sector still remains in a precarious position and is faced with massive structural challenges. The industry capacity utilization increased from levels of below 10 percent in 2008 and 35 percent by end of 2009 to the average capacity levels estimated at 57.2 percent by the end of the first half of 2011. Despite this improvement, the sector continues to be constrained by several factors which include low product demand[22], lack of working capital and the associated high interest rates, decline in supply of raw materials both local and imported, obsolete machinery and breakdowns and increase in the cost of raw materials (cost of local raw materials increased by 7 percent, while that of imported raw materials increasing by almost 100 percent between the second half of 2010 and the first half of 2011) and the electricity crisis (2012 National Budget). The most affected sub-sector is the clothing and textiles whose capacity utilization levels remains as low as 20 percent (*ibid*).

As a result, most retail shops (who supply foodstuffs and non-food items such as clothing, textiles, footwear and electric gadgets) have continued to rely on imports as local producers have failed to adequately meet the local demand. Those companies who manage to produce locally have also been heavily hit by the high cost of raw materials (both local and imported) which has resulted in their highly priced products which have remained uncompetitive as compared to imported finished products.

It is in this kind of scenario that the informal economy has also thrived. For example, the Tanzanian Ambassador to Zimbabwe, Mr Adudi Kajabu indicated that everyday there are three buses that leave Harare to Tanzania with cross boarder traders and he expressed his willingness to assist Bulawayo traders to link up with the Tanzanian business community[23]. The informal economy traders have continued their role through provision of the much demanded goods such as foodstuffs, clothing, footwear and electronic gadgets at relatively

[22] Due to low levels of remuneration and high operation costs, the pricing of local products is higher if compared to regional prices for commodities.

[23] Newsday, " Tanzania extends hand to cross-border traders", 09 October 2011, http://www.newsday.co.zw/article/2011-10-09-tanzania-extends-hand-to-crossborder-traders

cheaper prices so as to cater for the need of most Zimbabweans who are living in poverty and earning wages below the Poverty Datum Line (PDL). These products are regarded by the informal economy as the “hot-line” products, which the local industries are failing to adequately provide. Both foodstuffs and clothing (used and unused) have become a highly visible phenomenon in the informal economy. While in the past, the informal economy for clothing was regarded as serving mainly the poorer consumers, recent trends are showing that this is no longer the case. Some designer or other desirable labels are carefully picked off from bales and some are sold in the clothing boutiques in the city centre at a price premium, after careful repair, cleaning and ironing. Therefore, the role of the informal economy in filling the gap created by the poor performance of the manufacturing sector cannot be undermined.

The import duty regime in Zimbabwe since 2010

In the 2010 Mid-Term Fiscal Policy Review, the government extended suspension of import duty on basic food items in order to allow industry ample time to increase capacity utilisation. In the same policy review, the government also re-introduced modest rates of duty on selected non-food basic commodities, in view of increased capacity utilisation by the local industry. In the 2011 National Budget, the government extended suspension of import duty on basic commodities from 31 December 2010 to 30 June 2011 in a bid to address food shortages and stabilise prices as well as ensuring continuous availability of basic food items, thereby cushioning consumers against the high cost of living. However, in the July 2011 Mid-Term Fiscal Policy Review, the government re-instated duty on basic commodities such as rice, maize, maize meal, flour, cooking oil and salt. However, a month after, the Finance Minister, Mr Biti threatened removal of these duties following the abuse of the policy by some retailers who were unjustifiably hiking prices[24].

In the 2012 National Budget, a new import duty regime was announced as a measure to support increased domestic production and level the playing field with regards to some of the imported commodities. Mr Biti highlighted that finished consumption goods continued to account for a disproportionate share of Zimbabwean imports, implying the need for greater support for investment in domestic manufacturing value addition (Section 213). Mr. Biti rightfully noted that fuels, food, machinery, chemicals, manufactured goods, transport equipment and passenger cars accounted for the larger share of imports in 2011 and 2012 (Section 211).

In this regard, commodities which had duty placed on them included:

- ✓ cooking oil, maize meal, pre-packed rice, salt and flour, wheat flour (between 5 and 15 percent);
- ✓ imported clothing (the rate of duty was adjusted from 40 percent plus US$1.50 per kg to 40 percent plus US$3 per kg). Clothing items were also removed from the traveller’s rebate[25]; and,
- ✓ fresh produce (25 percent duty rate on items such as potatoes, spinach, carrots, onions, peas etc).

[24] Zimbabwejournalist.com, “Biti Threatens to lift duty on food imports”, 24 August 2011

[25] A rebate is where a person is allowed to bring in products duty-free once in a calendar month.

Furthermore, a surtax of 25 percent was placed on selected imported finished products such as motor vehicles, electrical goods, soaps and cosmetics, milling industry products, fruits and vegetables (when in season), meat products, beverages, tobacco, sugar, dairy products, footwear and textiles (Section 792). A clear look at the products that were placed on the import duty list shows that these are products that are largely provided by the informal economy via cross boarder traders and are currently 'hot-line' products due to their unavailability from the local producers. All these items were initially included in travellers rebate and were removed. However, after a few months of introducing the above duty rates, it was announced by the Finance Minister that food items and clothing were placed back on the traveller's rebate.

Economic and social impact of the import duties on the informal economy

Economic impact

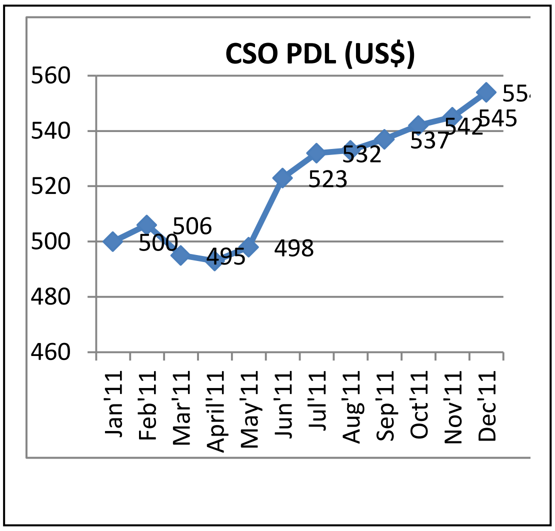
a) Price effect impact

As we have seen in the previous Chapter, the imposition of an import tariff means that the domestic price of the imported product rises by the amount of the tariff or even higher and the burden of the price increase is passed on to the final consumer. This effectively has a knock-off effect on inflation, thereby hurting the local people who are already struggling to make ends meet. The majority of the import duties were too high, as they surpassed the purchase price of the imported goods especially footwear and clothing. For example, shoes which would have been bought at a price of $3 a pair are required to pay duty amounting to $5 a pair. One particular example from one informal trader is that some slippers which he had bought for 20 cents a pair were made to pay duty amounting to $5 a pair by ZIMRA officials. In another case, a blanket attracted $40 duty and yet the purchase price was around $25. As a result, business becomes unviable for most of the traders who are forced to increase the prices of goods or risk losing income which further pushes more people into poverty. The same trader again will be required to complete with low-cost Chinese imports which are imported in bulk and therefore have economies of scale.

Given that the import duties were levied at a time when the industry capacity utilisation was low, some companies and dealers responded by increasing the prices of products that were placed on the import duty list. The Minister of Finance clearly gave examples of what transpired late 2011 when some products were placed on the duty list. Section 159 of the 2012 National Budget stated that there was a sharp increase of 0.5 percent in food prices between August and September 2011, related to unwarranted retrogressive price adjustments on some basic commodities, following review of import duties. He also noted that some unscrupulous traders took advantage of the policy measure to increase prices which resulted in the rise in the food inflation index for the month of September 2011 (Section 766 of the 2012 National Budget). During the same period, prices shot up by between 50 cents and one dollar. For example, a 2 kilograms (kgs) packet of sugar increased by a dollar to $2,26, a 10kgs maize meal packet rose to $5,56 while a 2 litre cooking oil bottle shot up by almost a dollar to about $3,85[26]. This resulted in the increase of the Food Poverty Line (FPL) and the

[26] voanews.com, "Zimbabwe Supermarkets Raise Food Prices After Import Duty Restoration", 11 August 2011

Poverty Datum Line (PDL) as reflected in Figures 2a and 2b. These price hikes came at a time salaries and wages were stagnant thus eroding the purchasing power of the majority of people who are already impoverished.



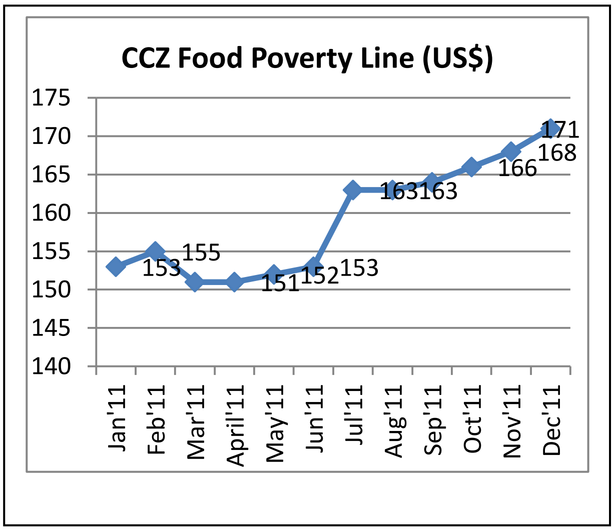


Figure 3.2a: Trend in PDL in 2011 **Figure 3.2b: Trend in FPL in 2011**
(*Source*: ZIMSTATS and CCZ)

b) Provision of low-cost products to the poor

The informal economy has been able to provide low-cost products such as clothing, shoes and food for people living in poverty who cannot afford to buy from exclusive retail shops. Imposition of import duties would effectively mean that the availability of most of these low-cost products may be reduced, which ultimately hurts the poor.

Social Impact

a) Impact on social protection

As indicated above, the informal economy has become a buffer for social protection of most citizens through schemes such as saving clubs, housing schemes, burial societies, grocery schemes and support to people living with HIV and AIDS. The rise in uncertainty of informal economy business will negatively impact provision of these social protection schemes for most households. Since only a small proportion of people working in the formal economy are covered by formal social protection schemes such as pensions and medical aid, the majority rely on these informal schemes. In addition, given that only those in formal employment have access to and can afford housing loans from the banking sector, this leaves the majority of the population who are in the informal economy and unbanked (about 70 percent of the population) out of these schemes. Therefore, inability to participate fully in the informal economy leaves most households vulnerable.

b) An Increase in import duty rise that is not accompanied by an equity driven redistributive policy

Most governments in developing countries including Zimbabwe rely on taxes such as import duties in order to provide social services to its citizens. Therefore, the general expectation is that when such duties are imposed, social service provision should also improve. In such a scenario the rise in import duties is then justified. However, in the current case of Zimbabwe, social service provision such as health, water and sanitation has remained poor despite the imposition of import duties. Major cities have been hit by a spat of water shortages and unclean water which has triggered such as cholera and typhoid. In fact, by the end of February 2012, a cumulative 3 244 cases of suspected typhoid had been reported nationwide[27], a clear reflection of lack of prioritisation of a basic human right, water treatment. Thus, imposition of import duties which does not translate into an improvement in social service provision remains questionable.

c) Impact on socio-economic rights

Loss of income from informal businesses also impacts negatively on other important social and economic rights such as food security, education, health, housing and basic utilities (electricity, water and sanitation). For example, most parents, especially female-headed households rely on income from informal economy businesses for school fees. An erosion of income will thereby result in some school children losing out on education as their parents struggle to make ends meet. Therefore, imposition of such import duties without wider consultation will not only affect the informal economy but national developments at large. Therefore, it becomes critical for authorities to examine some of these negative externalities before implementation of certain policies.

In the same way, the negative impact of import duties on informal economy traders' income also has a negative implication of payment of bills such as water and electricity by residents. Given that most formal economy workers are earning poverty wages[28] and the majority of the populace relies on the informal economy activities, an interruption of business in the informal economy as a result of imposition of import duties means that most citizens are also unable to pay electricity and water bills, which are already excessive in nature. For example, the government's upward review of utility tariffs by 31 percent in September 2011 during the same period of introduction of import duties had a bearing on inflationary pressures in the economy.

d) Impact on women

Women form the majority of those who are involved in the informal economy. Their participation in this economy especially cross border trading has assisted them to gain greater control over financial resources and participation in household decision making. The United Nations Secretary-General Ban Ki-Moon noted in 2008 that "...investing in women is not

[27] Zimbabwe Broadcasting Corporation (ZBC), "Typhoid reported cases reach 3 244", 6 March 2012, http://www.zbc.co.zw/news-categories/health/17275-typhoid-reported-cases-reach-3-244.html

[28] By December 2011, the average minimum wage was only $239 as compared to the Poverty Datum Line (PDL) of $548. This meant that the average minimum was only about 44 percent of the PDL. The major worry is where are people getting the rest 56 percent to supplement their daily living

only the right thing to do, it is the smart thing to do... and when women have access to finances, credit, technologies and markets, they are likely to expand their businesses and contribute effectively to sustained economic growth and development...". Therefore, women in the informal economy need to be greatly supported. Any uncertainty and disruption of their business and income as a result of these import duties negatively affects their income and effectively household income.

e) Inhumane treatment at the Borders

After the introduction of the import duties, ZIMRA introduced a 100 percent body search to flash out items to charge duty on[29] although some ZIMRA officials have denied the reports on body searches. Given that most of those who operate in the informal economy are women, such treatment and harassment by officials mostly males is a clear violation of human rights. Furthermore, such inhumane treatment coupled by high import duties results in informal traders evading payment of duty by smuggling good. Ultimately, the government loses out in terms of revenue.

In addition, such inhumane treatment of body search also affects tourism and is against international laws such as the Chicago Convention, to which Zimbabwe is a signatory to[30].

Way Forward

Mainstreaming the informal economy

While acknowledging the need to harness national revenue, it must be pointed out that Government must recognize the role played by the informal economy in national development, develop the informal economy, and integrate it into the mainstream of the economy before putting in place measures to collect taxes from it. One of the most formidable challenges that has not been addressed is the structural inadequacy of the inherited economy at independence (Figure 1). In fact, the informal economy should not be romanticised as a permanent fixture of the economy. Doing so actually perpetuates the duality between the informal and the formal economy. Government therefore needs to recognise the importance of the informal economy, restrict it and regulate it when necessary, but mostly seek to increase the productivity and improve working conditions of those who work in it (SIDA, 2004). This ultimately reduces their vulnerability and exclusion of the majority of the people from national development processes.

Revenue proposals

The government should find alternative ways of harnessing national revenue from the informal economy in a way that does not penalize the informal economy and its citizens. Reasonable import duty can be applied with consultation with the associations that represent informal economy traders. Lower import duties encourage people to legalize themselves and to pay. In addition, taxing someone who is already trying to find a living out of informal trading is not morally wrong but rather regressive.

[29] Bulawayo24 News: "ZIMRA introduces 100 percent body search at boarder posts", 16 February 2012
[30] Bulawayo24 News: "ZIMRA introduces 100 percent body search at boarder posts", 16 February 2012

Transparency in implementation of import duty

Interviews with those in the informal economy indicated that most are not aware of how the import duties are calculated. Therefore, the government should put in place mechanisms at the borders to ensure that the public is aware of the actual duties and how they are calculated.

Some traders reported that they are also caught unawares by these changes (as some of these changes occur overnight) in import duties whilst the borders and therefore lacked knowledge on the products that have been listed for import duties. Some ended up leaving their goods at the boarders as they were unable to raise the required amount of duty[31]. For example, some were asked to pay as much as $40 per blanket which they had not budgeted for[32]. Therefore, it is important that such information be made public for the informal and cross boarder traders.

Although it was highlighted during the research that there are Station Managers with offices at the boarders, informal cross-boarders have indicated that in most cases they are not helpful to their cause at all.

It is therefore suggested that ZIMRA officials should engage with the relevant associations for informal traders who will in turn educate their membership so as to reduce conflicts, long waiting hours and corruption at the boarders. Transparency leads to increased compliance by traders. In addition, information desks for the informal economy traders should be provided at each of the boarders so as to reduce information asymmetries.

Increasing capacity utilization of industries

It goes beyond saying that the reason for introduction of import duties was meant to protect local industries. However, in an economy where industries lack the adequate resources (working capital and favourable interest rates) to increase their capacity utilization, the imposition of import duties will only make worse the living standards of people (who are forced to buy import products at a high cost) and informal traders (who are forced to either reduce sales and thus income or increase their pricing). Therefore, if the import duties should become effective, the government should begin by capacitating the local industries to be more productive.

The role of Social Dialogue

Internationally, it is being recognized that social dialogue is key to national development because it facilitates social cohesion. In the same light, it is critical that the government creates space for dialogue and engagement with the affected parties. The government can identify the informal and cross-border associations or related pressure groups to discuss some of their policies before implementation. The Zimbabwe Chamber of the Informal Economy noted that the lack of engagement between the government and their organization is the missing link. In an economy where about 85 percent of the population relies on the informal economy, it is critical that the government consults with the relevant bodies and those that are affected by their policies so as to instill a sense of ownership of policies among affected stakeholders thus, reducing conflicts and smuggling of goods and leakage of revenue. Furthermore, social dialogue results in “win-win” outcomes for all concerned stakeholders.

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[31] The Standard: “Zimbabwe: Cross Boarder Traders Hit by Duty on Blankets and Shoes”, 07 August 2011

[32] The Standard: “Zimbabwe: Cross Boarder Traders Hit by Duty on Blankets and Shoes”, 07 August 2011

Conclusion

The introduction of the import tariffs on most food stuffs and other items that are largely being obtained from the informal economy was prematurely implemented. It was based on the assumption that the industry would quickly address its supply-side constraints so as to boost local production. However, instead of promoting local industries, the move actually resulted in the increase in prices of locally produced basic products as some domestic producers sought to profiteer from the scenario. On the other hand, informal economy traders who could still afford to import and pay the import duty automatically passed on the burden to the final consumers who most are struggling to make ends meet. This is happening at a time when the salaries of the majority of Zimbabweans are still very low and far off from the PDL. As a result, the import duties caused more harm than the good they were intended to bring about.

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CHAPTER 4: CONCLUSIONS AND RECOMMENDATIONS

Key Observations

Study after study have shown that tariffs are harmful to the domestic economy, this is more so given that it leads to an increase in domestic prices which might be detrimental to growth. However, it should be pointed out that tariffs have distributive effects among consumers, producers and government. A tariff is equivalent to a combined policy of a production subsidy plus consumption tax, particularly given that it raises the prices that domestic producers of protected commodity that producers can charge to consumers but, at the same time being a tax on consumers since they will pay higher price for the commodity. However, the pass through effect on prices might be 100% to consumers which might be detrimental to domestic demand and production. In Zimbabwe, we can infer that this might be the near case though the pass through might not be 100%.

Regional trade agreements are not going backwards in liberalisation agenda hence the need for industry to look for other avenues to increase their competitiveness.

Policy Recommendations

The policy recommendation coming from this exposition is that tariffs for a small country like Zimbabwe might not bring positive welfare. By small country we mean Zimbabwe can not affect world prices. What is required for Zimbabwean producers is to keep watch on what is happening at the regional level. Imposition of import tariffs should be just a temporary measure if the responsiveness is high. However, for the case of Zimbabwe the elasticity of export demand seems to be inelastic, the production elasticity is moreover low. This leaves the government in a dilemma of which policy to follow, which explains the high incidence of policy reversals that has characterised the country's industry and trade policy over the years. The way forward is to continually embrace liberalisation.

This should be accompanied by trying to adopt policies that increase competitiveness of Zimbabwean industries. What should be kept in mind is that in this global village, consumers' desire for product diversity and quality might put a strain to the protection agenda since consumers may not necessarily substitute foreign goods for domestic products, depending on the demand elasticity, as well as the capacity of local industry to produce timely to meet the uplift in demand, owing to the tariff movement. This no doubt obviates the need for industries to continuously invest in innovation, and other low cost yet high pay off investments. They should try to retool; invest massively in high technology and forge joint ventures with foreigners which will bring the needed capital for innovation. Government should address the current structural challenges compromising productivity in industry, such as energy supply, water systems, transportation, as well as other supply side hindrances such as access to affordable domestic credit.

The industries should try to embrace operational effectiveness. The industries should try to shift from product manufacture to task manufacture via off shoring and participation in global or regional value chains - South Africa can be used as starting point. Outsourcing and off shoring are now the dictates in global manufacturing value chain. This can only be achieved by doing away with the attractive side of protectionism. It should be known that catching up of Zimbabwe industries is not going to be easy but it should be kept in mind that competitiveness is now driven by knowledge, skills and technology rather than trying to pursue protective outcry. Whether a country will follow import substitution or export led industrialization should not be decided by government. Government should be providing an autonomous night- watchman role. Its role as a development agency is simply to provide the right framework for market forces to flourish and provide a level playing field for private sectors to choose viable projects. Viable projects cannot be borne out of a protective business environment, and in fact innovation thrives under competition. Government should foster to create an enabling business operating environment, one where price stability is guaranteed, so as to ease the costs of production, and hence assure business viability. Stop gap policies have since 1980 eroded the credibility of government policies, and the last 3 years have witnessed some relative degree of policy credibility. The current tariff review is a major dent to the solid credibility under reference, and hence government should endeavor to maintain the largely predictable business operating regime ushered in under the Government of national Unity (GNU).

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