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ZIMBABWE

COUNTRY ECONOMIC MEMORANDUM

BOOSTING PRODUCTIVITY AND QUALITY JOBS

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ABBREVIATIONS AND ACRONYMS

AfCFTA	African Continental Free Trade Area
CAAZ	Civil Aviation Authority of Zimbabwe
CEM	Country Economic Memorandum
COVID-19	Coronavirus Disease 2019
EFA	Education For All Program
EMDE	Emerging Market and Developing Economies
FDI	Foreign Direct Investment
Forex	Foreign Exchange
GDP	Gross Domestic Product
GMB	Grain Marketing Board
GNI	Gross National Income
GoZ	Government of Zimbabwe
GVCs	Global Value Chains
HDI	Human Development Index
IFI	International Financial Institution
ILO	International Labour Organization
IMF	International Monetary Fund
IMTT	Intermediated Money Transfer Tax
LFS	Labor Force Survey
LIC	Low-Income Country
LMIC	Lower Middle-Income Country
MIC	Middle-Income Country
MoFED	Ministry of Finance and Economic Development
NDS	National Development Strategy
NDS1	National Development Strategy 1
NDS2	National Development Strategy 2
NTMs	Non-Tariff Measures
PFM	Public Financial Management
PPG	Public and Publicly Guaranteed Debt
PPP	Purchasing Power Parity
QFAs	Quasi-Fiscal Activities
RBZ	Reserve Bank of Zimbabwe
SMEs	Small and Medium Enterprises
SOE	State-Owned Enterprise
SSA	Sub-Saharan Africa
TB	Treasury Bill
TFP	Total Factor Productivity
TFPR	Revenue-Based Total Factor Productivity
UMIC	Upper Middle-Income Country
US$	United States Dollar
WBES	World Bank Enterprise Surveys
WTO	World Trade Organization
ZESA	Zimbabwe Electricity Supply Authority
ZIDA	Zimbabwe Investment and Development Agency
ZIMRA	Zimbabwe Revenue Authority
ZimTrade	National Trade Development and Promotion Organization of Zimbabwe
Z$	Zimbabwe Dollar

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EXECUTIVE SUMMARY

Despite various economic setbacks, Zimbabwe regained lower middle-income country (LMIC) status in 2018 and aspires to become an upper middle-income country (UMIC) by 2030. Zimbabwe's economic structure is closer to UMICs' averages in terms of sectoral shares of the gross domestic product (GDP), but the employment structure resembles more that of low-income countries (LICs), with employment in agriculture accounting for two-thirds of total employment. Considerable macroeconomic instability and distortions led to high inflation and multiple exchange rates in Zimbabwe. These consequences, coupled with a high-cost regulatory environment, external shocks and productive resource misallocation, have reduced economic growth to below its potential, lowered incomes, and increased poverty. Nonetheless, a period of sustained growth and rebasing of GDP enabled the economy to regain LMIC status in 2018. Building on its highly educated workforce, abundant natural resources, and recent advances in economic policy, Zimbabwe has the potential to achieve steady and rapid growth, and converge toward UMIC status. The Government of Zimbabwe's Vision 2030 aims to achieve UMIC status by 2030. In this regard, the authorities have made progress in stabilizing the economy and reforming the business environment. But significant structural, institutional, and economic challenges still remain.

The focus of this Country Economic Memorandum (CEM) is to identify options for structural reforms to help Zimbabwe accelerate economic growth and to achieve UMIC status. This is the first CEM for Zimbabwe since 1985 and it comes at a critical juncture along Zimbabwe's development path. The objective of the report is to support and inform policy makers and stakeholders on policies to accelerate economic growth, boost productivity, and create high-quality jobs. In this regard, the CEM first establishes macroeconomic stability as a necessary condition for high and sustained growth. It then uses productivity as an overall framing to identify key structural bottlenecks, before providing deep-dives on informality and trade as priority areas to address in order to unleash productivity growth. Importantly, the report also aims to present data about Zimbabwe's economic performance in a systematic fashion, focusing on the previous two decades and comparing Zimbabwe with its peers in the region, as well as aspirational peers globally.[1]

Macroeconomic policies, shocks, and structural transformation

Zimbabwe's economic performance over the past two decades has been characterized by low economic growth on average but also very high volatility. Real GDP growth averaged only 0.1 percent per year between 2000 and 2021, averaging -3.9 and 2.3 percent in the first and second halves of this period, respectively. Considerable economic turmoil due to policy missteps, external shocks, and structural challenges culminated in two major recessions in 2000–08 and 2019–20, including hyperinflation in 2008 and near-hyperinflation in 2020. The effects on the country were profound: formal sector employment shrank, labor migration increased, investment levels collapsed, and poverty reached unprecedented levels. Zimbabwe fell behind its peers in terms of GDP per capita and living standards.

Nonetheless, Zimbabwe has strong foundations for accelerating future economic growth and improving living standards. The economy has excellent human capital: a youthful, well-educated labor force with a strong entrepreneurial culture. In fact, the level of skills among Zimbabwe's current workforce is on a par with UMICs in Sub-Saharan Africa (SSA), although skill shortages are emerging in some sectors. Moreover, Zimbabwe possesses abundant mineral and natural resources that, if well-managed, can support the country's broader development goals over the long term.

Harnessing these strengths will require Zimbabwe to focus on policies that address the key constraints to economic growth. Zimbabwe's economic performance over the past two decades sheds light on what has worked well. Fiscal discipline, non-inflationary monetary policy, and effective exchange rate management remain necessary for economic stability. Similarly, recent reforms to improve public finances should support improved economic management going forward. Fiscal deficits have shrunk to under 2 percent per year by reducing the public wage bill, preventing excessive government support to the agriculture sector, and strengthening revenue collection. Public financial management (PFM) reforms have also been undertaken, including program-based budgeting (PBB), PFM systems, budget and debt transparency. Finally, the

[1] Peers differ with the level of analysis. For example, for firm level data 42 Sub-Saharan Africa (SSA) countries are used, while aggregate data use, for example, SSA countries in LMIC or UMIC status.

Government of Zimbabwe (GoZ) has also taken steps toward devolution, and improved the business environment (e.g., by repealing the Indigenization and Empowerment Act), signing the global land compensation deal, simplifying business start-up and property registration, strengthening access to credit, and making resolving insolvency easier.

At the same time, those policies that have been detrimental to economic growth need to be discontinued. Economic development has been hampered by macroeconomic instability (particularly price instability), low investment, and limited structural transformation. Expansionary fiscal and monetary policies, coupled with multiple exchange rates, have resulted in considerable price volatility. The management of public finances was complicated by a high public wage bill, many unprofitable state-owned enterprises (SOEs), and guarantees to the agriculture sector. Similarly, monetary policy included frequent monetary financing of the budget and quasi-fiscal activities (QFAs). Meanwhile, a significant public debt burden financed by domestic issuance, coupled with a high-cost regulatory environment, has limited private investment and economic activity. Finally, the economy's dependence on key products and subsectors, and strong government support for lower value-added agriculture over higher value-added services and manufacturing, has reduced the potential for higher rates of economic growth. External/climatic shocks have contributed to low growth, hence investing in resilience/adaptation measures is critical to mitigate associated risks.

Recent price volatility risks derailing the post-COVID-19 recovery. While inflation decreased from a high of 557.2 percent in 2020 to 98.5 percent in 2021, it has accelerated sharply since the beginning of 2022, reaching almost 285 percent year-on-year in August 2022. The acceleration of prices reflects monetary expansion, limited fiscal and monetary coordination, and a surge in global prices due to the war in Ukraine. To tame inflation, the Central Bank tightened monetary policy, raised the interest rates, further liberalized the forex market, and issued gold coins as a store of value. These measures have narrowed the parallel market premium from over 100 percent in April 2022 to below 35 percent in September 2022. It is important that exchange rate distortions are discontinued. In addition, fiscal policy will need to remain cautious, with no pre-election spending increases to contain prices from spiraling.

Accomplishing Zimbabwe's vision of upper middle-income country (UMIC) status by 2030 will necessitate a sharp acceleration in growth rates. Simulations show that achieving UMIC status by 2030 will require elevating real growth rates to around 15 percent over the period 2023–30, underpinned by substantive growth of productivity, investment, and exports. Accelerated growth could create around 1–1.5 million additional jobs and reduce poverty substantially. In the baseline scenario, however, economic growth will linger at around 3 percent per year, while living standards and employment will only marginally improve and achieving UMIC status will be delayed significantly.

Cross-country experience shows that macroeconomic stability is a necessary condition for sustained growth and needs to be supported by strong institutions and structural transformation. Substantial policy reforms were introduced by the 25 countries that have successfully transitioned from LMIC to UMIC status over the past three decades.[2] These included reforms to improve and maintain macroeconomic stability, strengthen institutions, and facilitate structural transformation. Achieving UMIC status required a sustained policy commitment by successive governments over many years to achieve their goal. On average, it took these countries 15 years to achieve UMIC status, with median GDP growth maintained at 5.4 percent per year. Achieving macroeconomic stability in the medium term was a key characteristic of transition countries' economic reform programs, with most countries limiting inflation to below 10 percent per year, with none of the countries having multiple exchange rates. Institutional reforms in countries transitioning from LMIC to UMIC status focused mainly on strengthening voice and accountability, the rule of law, regulatory quality (including of trade policies), and government effectiveness. Supported by a stable macroeconomic environment and better institutions, investment levels in these countries averaged 27 percent during the transition period. Finally, the transition countries managed to reallocate employment from agriculture to industry and services, and from the informal to the formal sector, and boosted external trade by integrating into global value chains (GVCs).

An immediate priority for Zimbabwe is to achieve and sustain macroeconomic stability over the medium term that will underpin efforts to address key binding structural constraints to high growth. Achieving and maintaining price and exchange rate stability—a necessary condition for high growth—will require the GoZ to implement a macroeconomic stabilization program that has broad public support and is consistently implemented. The GoZ is engaged with the International Monetary Fund (IMF) on priorities for a stabilization program, including efforts to control inflation, increase the independence of the central bank, discontinue QFAs and multiple currency practices, improve coordination with fiscal authorities, and strengthen fiscal controls (IMF, 2022). To be sustainable, this stabilization program should also put in place measures to mitigate the impact of policy adjustments on the most vulnerable.

[2] The 25 countries were: Albania, Algeria, Angola, Armenia, Azerbaijan, Belarus, Botswana, Bulgaria, China, Cuba, Georgia, Guyana, Indonesia, Iran, Islamic Republic, Iraq, Kazakhstan, Kosovo, the Maldives, the Marshal Islands, Moldova, Namibia, North Macedonia, Suriname, and Turkmenistan. These countries transitioned from LIC to LMIC and then to UMIC without going back to a lower income category.

Trends and Drivers of Productivity

Productivity is the ultimate driver of economic growth and living standards. Increasing productivity is essential for raising incomes and improving livelihoods. In fact, most of the difference in income per capita between countries can be explained by differences in total factor productivity (TFP).[3] Based on simulations of future growth of labor and capital, achieving high and sustained growth to converge with UMIC status will require productuvity growth rates of 8–9 percent per year.

However, despite a well-skilled workforce, Zimbabwe's labor productivity growth has remained depressed over the past two decades. Zimbabwe's labor productivity level over the past decade ranks second to last among 17 LMIC economies in SSA. Prior to the COVID-19 pandemic, macroeconomic stabilization and the implementation of reforms have boosted labor productivity in Zimbabwe, despite remaining lower than LMIC peers in SSA. The economy has experienced lower employment growth rates than its peers across most sectors.

The COVID-19 pandemic has further widened Zimbabwe's productivity gap with its peers. The COVID-19 pandemic exacerbated Zimbabwe's already weak productivity performance. It is now ranked last out of SSA LMICs. Strict lockdown rules, needed to curb the spread of the pandemic, coupled with supply disruptions, meant that most firms suffered a severe reduction in labor productivity growth. This decline in productivity growth was more adverse for firms in Zimbabwe than for firms in Zambia and Mozambique.[4]

Overall productivity has been constrained by weak productivity in the agriculture sector. The GoZ has provided significant support to the agriculture sector since the early 2000s, recently in the form of command agriculture and input schemes. But despite large public support, growth of labor productivity and yields of major crops have been well below those in peer countries (this relates to LMICs in SSA). Given that the agriculture sector accounts for two-thirds of the country's employment, the performance of the sector has a major bearing on overall labor productivity.

Recent gains in industry and services productivity growth have been offset by low productivity growth in the informal sector. On the one hand, productivity growth of industry and services has been significant, though it is still below its peers in SSA. Focusing on firm level data, Zimbabwe is on a par with its peers in SSA in terms of manufacturing sector productivity, and productivity is even above regional peers[5] in subsectors such as food and chemicals. On the other hand, the further expansion of informality in industry and services in recent years has offset these gains and served to pull down overall productivity. Despite the decline in output informality between 2009 and 2019, output informality in 2019 remained above the level before the recession episode. Creating more and better jobs in the formal sector will require policies that tackle obstacles to both formal and informal productivity growth.

Macroeconomic instability, limited investment in infrastructure, inefficient public services, and the misallocation of productive resources have been the key drivers of low productivity, informality, and poor trade performance. High inflation, multiple exchange rates, unsustainable debt levels, and ineffective control over government spending have increased the cost of production, reduced incentives for productivity-enhancing investment, and encouraged informality. Underinvestment in sectors where Zimbabwe has a comparative advantage and inefficient investment in high-skilled sectors have contributed to low TFP. In an increasingly competitive environment, Zimbabwe's ability to compete successfully, both in domestic and foreign markets, requires upgrading and modernizing equipment and technologies.

The misallocation of resources[6] creates distortions that lead to a sub-optimal allocation of resources across firms thereby reducing aggregate productivity. Productivity is reduced by discouraging the entry of new potentially productive firms, force productive firms to exit, and allow the survival of less competitive firms. This is usual done through subsidized loans and exchange rates, price controls, and the uneven implementation of regulations. As a result, the cost of production remains high, with the manufacturing sector operating at below 50 percent capacity. High informality is a further drag on productivity levels, as informal firms have lower productivity levels than formal firms. In addition, the productivity of exporting firms in Zimbabwe is lower than in peer countries and limited expansion of external trade has meant limited learning from international markets.

3 World Bank. 2020. "Fading Promise: How to Rekindle Productivity Growth?" In Global Economic Prospects: Slow Growth, Policy Challenges, January. Washington, DC: World Bank.

4 The analysis is restricted to only these countries because of availability of COVID-19 follow-up surveys in the region.

5 This is based on 42 SSA countries where firm level data is available- https://www.enterprisesurveys.org/en/data.

6 Misallocation of resources is defined as an inefficient allocation of productive resources (production inputs) across firms within a sector. Appendix 1 provides a detailed discussion of defining and measuring the misallocation of resources.

The CEM proposes six key pathways to boost productivity and quality jobs. These six pathways contain several key reforms that will need to be implemented if Zimbabwe is to achieve its objective of achieving UMIC status (Table 1). The pathways are as follows:

1. Ensure and sustain macroeconomic stability;
2. Remove distortions and misallocation of resources;
3. Enhance the productivity of the informal sector and linkages with the formal sector;
4. Encourage the formalization of informal firms;
5. Support export diversification and participation in GVCs; and
6. Take greater advantage of regional trade integration.

The implementation of the first two pathways is a necessary condition to ensure the success of the remaining four pathways. Therefore, the modality and sequencing of the required reforms will need to be agreed upon and discussed with broad stakeholder involvement. The remaining chapters of the CEM focus on structural policies identified in pathways 3 to 6. Lastly, there is certainly scope for additional research and analytical work in other reform areas that are important for Zimbabwe's development and successful transition to UMIC status. These include upgrading infrastructure and strengthening institutions, for example, which should be part of a continuing effort to design, review and adjust structural reform efforts.

Enhancing Productivity and Job Quality in the Informal Sector

The informal sector has been the largest employer in Zimbabwe over the past four decades, suppressing productivity growth and long-term development. The size of the informal sector in Zimbabwe is significantly higher than its peers. At present, informal activity accounts for nearly two-thirds of Zimbabwe's output and four-fifths of its employment, which is higher than the average level in LMICs and UMICs. While a declining trend in employment informality has been observed in an average LMIC and UMIC, during the past two decades, employment informality in Zimbabwe has been persistent and has edged up during output recessions, offering a source of resilience against shocks. However, the high levels of informal employment suggest a lack of opportunities in the formal sector, given that informal jobs provide lower wages and offer more limited protection for workers. Employment informality covers all sectors of the economy, including critical sectors of the economy such as agriculture, mining, and tourism. Despite these sectors' importance in the economy, they present less opportunity for Zimbabwe to move its economy up the value-added chain or provide quality jobs for workers.

There are considerable productivity gaps between formal and informal firms in Zimbabwe. As shown by the recent enterprise surveys, labor productivity in a median informal firm is one-tenth that of a formal firm of similar size, suggesting a relatively high productivity gap of nearly 90 percent.[7] Moreover, over three-quarters of formal sector firms face competition from informal firms, which is significantly higher than in middle-income countries (MICs) and peers in SSA. Three-quarters of formal firms in Zimbabwe identified the competition from informal firm as a major obstacle to their business. Cross-country evidence suggests that competition from informal firms can lower formal firms' productivity by 24 percent compared with firms that do not face such competition.

Lack of sustained growth and a business environment with heavy regulatory burdens have contributed to the persistent and pervasive informality. Limited economic development and an unfriendly business climate have incentivized firms and workers to move to the informal sector, while reducing the benefits of joining the formal sector. The two recessions during the past two decades have significantly impacted economic activity and jobs, and have led to the rise in output informality and employment informality. Subsequent positive output growth between 2009 and 2018 did little to reverse this structural change.

The COVID-19 pandemic further fueled the expansion of the informal sector. The occurrence of the COVID-19 pandemic in early 2020 disrupted supply chains and, coupled with the lockdown, severely weakened the country's economic fundamentals. As a result, the size of the informal sector is estimated to have increased to 62.2 percent of GDP, while triggering structural shifts within the economy. Employment shifted from industries with higher value added, such as manufacturing and high-productivity services, to industries with lower value added, including the wholesale and retail trade, and other low-productivity services activities. Given the difficulty of reversing the expansion of the informal sector after the 2000–08 recession, the recession induced by the COVID-19 pandemic may also cause a long-lasting expansion of the informal sector in Zimbabwe.

Tackling informality needs to be at the forefront of Zimbabwe's development strategy to enhance productivity, achieve high and sustained growth, and attain UMIC status. There are two pathways to realize the productivity potential trapped in the informal sector and boost its overall productivity level. The policy packages listed below, however, will need to be supported by policies that ensure and sustain macroeconomic stability and remove distortions and misallocation of resources (the first of two pathways mentioned above).

7 The literature documents that informal firms in Emerging Markets and Developing Economies (EMDEs) are less productive than formal firms, with a productivity gap ranging between 30 to 216 percent (Perry et al., 2007; La Porta and Shleifer, 2008).

- **Policies to enhance the productivity of the informal sector and linkages with the formal sector.** Such policies include: ensuring better access to finance for formal firms and seed funds and training provided to informal firms; better access to information, training, markets, public goods and services; tax mediation services and individualized training; and policies to close the digital gender divide.

- **Policies to encourage the formalization of informal firms.** These policies will need to be implemented in the medium term but their impact on the formal sector will take longer to materialize. Providing incentives for formalization will require: the simplification of business start-up formalities; lowering the tax burden, compliance costs, and red tape to reduce the costs of joining the formal sector; promoting digitalization to lower government administrative costs; and improving governance and the provision of public sector services.

Boosting Trade to Scale Up Productivity of the Formal Sector

Zimbabwe's export performance has been declining over the past two decades. Trade is a driver of economic diversification, productivity, and economic growth. However, Zimbabwe's exports of goods and services have been underperforming over the past two decades, falling from an average of 33 percent of GDP between 2002 and 2009 to 25 percent of GDP a decade later (2010–19). Merchandise exports have been improving since 2017, owing to rising commodity prices, as well as changes in legislation on artisanal gold mining that have improved gold deliveries and production.

While merchandise exports have recently improved, only a handful of products, mainly primary goods, represent more than 90 percent of total exports, reflecting limited diversification in merchandise exports. In 2020, gold, tobacco, and other metals and minerals accounted for more than 90 percent of total exports. These exports are also increasingly concentrated in just a few destination markets. Exports of services remain concentrated on tourism and transport. The lack of diversity of exports is primarily due to macroeconomic instability, coupled with a difficult business environment, particularly distortions that limit competitiveness. The implementation of Zimbabwe's National Export Strategy by the authorities, which aims to support the development and promotion of exports of goods and services, should be strengthened and have an explicit productivity lens aligned with African Continental Free Trade Area (AfCFTA) implementation.

Broad based distortions have stifled those sectors that can catalyze Zimbabwe to become a successful exporter. Zimbabwe is aiming to build comparative advantage in the manufacturing sector, but only primary sectors such as metals, minerals and foodstuffs (tobacco) contributed positively to export growth between 2015 and 2020. There is little evidence that Zimbabwe's comparative advantage in the manufacturing sector is growing, and this may be a result of across-the-board distortions that are limiting competitiveness in the formal sector. These distortions, which include export retention policies, have acted as a tax on the tradeable sector.

Zimbabwe is yet to successfully integrate into GVCs, although there are significant opportunities to reboot the country's participation. An analysis by manufacturing subsectors indicates little growth in Zimbabwe's GVC participation over the past decade in previously large export sectors, such as apparels, footwear, and textiles. In fact, GVC participation across all sectors declined faster after the 2008 economic crisis. For a country like Zimbabwe, transitioning into limited manufacturing requires substantive efforts in addressing the investment climate, establishing simple procedures for registering foreign investors, giving priority to improving trade related infrastructure and above all maintaining price and exchange rate stability.

Lowering tariffs on intermediate and capital goods, and tackling trade facilitation issues would help ensure that the country benefits significantly from the implementation of the AfCFTA. Despite being a signatory of several regional trade agreements, high tariffs and trade facilitation hurdles continue to constrain trade. More specifically, high tariffs on intermediate inputs and capital goods limit value addition and the diffusion of technology, while duty concessions distort economic incentives. Furthermore, weak performance on trade facilitation and border management is a barrier to Zimbabwe becoming a significant regional exporter. Zimbabwe could become a regional transit hub, but this would require significant investment in border management operations and logistics infrastructure. There are opportunities for investments in transport and logistics infrastructure to support the development of regional economic linkages and value chains. Finally, the benefits of joining the AfCFTA are estimated to be significant for Zimbabwe, with intra-AfCFTA trade predicted to increase with the full implementation of the trade agreement. Given Zimbabwe's exports of processed foods, both the agriculture and manufacturing sectors stand to gain most in terms of exports to AfCFTA partners, supporting the development of intra-regional partners (World Bank, 2019c).

There are two pathways (that also depend on macroeconomic stability) for boosting trade to scale up productivity:

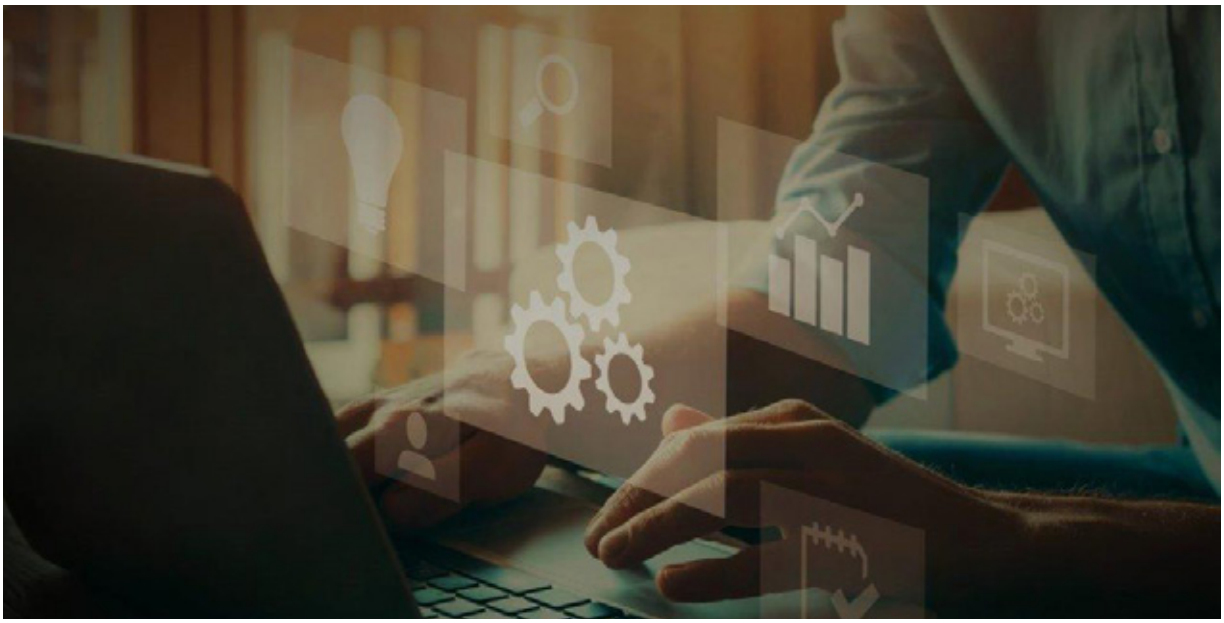
- Support export diversification and participation in GVCs—such policies will involve developing linkages between downstream and upstream firms through supplier linkage programs and also incentives that allows research and development expenditures to be offset against taxes.

- Enhance participation in regional integration—these policies will involve implementing the tariff reductions required within the AfCFTA agreement. It also involves

improving on trade facilitation measures such as fully automating all agencies that provide export licenses and permits, such as the Ministry of Lands, Agriculture and Rural Settlement, the Ministry of Industry and Commerce, and the Environmental Management Agency, and reduce the number of inspections, including by replacing paper-based documentation with electronic-based documentation.

TABLE ES1 PATHWAYS FOR BOOSTING PRODUCTIVITY AND QUALITY JOBS

PATHWAY	POLICY AREAS
1. Ensure and sustain macroeconomic stability	· Restore price and exchange rate stability · Clear external debt arrears · Improve PFM
2. Remove distortions and misallocation of resources	· Remove retention policies · Remove arbitrage opportunities offered by the forex auction · Ensure equal access to credit
3. Enhance productivity of the informal sector and linkages with the formal sector	· Improve access to finance (seed funds) · Enhance access to information, training, markets, and general support for enterprises · Implement sector/gender specific programs
4. Encourage formalization	· Simplify business start-up formalities · Reduce the tax compliance burden · Digitalization of government services
5. Support export diversification and participation in GVCs	· Tax incentives on research and development expenditure · Facilitate and strengthen the supplier linkage programs between domestic SMEs and large-scale firms that are into exporting · Address restrictions to the trade in services
6. Take advantage of regional trade integration	· Simplify the tariff structure · Tariff reductions and zero rating the tariff of intermediate and capital goods · Update the current National Export Strategy and the National Industrial Development Policy to align with AfCFTA implementation · Improve trade facilitation measures (review and benchmark the customs modernization strategy)



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CHAPTER 1

MACROECONOMIC POLICIES, SHOCKS, AND STRUCTURAL TRANSFORMATION

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1. Introduction

Zimbabwe possesses significant, unrealized potential. The country can achieve steady and rapid economic growth, given its abundant natural resources, highly educated workforce, and strong entrepreneurial culture. Moreover, with further investment, Zimbabwe's public infrastructure can support future growth.

However, so far, the country has struggled to reach its full economic potential, partly because of high economic volatility. Economic growth averaged 0.1 percent per year in the two decades between 2000 and 2021, but this increased to 2.3 per year over the past decade. Considerable economic volatility over this prolonged period, including two major recessions with high inflation and multiple exchange rates, significantly set back economic progress. This volatility was primarily driven by a mixture of policy missteps, climate shocks, and limited structural transformation.

The Government of Zimbabwe (GoZ) has made recent progress in stabilizing the economy, but significant challenges remain. Adoption of a tight fiscal and monetary policy has meant that inflation has been reduced, albeit short-lived. However, the economy faces considerable headwinds: a worsening external environment, coupled with a substantial public debt burden, has placed the economy under considerable pressure. More recently, exchange rate volatility experienced in the first half of 2022 was contained but subsequent triple-digit inflation has reduced the policy space to address future shocks.

Reaching UMIC status by 2030 will require a monumental acceleration in economic growth, boosting productivity and quality jobs. Achieving the GoZ's Vision 2030 objective of reaching UMIC status by 2030 will require raising economic growth to bold double-digit levels and significantly boosting productivity. This will also enable an unprecedented expansion in the quality and quantity of jobs, improvements in livelihoods, and significant poverty reduction. However, elevating economic and productivity growth rates throughout the next eight years will require agreeing upon, and then consistently implementing, an ambitious economy-wide strategy.

Securing long-term macroeconomic stability, structurally transforming the economy, and strengthening institutions will be vital to accelerating economic growth and creating better-paid jobs. Given the multitude of systemic issues facing the economy, a macroeconomic stabilization program will be required to support a major acceleration in, and then sustain, economic growth in the period 2023–30. Such a program will need to be underpinned by robust economic institutions that facilitate shifting the economy away from low- to higher-productivity sectors and economic activities.

The purpose of this chapter is to identify and address the key macroeconomic constraints as a way of dramatically increasing economic growth and living standards for the majority of Zimbabweans. The analysis will consider lessons learned from Zimbabwe's economic development over recent decades, as well as lessons from other countries that have succeeded in the kind of structural transformation sought by Zimbabwe. The objective of this chapter is to support and inform policy makers and stakeholders on macroeconomic policies to accelerate economic growth and job creation.

2. Learning from the Past

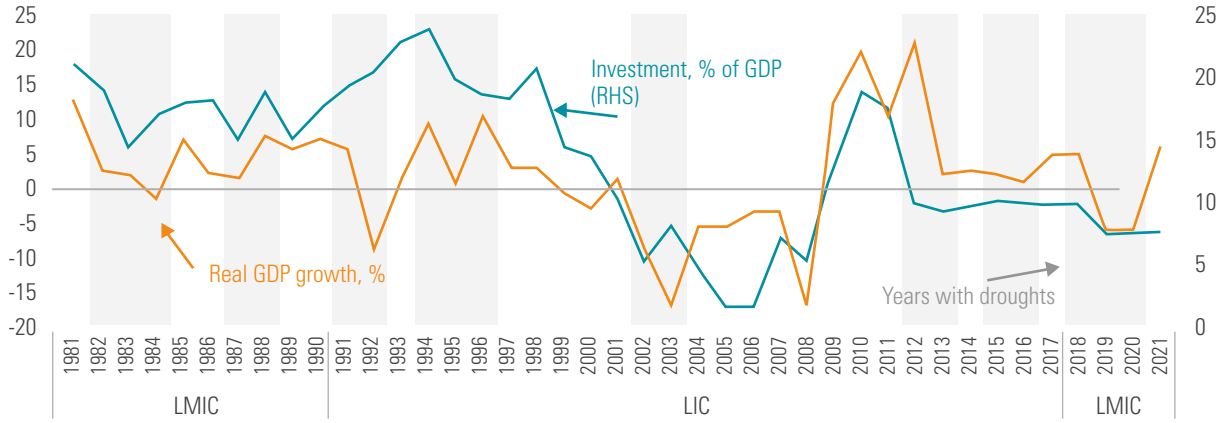
Zimbabwe's economic development over the past four decades has been held back by macroeconomic instability, shocks, and structural challenges. Policy choices, adopted by the GoZ, coupled with limited external support, resulted in two major recessions, the first taking place between 2000 and 2008, with a further recession occurring from 2019 to 2020, exacerbated by climate shocks and the recent COVID-19 pandemic. Hyperinflation in 2008 and near-hyperinflation a decade later eroded incomes and increased poverty. Frequent droughts and limited investment have reduced the resilience of households and firms, while fiscal space to mitigate the adverse impacts of economic volatility has remained limited. Finally, structural challenges, such as an overreliance on agriculture and commodity exports and the lack of fiscal resources due to pervasive informality have amplified the economic instability and prevented the economy from reaching its potential.

Photograph Credit: ArneHoel / WorldBank

Zimbabwe's overall performance from 1980 to 2021 was characterized by low growth and substantial economic volatility, especially over the past two decades. Growth of the economy has been volatile (Figure 1.1), averaging just 0.1 percent per year over the past two decades, but accelerating to 3.5 percent per year since 2010. The country's growth profile followed discernible cyclical trends, characterized by the loss of formal jobs, limited investment, out-migration, and increased poverty. Periods of prosperity with commensurate higher levels of investment were followed by subsequent periods of instability, a collapse in investment, and low or negative growth. This substantial economic volatility imposed a real cost on the economy and households, and created lasting effects on growth due to damage to physical, organizational, and human capital.

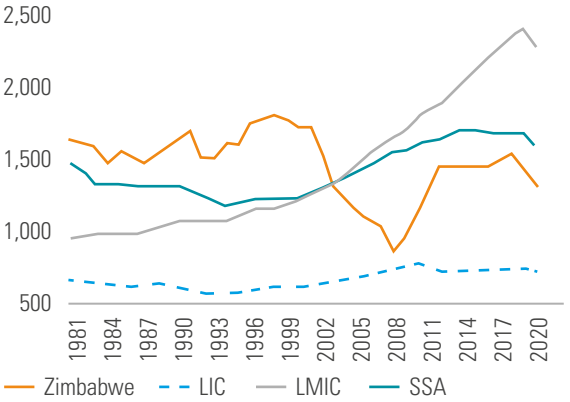
Its weak growth performance has meant that Zimbabwe has lagged its peers, while living standards of Zimbabweans have deteriorated, although improvements are on the way. In the first two decades of its independence, Zimbabwe experienced higher GDP-per-capita growth than peers in other LMICs and SSA (Figure 1.2). However, since 2003, living standards in Zimbabwe have fallen sharply, with the economy only recently regaining lost ground with SSA. Economic and climate shocks have weakened household budgets, with poverty increasing to levels close to those of LICs. Nevertheless, in 2018, Zimbabwe finally transitioned from LIC status to LMIC status after almost three decades, and poverty levels have declined since 2020 (Figure 1.3).

FIGURE 1.1. GDP GROWTH, INVESTMENT, AND DROUGHTS



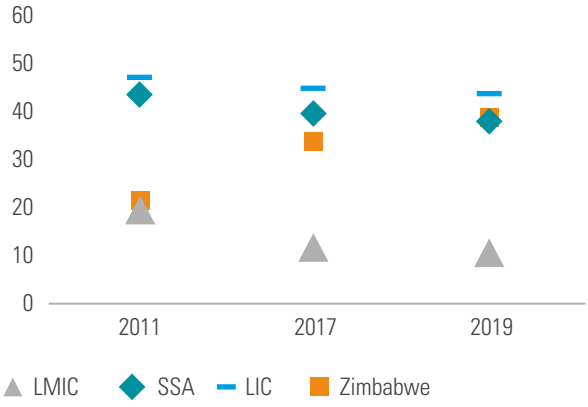
Source: MoFED, Zimstat, WDI, World Bank.

FIGURE 1.2. GDP PER CAPITA (US$ CONSTANT 2015 PRICES)



Source: WDI.

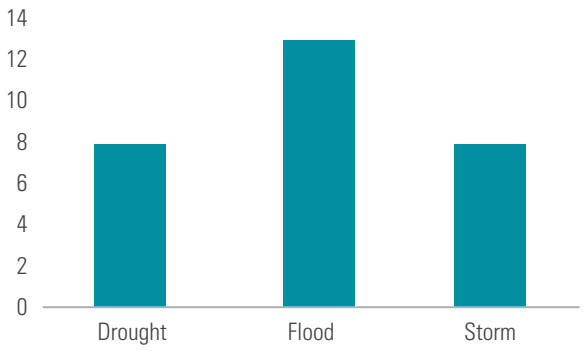
FIGURE 1.3. POVERTY HEADCOUNT RATIO AT US$1.90 A DAY (2011 PPP) (% OF POPULATION)



The frequency and magnitude of natural disasters experienced by Zimbabwe over the past four decades have been a contributing factor to the country's underwhelming economic performance and the associated turmoil. Zimbabwe has experienced eight droughts, 13 floods, and eight storms since 1980 (Figure 1.4). These shocks have had significant impacts on the economy and livelihoods, and served to undermine private finances. Frequent droughts have considerably reduced agricultural production, incomes, and livelihoods, particularly for the rural population where poverty rates are highest. Droughts have also adversely affected hydroelectric power generation. This has resulted in shortages of power, pushing up the costs of production, particularly in the industrial sector, and worsening the finances of electricity companies. Moreover, other climate shocks, such as Cyclone Idai in 2019, have destroyed critical infrastructure and affected the livelihoods of nearly 200,000 households.

High volatility to climate shocks was a result of significant reliance on rain-fed agriculture for employment despite a relatively diversified economy. Though the gross value added of agriculture is declining (Figure 1.5), the share of employment in agriculture remains persistently large, at two-thirds of total employment (Figure 1.6). The services sector, dominated by trade and transport, has grown steadily over the past decades, generating 58 percent of GDP between 2010 and 2019, but employment levels in the sector have remained largely unchanged. The share of industry in gross value added increased over the past decade, mostly on the account of robust improvement in mining output. Manufacturing output also improved, although more moderately, and represented more than half of industrial output. Overall, Zimbabwe's economic structure is close to that of UMICs in terms of sectoral shares of GDP, but resembles the employment structure of LICs with its high employment in agriculture.

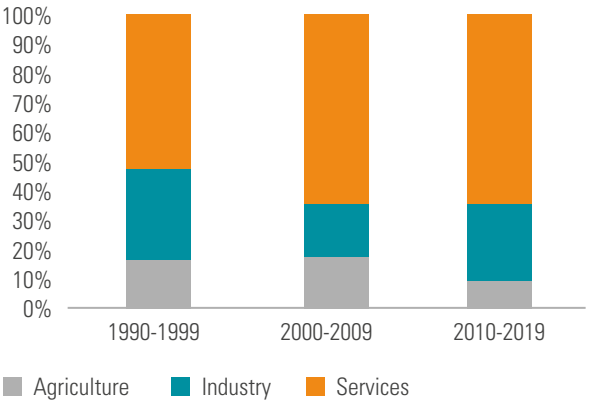
FIGURE 1.4. NATURAL DISASTERS OCCURRENCES, 1980–2022



Source: EM-DAT: Emergency Events Database, Université Catholique de Louvain (UCL), CRED, D. Guha-Sapir, Brussels, Belgium.

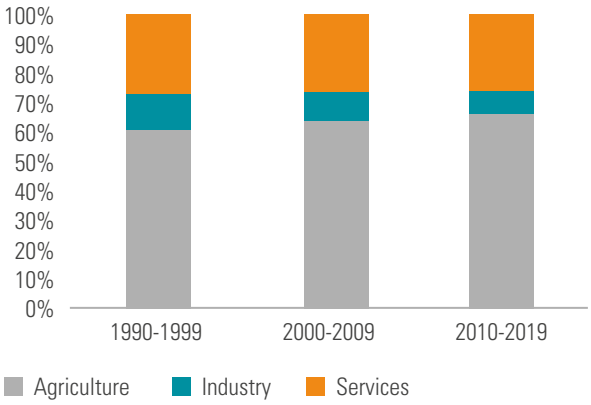
Photograph Credit: ArneHoel / WorldBank

FIGURE 1.5. GROSS VALUE ADDED DISTRIBUTION BY ECONOMIC SECTOR, %



Source: WDI

FIGURE 1.6. EMPLOYMENT DISTRIBUTION BY ECONOMIC SECTOR, %



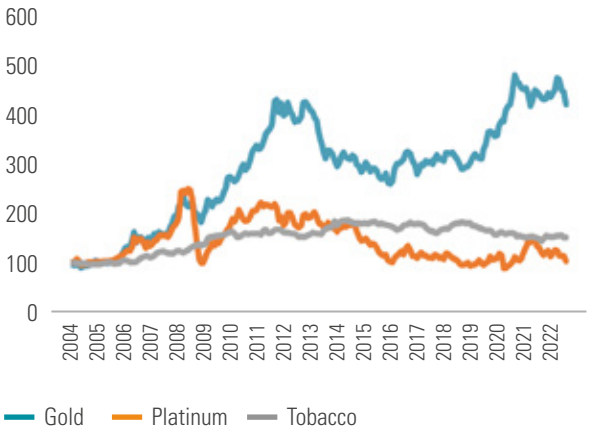
External economic shocks, primarily due to changes in commodity prices, have also adversely affected the economy. Zimbabwe's reliance on primary commodities, coupled with its status as a small, open economy, together with its fragile macroeconomic fundamentals, has made the country especially susceptible to external shocks. Repeated price instability of three of Zimbabwe's key export commodities (Figure 1.7)—gold, platinum, and tobacco—has increased the volatility of export earnings and fiscal revenues, and complicated macroeconomic management, especially during 2013–16. In addition, recent increases in the global prices of food, energy, and fertilizers (Figure 1.8) due to the war in Ukraine have significantly reduced the purchasing power of households and elevated the costs of production.

Furthermore, the COVID-19 pandemic has adversely impacted Zimbabwe's economy. Lockdown measures imposed by the GoZ helped to save lives, while good vaccination levels helped to limit the transmission of the virus. However, preventive measures, coupled with global supply chain disruptions, adversely affected economic activity and the delivery of public services. As a result, the economy continued to contract, with employment and incomes falling and poverty levels increasing further, especially in urban areas where the reach of government social assistance programs was severely limited. Extreme poverty increased and reached a peak of 49 percent in 2020, while unemployment increased from 16 percent in 2019 to 20 percent in Q4-2021.[8]

Policy inconsistency has contributed to the volatility of the economy, which has adversely affected incomes and livelihoods. A controversial land reform and weak management of state-owned enterprises (SOEs) led to weak public finances, as they required an expansionary monetary policy. Moreover, a default on external debt in 2000 and the accumulation of significant arrears have limited Zimbabwe's access to external financing. As a result, public and private investment has remained at low levels, negatively impacting growth.

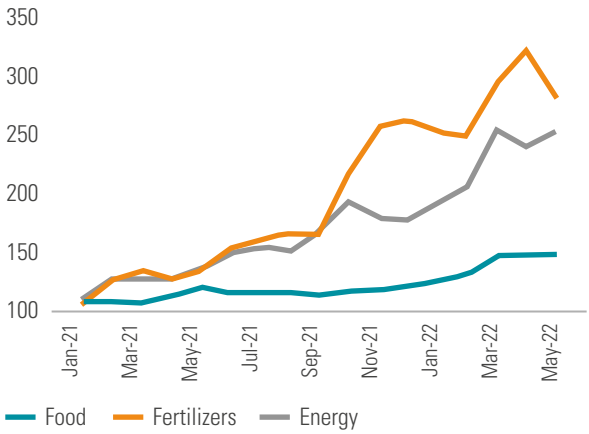
Achieving a substantial improvement in living standards will require the authorities to adhere to policies that have served Zimbabwe well in the past and avoid policies that are detrimental to development. Policies that stabilized prices and exchange rates, and supported development of institutions and the private sector, have been beneficial for economic growth. Adhering to fiscal discipline, strengthening public financial management (PFM), and advancing structural reforms have served Zimbabwe well in the past and will continue to do so if deepened and consistently implemented going forward. However, in the past these policies were often not systematically applied, or frequently changed without prior consultation with stakeholders, undermining the achievement of the intended impacts. At the same time, lax and non-transparent fiscal and monetary policies, and unconventional exchange rate policies increased price volatility, undermining stability, and growth. Meanwhile, cumbersome business regulations, unsustainable public debt levels, and long-standing external debt arrears constrained access to credit and limited private sector activity. In addition, weak structural transformation resulted in high levels of informality, low competitiveness, high vulnerability to shocks, and a large share of employment comprising low-paid jobs. Finally, policies to tackle climate change risks amid limited financing options were ineffective at ensuring the resilience of the economy.[9]

FIGURE 1.7. PRICE INDICES, DECEMBER 2003=100



Source: World Bank Commodity Prices.

FIGURE 1.8. PRICE INDICES, DECEMBER 2020=100



[8] Zimstat, Labour Force Surveys (LFS), 2019 and 2021.

[9] Climate change risks and related policies will be discussed in more details in an upcoming Country Climate Development Report (CCDR) for Zimbabwe.

2.1 Policies that have served Zimbabwe well

Recently, economic management has been bolstered to a large extent by a tight fiscal policy, in particular the management of central government finances. In a difficult external environment, the GoZ has implemented some prudent fiscal consolidation centered on revenue enhancement and austerity measures. The introduction of an Intermediated Money Transfer Tax (IMTT) has enabled improved revenue collection, making more room for public infrastructure spending. At the same time, unsustainable public spending has been adjusted downward. A costly public wage bill was reduced from a peak of around 13.6 percent of GDP in 2017 to 7 percent of GDP in 2020 and 2021. Similarly, support to the agriculture sector, as well as subsidies, were downsized and became more transparent. As a result, fiscal deficits of the central government were reduced from an average of 8.4 percent of GDP in 2016–18 to less than 0.5 percent in 2019–21 (Figure 1.9).

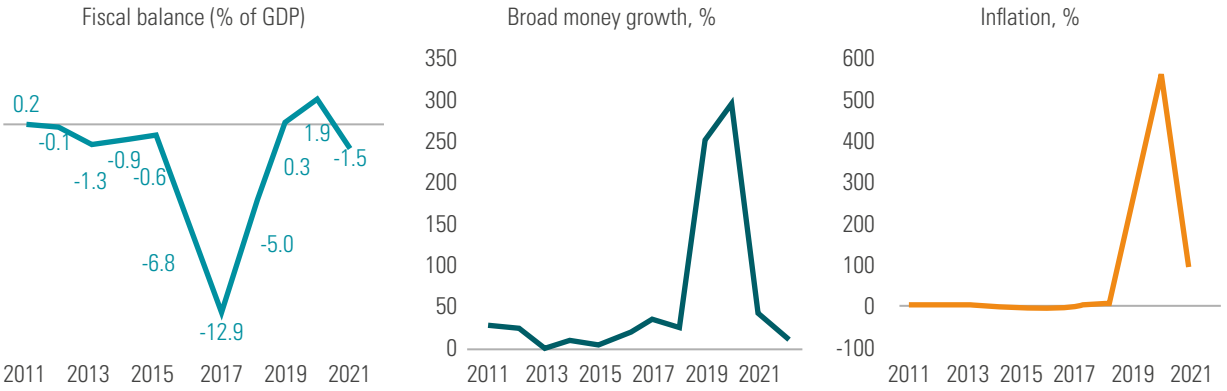
This fiscal adjustment has enabled the GoZ to re-prioritize expenditure, consolidate finances, and expand public investment. The freeing-up of fiscal space has allowed the authorities to recently increase public investment spending, especially on infrastructure projects such as new roads and thermal power stations, despite the difficult economic environment. Revenue-enhancing measures were implemented as stated above. Moreover, the GoZ has begun consolidating its finances, discontinued borrowing from the Reserve Bank of Zimbabwe (RBZ), and reduced QFAs significantly since 2019. Furthermore, the issuance of Treasury Bills (TBs) has been limited to smooth cash flows and restructured maturities, moving away from the private placement of TBs to a pre-announced calendar for the issuing of TBs.

While the large public debt burden remains unresolved, the GoZ has made strides in advancing the re-engagement agenda as efforts to clear arrears continue. In 2019, the GoZ restarted making pari-passu payments on debt to international financial institutions (IFIs) and, in 2021, also commenced payments to Paris Club creditors. The GoZ came up with an Arrears Clearance, Debt Relief and Restructuring Strategy approved in 2021, which set out a roadmap for arrears clearance.

The fiscal adjustment (from 2019 to 2021) was accompanied by a series of monetary and foreign exchange reforms that helped reduce price and exchange rate volatility (Figure 1.9), but inflation returned to triple-digits in 2022. Annual average inflation slowed significantly from 557.2 percent in 2020 to 98.5 percent in 2021, following the introduction of rules-based reserve money management, a foreign exchange auction, and the relaxation of dedollarization. Further monetary tightening and liberalization of the forex market, the issuance of gold coins, and the review of procurement rules helped contain the growing foreign exchange rate distortions (high parallel market premium over the official exchange rate and limited access to foreign currency at the official rate) and pressures from global price increases during the first half of 2022. As a result, the local currency stabilized on the parallel market and the parallel market premium was significantly narrowed. Nevertheless, annual inflation reached 285 percent in August 2022.

Notable strides have also been made to enhance accountability and transparency in the public sector through public financial management (PFM) reforms, including the implementation of program-based budgeting (PBB). Fiscal reporting has been improved with the publication of a detailed national budget in PBB format, tracking output and outcome indicators by program, and linking the budget with the National Development Strategy (NDS). In addition, the annual budget report has been expanded, including a section on the impact of fiscal risks on the budget. Regular publication of debt bulletins since 2019, with expanded information on RBZ debt and

FIGURE 1.9. KEY ECONOMIC INDICATORS, 2011–21



Source: MoFED, RBZ and Zimstat.
Note: Annual average inflation.

contingent liabilities, has improved the transparency of debt reporting. Financial reporting reforms have been enhanced through: (i) the adoption of International Public Sector Accounting Standards in the public sector; (ii) the expansion and optimization of the PFM system to cover government transactions previously outside the Ministry of Finance and Economic Development's (MoFED) central online visibility (grants and funds); and (iii) strengthening of the internal controls environment by introducing the Central Internal Audit Unit within the MoFED, which oversees all internal audit units in ministries and agencies. These reforms made possible a significant improvement of country's budget transparency score, which rose from 23 in 2017 to 59 in 2021, just behind Chile.[10]

The GoZ has advanced important structural reforms, though the full impact has been constrained by other macroeconomic challenges, such as high inflation and the lack of a functional formal foreign currency market. The GoZ repealed the Indigenization and Economic Empowerment Act (mandating that foreign companies with a capital threshold of US$500,000 and above acquired an indigenous shareholding of 51 percent). The creation of the Zimbabwe Investment and Development Agency (ZIDA) with a strong private sector orientation bodes well for addressing the adoption of global best practices for investment promotion agencies. The GoZ also embarked upon various reforms aimed at improving the business environment, including making it easier to start a business, reducing the time needed to approve construction plans for commercial developments, strengthening access to credit, and reorganizing the resolution of insolvency.

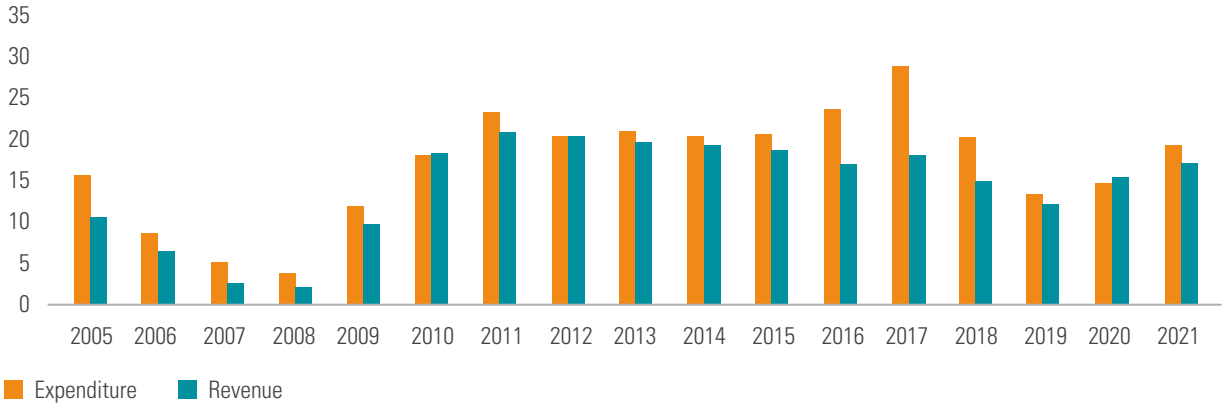
2.2 Policies that have been detrimental to growth

Price instability, low investment, and limited structural transformation remain key economic management challenges that need to be addressed. Lax fiscal and monetary policies, coupled with multiple exchange rates, were primarily responsible for price instability. Price volatility was a key feature of the recessions in 2000–08 and 2019–20 that, coupled with a difficult business environment, served to limit economic activity and disincentivize investment. After bottoming out in 2021, inflation is on the rise again, returning to triple-digit levels in June 2022, with the local currency weakening at a rapid pace.

Expansionary fiscal policy, especially during the periods before the recessions, contributed significantly to economic instability, undermining growth. Weak revenue mobilization, coupled with surges in spending due to a large public wage bill, agriculture spending, and transfers to SOEs, resulted in periodic shortfalls in public finances (Figure 1.10). Limited access to external financing meant that fiscal deficits had to be primarily financed through monetary financing and QFAs, stoking inflation. Such practices were especially pronounced in the periods of 2005–07 and 2016–18 that preceded the two recessions. While some spending pressures have been recently addressed and PFM reforms are underway (see preceding section), risks for the budget remain high and need to be managed carefully so that price volatility can be contained.

Fiscal management was particularly undermined by high public employment costs, partly because of inefficient spending controls, which allowed spending overruns and the inclusion of 'ghost' workers. Zimbabwe had one of the largest wage bills in the SSA region, growing from 7.6 percent of GDP in 2010 to around 14 percent of GDP in 2018. An audit of public servants' wages and corrective follow-up actions, including tackling the issue of 'ghost' workers and slower adjustments for inflation, helped reduce public sector employment significantly. However, wage spending continues to exceed targets, the pay scale structure remains inadequate, and the allocation of public service employment across sectors is not conducive to

FIGURE 1.10. GENERAL GOVERNMENT EXPENDITURE AND REVENUE, % OF GDP



Source: IMF WEO.

[10] 2021 International Budget Partnership Open Budget Survey.

effective public service delivery. Despite several pay increases, high inflation has significantly eroded the incomes of public sector workers, particularly for teachers and nurses, with damaging impacts on the education and health sectors (World Bank, 2021a). Further efforts to improve the real wages of public servants have not been accompanied by measures to reduce inefficiencies in employment and pay structures.

Significant and extensive support to the agriculture sector imposed considerable pressures on macroeconomic policy. A large proportion of support to the agriculture sector was financed by QFAs and an increase in contingent liabilities. This support took many forms—subsidies to farmers for purchases by the Grain Marketing Board (GMB),[11] the provision of inputs (fertilizers and seeds) to maize contract farmers and for free to vulnerable households, the provision of equipment, cross-subsidized electricity, the capitalization of Agribank, the bailout of banks with high exposure to agriculture (2015), guarantees to banks (since 2020), and farmers' compensation,[12]—all of which added US$3.5 billion to public debt. Agriculture spending in the budget was subject to significant spending overruns and limited transparency on allocative efficiency, especially of command agriculture. However, despite significant public spending on agriculture, food insecurity remains high, while agricultural productivity is one of the lowest in the region.

Moreover, a large number of unprofitable, commercial SOEs[13] have had an adverse impact on public finances. In recent years, Zimbabwe's extensive commercial SOEs have required considerable fiscal support (around 11 percent of GDP, between 2011 and 2018)[14] and RBZ-financed QFAs. Despite this, a difficult economic environment, coupled with the impact of the pandemic, has worsened the financial outlook of SOEs. Several major SOEs are insolvent, while others are suffering from severe liquidity issues. As a consequence, most SOEs are in arrears: unable to adequately fulfil debt and payment obligations or deliver goods and services. In particular, power, water, and rail services are beset by delivery failures. The authorities have prepared an SOE reform program, but the pandemic, together with a lack of capacity and resources, has limited progress in SOE restructuring. So far, the GoZ has only managed to restructure GMB, the power utility company (Zimbabwe Electricity Supply Authority, ZESA), the Civil Aviation Authority of Zimbabwe (CAAZ), and Agribank.

An expansionary monetary policy, especially prior to the two recessions, stemming from institutional weaknesses, has been detrimental to price stability. RBZ's conduct of monetary policy has been hampered due to its lack of independence. Therefore, RBZ has been required to engage in QFAs and the monetary financing of public spending to support government policies. This has undermined price stability and impacted negatively on growth. QFAs by RBZ and monetary financing of the GoZ's budget led inflation to officially reach 231 million percent in July 2008 and, just over a decade later, to soar again to 557.2 percent in 2020.

Recent price volatility risks derail the post-COVID-19 recovery. While inflation bottomed out in 2021, it has accelerated sharply since the beginning of 2022, reaching almost 200 percent year-on-year in June 2022. The acceleration of prices reflects monetary expansion, limited fiscal and monetary coordination, and the surge in global prices due to the war in Ukraine. The GoZ introduced a set of fiscal and monetary measures to contain inflation, but exchange rate distortions and pressures for pre-election spending remain a risk.

Exchange rate policies have significantly disrupted the economy. Zimbabwe had a multiple exchange rate system in 2000–08 and 2018–21, including a parallel exchange rate, an interbank rate, and an official rate.[15] A parallel market developed because of excessive monetary growth, weak economic fundamentals, including a large trade deficit, and foreign exchange controls imposed by the Government to prioritize foreign exchange for key industries and imports. Moreover, frequent policy changes in relation to the currency—dedollarization, a dollarization ban, plus restrictions placed on foreign exchange trading—have increased uncertainty and raised volatility. In addition, the presence of a large informal sector, coupled with sizeable external debt arrears, has limited foreign exchange access through formal channels. These factors, coupled with weak economic fundamentals and a susceptibility to external shocks, have exacerbated exchange rate volatility and economic distortions. (Figure 1.11). The parallel market premium over the official exchange rate has widened sharply since mid-2021, undermining competitiveness of Zimbabwe's exporters as the imposition of forex retention policies acts as a tax on the tradeable sector. Limited access to the official foreign exchange market favors a small number of importers and creates rent-seeking opportunities.

[11] Prior to restructuring, government support to the GMB reached 2 percent of GDP in 2021.

[12] In 2020, the GoZ and former farmers agreed on the total amount and roadmap for compensating farmers for improvements on compulsory acquired land during the 2000 Land Reform Program. The GoZ agreed to pay half of the amount within one year and the balance over a period of four years. Subsequently, the first payment was rescheduled by one year with the GoZ planning to issue Treasury Bills to compensate farmers in 2022.

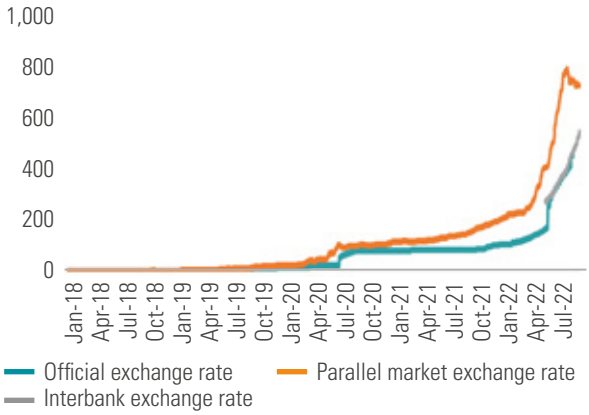
[13] For previous detailed analysis see Government of Zimbabwe; World Bank. 2017. Zimbabwe Public Expenditure Review 2017: Volume 3. State Enterprises and Parastatals. Washington, DC: World Bank.

[14] IMF Zimbabwe: Article IV, April 2022.

In addition to price instability, unsustainable and sizeable external public and publicly guaranteed (PPG) debt, mostly in arrears, has deterred investment, further undermining growth. Since 2000, the GoZ has stopped servicing debt to international financial institutions (IFIs) and has started accumulating arrears on external debt, which totalled US$6.6 billion at the end of 2021, or 44.5 percent of GDP (Figure 1.12). Arrears to IFIs have curtailed access to concessional financing and increased the cost of private sector borrowing. Meanwhile, exchange rate restrictions imposed by RBZ have made private sector borrowing from abroad increasingly difficult and expensive. To prevent an outflow of capital, the GoZ blocked external payments to foreign suppliers and investors in 2019, further limiting foreign direct investment (FDI). In 2021, the GoZ assumed these blocked funds, which totalled US$3.5 billion, and committed to making the payments on behalf of the private sector, although the payment modality and timeline remain unclear. As a result, the maintenance and upgrading of critical public infrastructure was either neglected or implemented at elevated cost. At present, less than half of the population are connected to the national electricity grid; roads to connect businesses and people to markets remain unbuilt or in disrepair; and access to drinking water has been constrained.

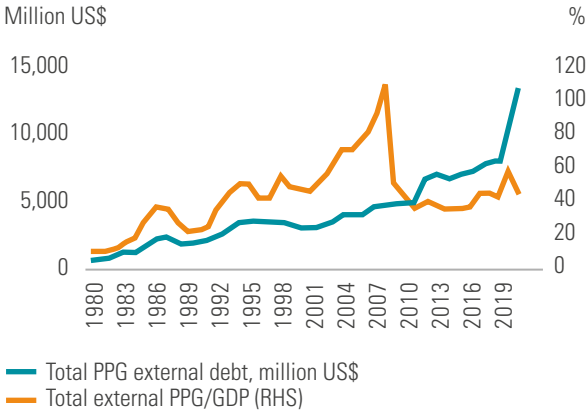
Limited access to affordable external credit lines and high exposure to public debt have also constrained domestic financing to the private sector. A large public debt burden has crowded out credit to the private sector, reducing it below levels required to support robust private investment and productivity growth. This was especially pronounced prior to the two recessions of 2000–08 and 2019–20. Since 2020, monetary financing has been discontinued and credit to the private sector has outpaced credit growth to the public sector, but levels remain too low to support investment (Figure 1.14). Nonetheless, overall investment levels have remained very low (Figure 1.13).

FIGURE 1.11. OFFICIAL AND PARALLEL MARKET EXCHANGE RATES, Z$/US$



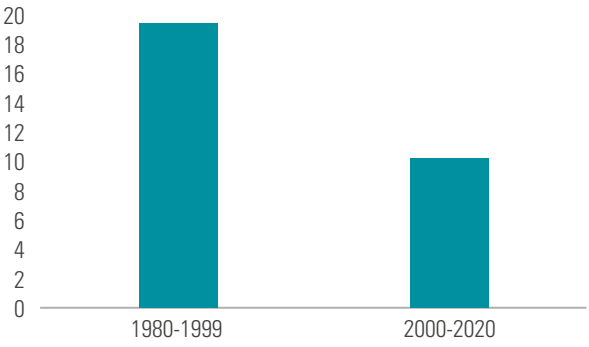
Source: RBZ and World Bank.

FIGURE 1.12. EXTERNAL PPG DEBT, 1980–2021



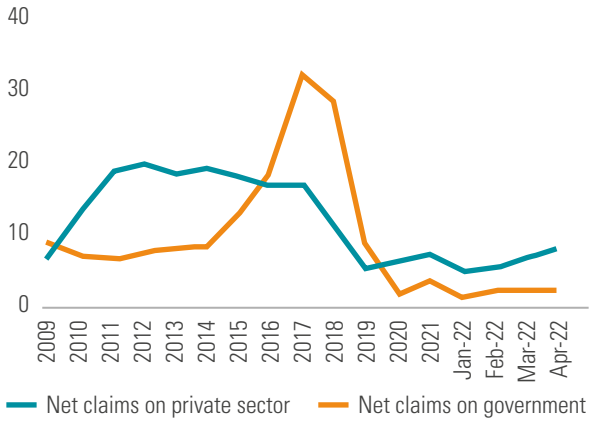
Source: 2021 Debt Bulletin, MoFED and WDI.

FIGURE 1.13. INVESTMENT (% OF GDP)



Source: WDI.

FIGURE 1.14. DOMESTIC CREDIT (% OF GDP)



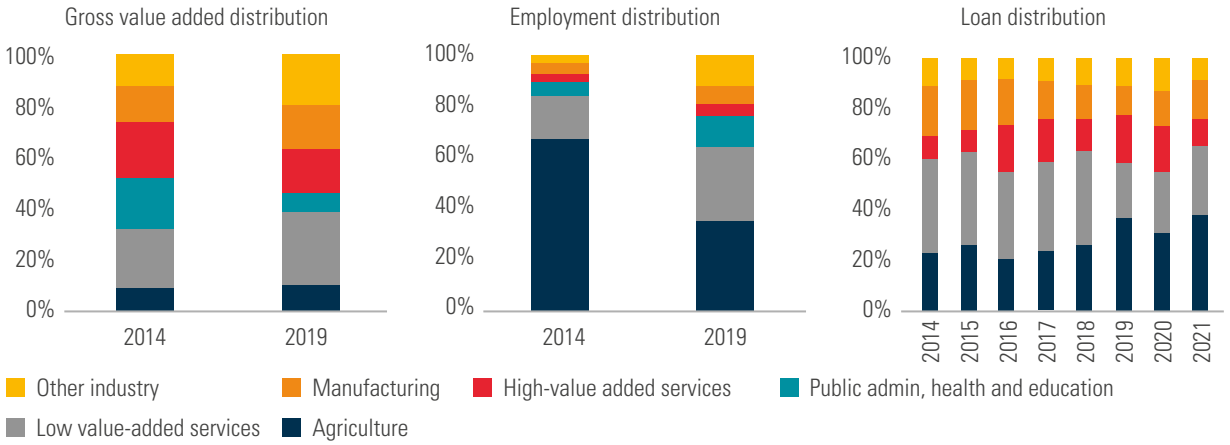
Source: RBZ and WDI.

[15] While foreign exchange is rationed at the official exchange rate, there is no shortage of foreign exchange at the parallel rate in Zimbabwe. The parallel market receives significant foreign exchange from workers remittances, coupled with informal flows through smuggling and over-invoicing of imports/ under-invoicing of exports and tourism.

Limited structural transformation has kept economic growth and incomes low and contributed to a high vulnerability to shocks. The economy remains highly concentrated on key firms and industries, with a small number of export products—mostly minerals and tobacco—generating the bulk of foreign exchange revenues. The agriculture sector continues to retain a sizeable share of production and employment in the economy and the bulk of lending, with significant government support and intervention. At the same time, higher value-added sectors, such as manufacturing and high-productivity services, employ a smaller share of workers and have a lower share of lending (Figure 1.15).

Zimbabwe's human capital base remains a considerable structural asset, but macroeconomic and structural challenges have stifled the opportunities to fully utilize human capital to drive the economy forward. The country possesses a high-quality human capital base, with a young and well-educated labor force, and vibrant entrepreneurial base, which could thrive if exposed to a more conducive business environment. Despite the economic challenges experienced over the past two decades, Zimbabwe's Human Capital Index (HCI) increased from 0.41 in 2000 to 0.47 in 2020. At present, the skills of the current working force, including digital skills, are comparable to Zimbabwe's peers—higher than the average for the SSA region and almost on a par with the LMIC average (Figure 1.16). However, this has not translated into better economic outcomes and the return to education has remained low. This has meant that most jobs are poorly paid and in the informal sector or in subsistence agriculture.

FIGURE 1.15. GROSS VALUE ADDED, EMPLOYMENT AND LOAN DISTRIBUTION ACROSS SECTORS IN ZIMBABWE[16]



Sources: Zimstat, WDI, World Bank. Note: ILO estimates show agriculture employment remains steady at close to two-thirds of total employment. Zimstat changed the methodology for estimating agriculture employment by excluding persons who worked for own final consumption from employment numbers in 2019. This methodological change resulted in a significant reduction of agriculture by 3.2 million persons.

FIGURE 1.16. SKILLS OF THE CURRENT AND FUTURE WORKFORCE, SCORE

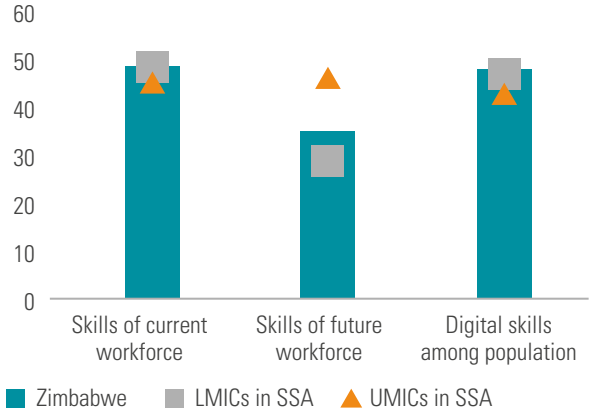
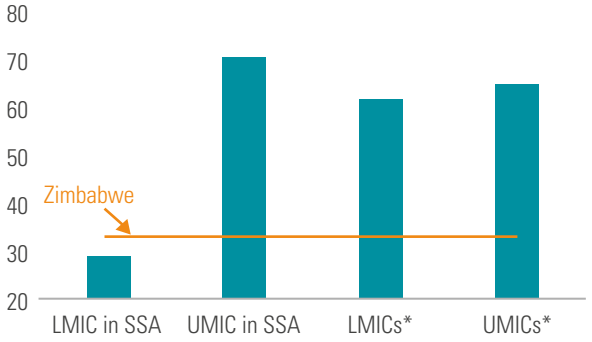


FIGURE 1.17. WAGE AND SALARIED WORKERS, TOTAL (% OF TOTAL EMPLOYMENT) (MODELED ILO ESTIMATE)



Sources: World Economic Forum, World Development Indicators, World Bank.

[16] Low value-added services include the wholesale and retail trade/motor vehicle repairs, accommodation & food services, and community, personal and other services. Other industry comprises mining, utilities and construction. High value-added services include financial, real estate, business & insurance services, transport & storage, and information and communications.

Moreover, a pervasive and persistent informal sector has constrained private sector growth and limited the number of quality jobs. Zimbabwe has one of the largest informal sectors in the world. The informal sector has grown in recent years in response to a harsh business environment, characterized by price and exchange rate distortions, burdensome regulations, and slow urbanization (Chapter 3). Only 33 percent of workers in Zimbabwe receive a salary (Figure 1.17), well below peers in the region and globally, suggesting a limited share of quality jobs despite relatively higher skills. Labor productivity in informal firms is only a fraction of the labor productivity in similar formal firms (Chapter 3), affecting overall productivity levels negatively. Moreover, competition from informal firms has tended to lower the productivity of formal firms by around 24 percent on average, compared with firms that do not face such competition.

Finally, limited diversification of exports, exchange rate policies, and a volatile business environment have caused underperformance of Zimbabwe's tradeable sector and lowered economic growth possibilities. Growth of exports and imports in Zimbabwe over the past two decades has underperformed other countries in SSA (Chapter 4). There remains an over-reliance on a small number of low value-added primary commodities—mostly minerals and tobacco. A difficult and volatile business environment, including foreign exchange retention policies, and the high relative costs of exporting and importing, have inhibited the tradeable sector within Zimbabwe. Nonetheless, there is considerable potential to expand Zimbabwe's tradeable sector under an optimal policy environment.

3. Looking Forward: Accelerating Economic Growth and Improving Living Standards

3.1 Achieving Zimbabwe's Vision 2030

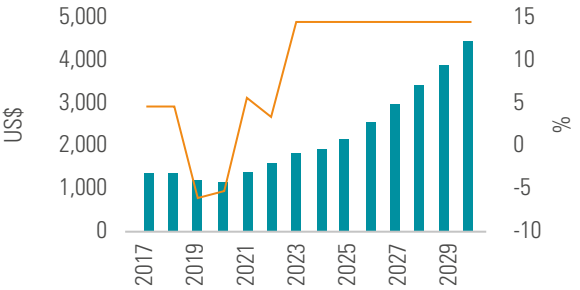
The Government's Vision 2030 document sets the objective for Zimbabwe to reach UMIC status by 2030. The current NDS1 covering the period 2020–25 outlines the envisaged economic planning required to stabilize and grow the economy to support achieving this goal. Currently, Zimbabwe is at the midpoint of implementation of the NDS1 and will need to consider whether to change course or accelerate reforms to ensure that the goal remains within reach. The remaining three years of NDS1 and the follow-up NDS2 (2026–30) will need to pave the way for the goal to be achieved.

Simulations show that achieving the GoZ's ambitious goal of UMIC status by 2030 will require a significant acceleration in economic growth, especially productivity growth (Figure 1.18). Real annual growth will need to reach 15 percent and be sustained during the period 2023–30 if Zimbabwe is to attain its Vision 2030 aspirations. While achieving such high growth is not impossible, sustaining it for such a prolonged period is rare and will require significant improvements in productivity. The simulation assumes that investment, supported mainly by private sector, will gradually reach 20 percent of GDP by 2030, while exports will increase to 29 percent of GDP. This will enable productivity growth of about 8–9 percent and employment growth of about 5 percent per year. Population growth will need to remain constant at around 1.5 percent per year. Such high growth rates will require dramatic improvements in the domestic policy environment, including eliminating exchange rate distortions and quickly restoring price stability, with local currency depreciation settling to single digits by 2024. It will also entail opening access to international financial markets. The external environment would also need to be supportive of such high growth rates.

Even if the goal is not achieved by 2030, getting closer to UMIC status will result in significant improvements in social indicators. Simulations show that between 1 and 1.5 million jobs could be created if the economy grows at double-digit rates. Extreme poverty could fall to between 6 and 16 percent of the population, moving 4–5 million people out of poverty. More jobs and less poverty will make access to health, education, and social protection easier, further improving human capital and supporting future productivity increases.

Without significant and sustained policy reforms, however, economic growth will remain depressed and living standards will only marginally improve. Under the no-reform scenario, convergence to UMIC status will be prolonged and economic growth will remain significantly lower, peaking at around 3 percent per year (Figure 1.19). Therefore, Zimbabwe's

FIGURE 1.18. VISION 2030 SCENARIO: ZIMBABWE GNI PER CAPITA AND ANNUAL GDP GROWTH

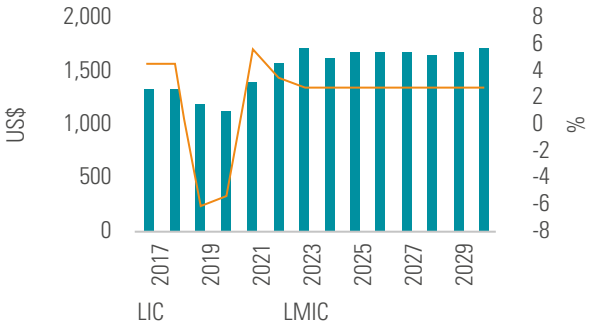


GNI per capita, Atlas method (current US$)

Annual GDP growth rate % (RHS)

Source: World Bank, Zimstat.

FIGURE 1.19. BASELINE SCENARIO: ZIMBABWE GNI PER CAPITA AND ANNUAL GDP GROWTH



GNI per capita, Atlas method (current US$)

Annual GDP growth rate % (RHS)

gross national income (GNI) per capita will remain below US$1,800, falling further behind its peers in SSA. Improvements in social conditions will be much smaller, with poverty falling to 34 percent of the population and only marginal employment gains. Risks for continuing economic volatility will remain high, with further negative impacts on future productivity growth and social conditions.

3.2 Lessons from other countries that have transitioned to UMIC status

Substantial policy reforms were introduced by the 25 countries[17] that successfully transitioned from LMIC* to UMIC* status over the past three decades. These included reforms to improve and maintain macroeconomic stability, strengthen institutions, and facilitate structural transformation. Achieving UMIC status required a sustained policy commitment by successive governments over many years to achieve their goal. On average, it took these countries 15 years to transition to UMIC from LMIC status, with median GDP growth maintained at 5.4 percent per year.

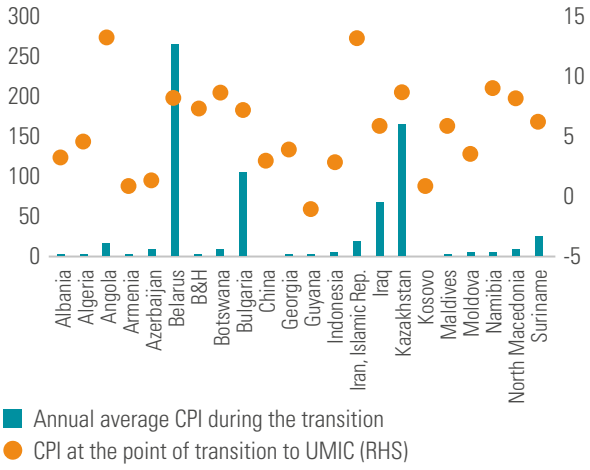
Macroeconomic stability

Macroeconomic stabilization programs were a critical element of the reform agenda that allowed countries to transition to UMIC status. Policies were implemented to address domestic and external imbalances. Public finance and monetary reforms, supported by structural improvements, stabilized prices and exchange rates, reduced PPG debt by 10 percentage points of GDP on average, built up foreign exchange reserves, and attracted significant foreign direct investment (FDI). None of the countries that transitioned to UMIC status had multiple exchange rates or unsustainable debt levels.

Price stability was a cornerstone of most countries' economic reform programs. Prudent fiscal and monetary policy enabled most countries to keep inflation to below 10 percent (Figure 1.20) during the transition process. Even those countries that had initially high inflation managed to reduce inflation significantly at the transition point. Fiscal discipline involved adherence to stringent fiscal targets coupled with public finance reforms, which comprised adjustment to key expenditures (public sector wage bill and public bodies outside central government), revenue administration modernization, and careful debt management. Bulgaria, which underwent its own hyperinflationary episode, managed to secure price stability by implementing a currency board arrangement, and tight fiscal and debt policy that saw a sharp reduction in inflation from 1997 onward, with public debt levels declining from almost 100 percent of GDP in 1997 to less than 30 percent by 2005. Price stability helped bring about significant FDI inflows—from less than 1 percent of GDP prior to the currency board introduction to 11 percent on average in 1997–2007.

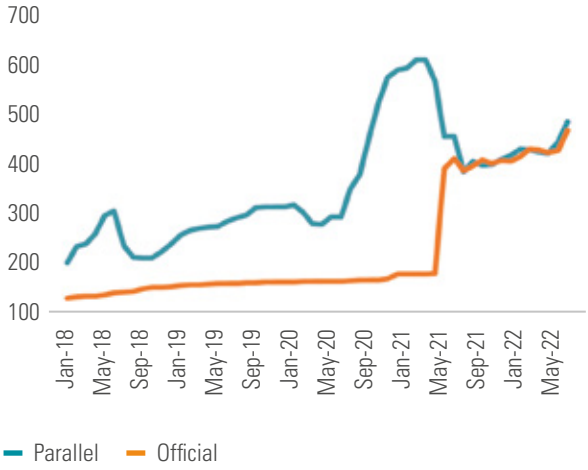
Similarly, achieving exchange rate stability remained vital for macroeconomic stability. To limit volatility in the exchange rate, transition countries typically implemented measures that addressed external public debt arrears, built up foreign exchange reserves, and expanded the size of the local foreign exchange market. Countries followed various paths to exchange rate stability, with some following a gradual approach and others a 'big-bang' approach.[18]

FIGURE 1.20. CPI INFLATION DURING THE TRANSITION FROM LMIC* TO UMIC* STATUS, ANNUAL AVERAGE (%)



Source: Zimstat, IMF, RBZ, WDI, World Bank.

FIGURE 1.21. SOUTH SUDAN POUND/US$ (OFFICIAL AND PARALLEL EXCHANGE RATES)



Source: Bank of South Sudan.

17 The 25 countries were: Albania, Algeria, Angola, Armenia, Azerbaijan, Belarus, Botswana, Bulgaria, China, Cuba, Georgia, Guyana, Indonesia, Iran, Islamic Republic, Iraq, Kazakhstan, Kosovo, the Maldives, the Marshal Islands, Moldova, Namibia, North Macedonia, Suriname, and Turkmenistan. These countries transitioned from LIC to LMIC* and then to UMIC* without going back to a lower income category. The group of these countries is shown as LMIC* and UMIC* as they are subsets of LMICs and UMICs.

18 A few countries have made rapid and identifiable adjustments to their exchange rate ("big bang"), such as Myanmar in 2012. Others have taken a gradual and more sustained change to the exchange rate, such as Azerbaijan, Kazakhstan, and Uzbekistan.

For example, South Sudan[19] —where parallel market premia expanded significantly—recently managed to achieve convergence of its official and parallel market exchange rates (Figure 1.21) by allowing banks to sell foreign currency at market rates and gradually adjusting the official exchange rate as part of an IMF Staff Monitored Program.[20] To improve exchange rate stability in Zimbabwe, the IMF recommended phasing out forex restrictions and multiple currency practices as soon as conditions permitted (IMF, 2022).

Lessons from macroeconomic stabilization programs implemented in other countries point to the need for strong political commitment for reforms, the systematic implementation of the reform agenda, and the forceful removal of structural and institutional constraints to growth. Political commitment is critical to ensuring support for difficult reforms that require disposing of all sources of rent-seeking revenues. The systematic implementation of disinflation policies has proven to be more effective if embedded in a comprehensive program of structural transformation that removes economic distortions and impediments to growth.

Strengthening institutions

Countries transitioning to UMIC status made significant reforms to strengthen institutions and thus expedite rapid economic growth. Institutional reforms in countries transitioning from LMIC to UMIC status focused mainly on strengthening voice and accountability, the rule of law, regulatory quality, and government effectiveness (Figure 1.22), all areas that saw the greatest improvements since the start of the transition (from LIC to LMIC status).

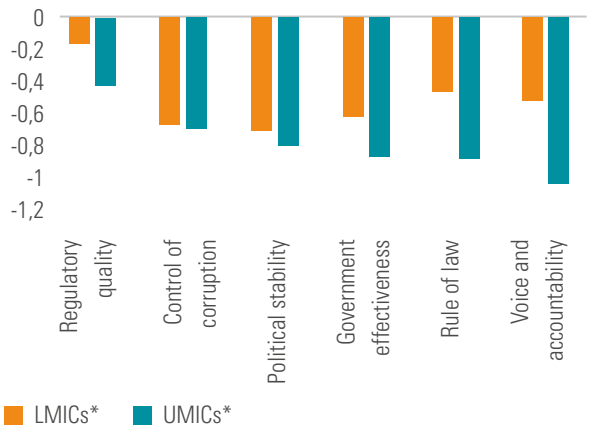
Zimbabwe fares well on political stability and corruption compared with the 25 transition countries, both at the start of the transition (LMIC*) and at the end of the transition (UMIC*). However, significant gaps exist with LMIC* and UMIC* in voice and accountability, the rule of law, and government effectiveness (Figure 1.23), areas where Zimbabwe would need to focus on its transition to UMIC.

Strengthening voice and accountability is a key priority for the country. Voice and accountability involve several aspects including the extent to which a country's citizens can participate in selecting their government, as well as freedom of expression, freedom of association, and a free media. A key element of voice and accountability within Zimbabwe would be to increase the transparency of government decision-making, by improving the transparency of public statistics and the public's access to them. This would require enhancing the quality and accessibility of overall national statistics, including public finances, monetary accounts, and national accounts, along with socioeconomic data. In this regard, the GoZ has sought to improve transparency of public accounts, with the regular publication of budget plans and implementation reports, improving the quality of budget and debt reporting, including on fiscal risks, as well as engaging in broad public discussions on budget plans. However, there is still limited information on public bodies, such as RBZ and SOEs, a large portion of the budget is spent without Parliamentary approval, and national accounts are published with significant delays.

Improving the rule of law in Zimbabwe in conjunction with other policies would be necessary to encourage investment. Ensuring robust rule of law would require

FIGURE 1.22. IMPROVEMENTS IN GOVERNANCE INDICATORS IN COUNTRIES TRANSITIONING FROM LMIC* TO UMIC*, POINTS

FIGURE 1.23. ZIMBABWE AND PEERS: DISTANCE BETWEEN LMICS* AND UMICS*, POINTS



Source: Worldwide governance indicators, World Bank.

[19] South Sudan is not among the countries that transitioned from LMICs* to UMICs* but offers recent experience with unifying exchange rates.

[20] IMF, the Republic of South Sudan, First Review under the Staff Monitored Program, November 2021.

strengthening contract enforcement, property rights, and the courts, as well as addressing crime and violence. More specifically, establishing secure and stable property rights and bankable 99-year land leases would stimulate and encourage investors to accumulate and innovate.[21]

Enhancing government effectiveness would require strengthening the quality of public services, the quality of policy formulation, and the credibility of the Government's commitment to these policies. While Zimbabwe has good coverage of education and health services, the coverage and quality of electricity, and water and sanitation services are well below the levels in comparator countries. Tackling PFM reforms will be necessary to enhance the effectiveness of government policies and spending. Such reforms include improving revenue and expenditure forecasting, integrating medium-term budget plans within the budget process, and improved parliamentary oversight of budget execution. In addition, making RBZ independent will help ensure a tight monetary policy in the long term and eliminate QFAs. Similarly, strengthening the debt management office will enable better integration with the budget process, increase the transparency of debt, and enable the implementation of an effective debt-restructuring strategy.

Advancing structural transformation

Countries that transitioned from LMIC to UMIC status saw significant structural transformation. These countries managed to reallocate employment from the agriculture sector to industry and services (Figure 1.25), reducing employment in agriculture on average by almost 7 percentage points, as they converged to higher levels of incomes. While most of the labor from agriculture shifted to services, the share of industry in gross value added improved in most of the countries (Figure 1.26). Supported by a stable macroeconomic environment and improved business regulations, investment levels in these countries averaged 27 percent during the transition period. Firms increasingly moved into the formal sector, where the number of quality jobs is much higher and there is a better return to education. Also, firms increasingly started competing globally, exporting more diverse and higher value-added products, and integrating into global value chains (GVCs).

Reallocating resources from sectors with low productivity to sectors with higher productivity will support the productivity improvements needed by Zimbabwe to achieve its UMIC aspirations. The structure of the economy seems to be comparable to those of countries that transitioned to UMIC status in terms of value added, but there are stark differences in terms of employment (Figure 1.24). Most of Zimbabwe's employment is in agriculture, remaining at nearly two-thirds of employment over the past decade. At the same time, the share of employment in industry has shrunk by half since 1991. First, to align employment levels to those of UMICs, Zimbabwe will need to improve the resilience of the agriculture sector (particularly during droughts), so that resources can be reallocated to other sectors. Improving resilience will require policy reforms to improve security of land tenure to create conditions for private sector investment in irrigation and modern equipment, as well as foster the skills of farmers to adapt to climate change (World Bank, 2019a). Second, it will be necessary to ensure a conducive environment for private sector growth and investment to support job creation in industry and services. In such an environment, firms and individuals will have equal access to foreign exchange and financial resources, prices will be stable, regulations will be rationalized, and SOEs will be restructured to eliminate economic distortions. This business environment will facilitate the FDI that is vital for boosting high value-added sectors and activities.

FIGURE 1.24. EMPLOYMENT BY SECTOR (% OF TOTAL)

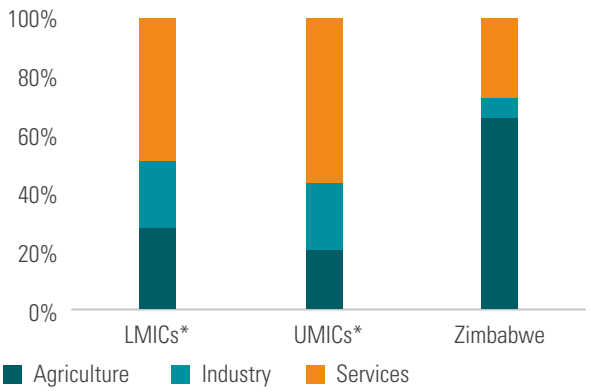
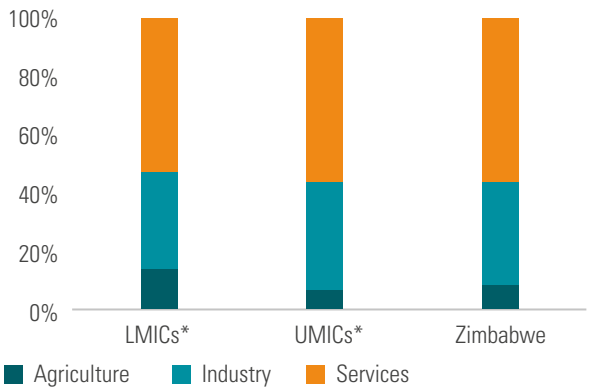


FIGURE 1.25. GROSS VALUE ADDED BY SECTOR (% OF GDP)



Source: WDI, World Bank.

[21] North and Thomas (1973) and North and Weingast (1989) discovered that secure property rights were a critical element of economic development among the advanced economies.

Reducing the size of Zimbabwe's informal sector will encourage competition and growth, and support structural transformation sought by the NDS1. As detailed in Chapter 3, achieving this will require improving the business environment for the formal sector, including start-up and business-running requirements, and providing support to enterprises. The implementation of greater digitalization should be used to simplify and improve the operating experience of businesses.

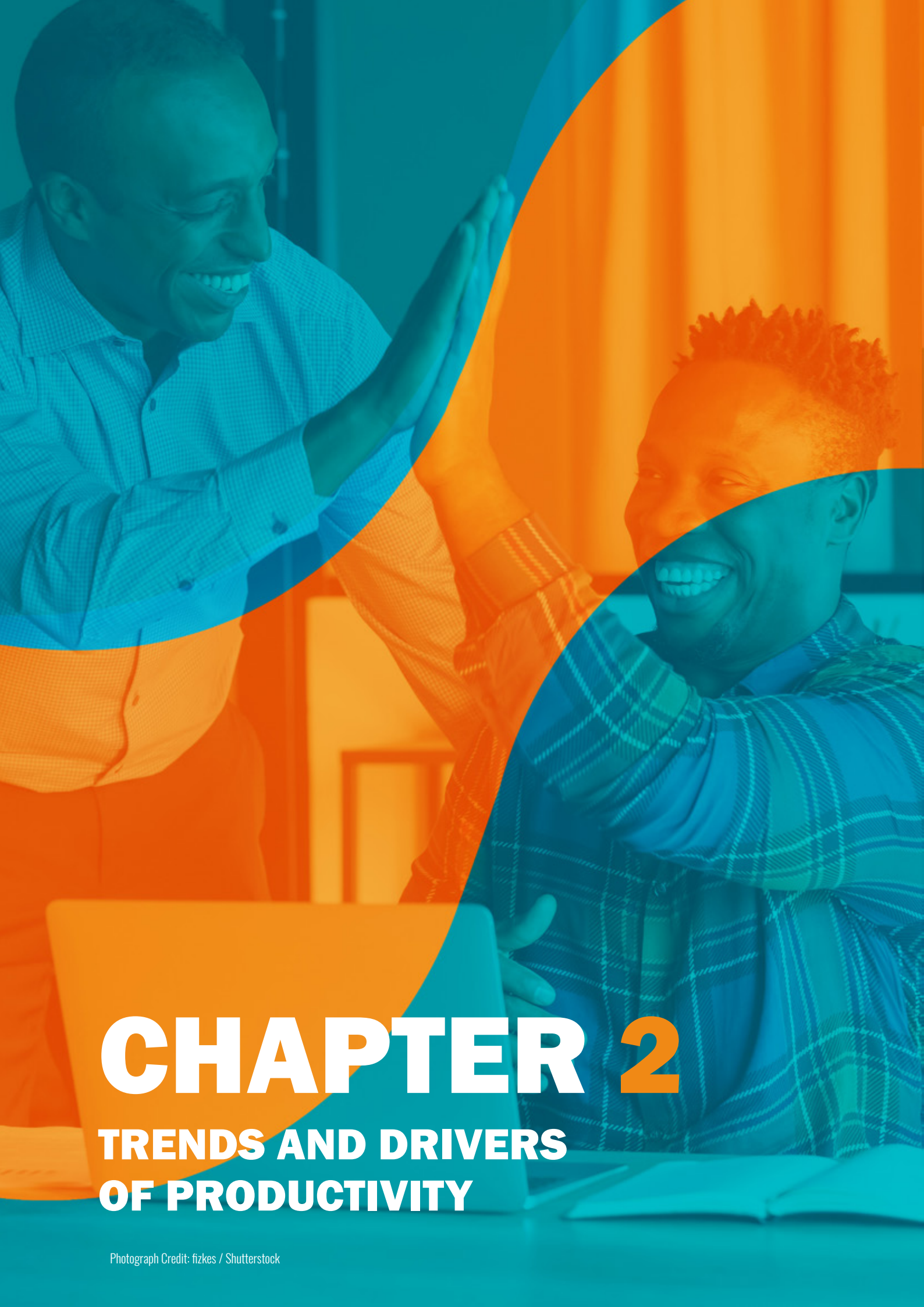
Finally, a significant expansion and diversification of trade will be required to accelerate economic growth and support structural transformation of the economy. As a small, open economy, an expansion of trade is required to enable substantial economic growth. Moreover, trade diversification will enable greater resilience for the economy to shocks. Achieving this means reducing price and exchange rate distortions, improving the business environment, ensuring further trade liberalization and integration, and nurturing the digital transformation.

4. Conclusion

Zimbabwe's growth challenge is significant if it is to achieve the income convergence sought by the Government's 2030 Vision. Achieving UMIC status is possible, even if it takes longer than initially planned, but it will require a monumental policy effort over a prolonged period of time, beyond the policy agenda outlined in the NDS. Building on its strong economic foundations—excellent human capital, rich resources, and recent policy reforms—Zimbabwe could design and implement an economic development strategy that addresses the key constraints to economic growth, such as macroeconomic instability, institutional weaknesses, and limited structural transformation.

Lessons from other countries that have converged with UMIC status show that addressing these key constraints has a high payoff in terms of improved productivity and ultimately better living standards. Macroeconomic stabilization programs that removed price and exchange rate distortions, and created conditions for productivity-enhancing investments, were at the center of reforms that made possible transition to UMIC status. The successful implementation of these programs was linked to the quality of institutions that ensured a level playing field for private sector-led growth and enhanced the efficient allocation of labor and capital across sectors and firms. Macroeconomic stability and better institutions have maximized the contribution of structural transformation on productivity. Chapter 2 discusses in more detail the drivers and pathways to improve productivity in Zimbabwe. Chapters 3 proposes ways to reduce the productivity gap between formal and informal firms and encourage a shift of toward the formal sector, while Chapter 4 proposes ways to boost productivity of the formal sector by expanding tradeable activities.

Photograph Credit: alphaspirit.it / Shutterstock



CHAPTER 2

TRENDS AND DRIVERS OF PRODUCTIVITY

Photograph Credit: fizkes / Shutterstock

1. Introduction

Productivity is the ultimate driver of economic growth and improvements in living standards. Raising productivity is at the center of policy discussions in developing and developed countries alike. As Paul Krugman (1994) succinctly put it, "Productivity isn't everything, but, in the long run, it is almost everything. A country's ability to improve its standard of living over time depends almost entirely on its ability to raise its output per worker." There is a consensus in the development literature that a large part of the cross-country per capita income gap is explained by differences in total factor productivity (TFP) rather than physical and human capital (Hall and Jones, 1999). Recent studies show that the inefficient use of factors of production driven by policy-induced distortion explains low TFP in developing countries (Hsieh and Klenow, 2009).

Accelerating productivity is critical for Zimbabwe to meet its goal of becoming a UMIC. Elevating and sustaining high growth rates will require addressing Zimbabwe's productivity challenge. Increasing productivity growth to around 8–9 percent per year (Chapter 1) will be needed if Zimbabwe is to reach its growth objectives within the planned period. So far, productivity convergence has been low (Kindberg-Hanlon and Okou, 2020), which is in stark contrast with the country's potential.

This chapter assembles the best available evidence to analyze the trends and drivers of productivity at the macro, sector, and firm levels. It begins with an overview of Zimbabwe's aggregate productivity trends since the 1990s. It then analyzes productivity patterns at the sector and firm levels and explores the constraints that hold back productivity growth in the formal sector, to guide the design of productivity-enhancing policies.

2. Overall Productivity Trends

Zimbabwe's labor productivity[22] and TFP[23] levels have improved, except for the recent years interrupted by the policy missteps, climate shocks and the COVID-19 pandemic. Following nearly a decade of negative productivity growth between 2000 and 2009 due to recession, labor productivity was boosted by macroeconomic stabilization and advancement of key reforms. Average productivity growth increased to 5.7 percent during the 2010–18, as it responded to a boom that was experienced soon after dollarization (Figure 2.1).[24] More specifically, TFP growth has been weaker than labor productivity due to the misallocation of resources and stable human capital growth to labor productivity: TFP growth reached a record of 3.8 percent on average in the period 2010–18. Both labor productivity and TFP declined during the 2019–20 recession, reflecting the impact of natural disasters and the pandemic.

Despite recent improvements, however, Zimbabwe's labor productivity level falls well short of SSA (LMIC) and UMICs. Despite the improvement of labor productivity in the first half of 2010s during the boom, Zimbabwe's productivity has been well below both its LMIC peers in SSA and its aspirational UMIC peers (Figure 2.2). In the recent years, labor productivity in Zimbabwe was almost one-tenth that of the average for UMICs.

FIGURE 2.1. LABOR PRODUCTIVITY GROWTH AND TFP GROWTH IN ZIMBABWE, 1990–2020

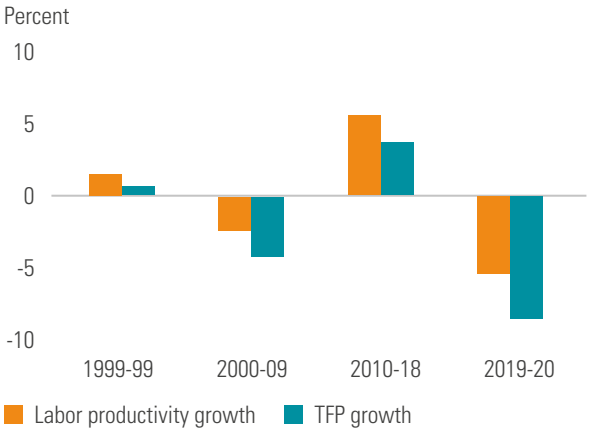
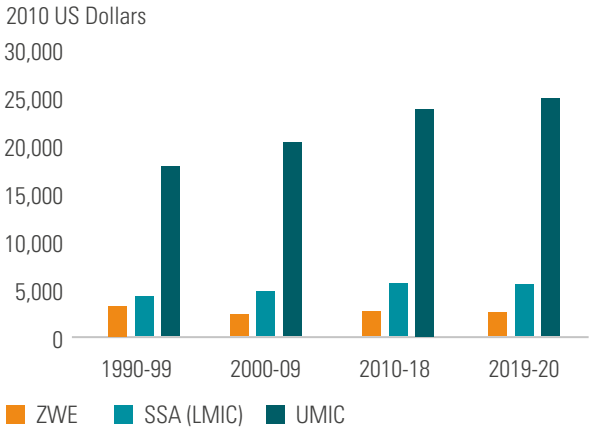


FIGURE 2.2. LABOR PRODUCTIVITY LEVEL IN ZIMBABWE COMPARED WITH SSA (LMICs) AND UMICs



Source: World Bank.
Note: SSA (LMIC) is the GDP-weighted average of 10 LMICs in the SSA region. UMIC is the GDP-weighted average of 25 upper middle-income countries.

22 Measured as GDP in constant (2010) US dollars divided by number of employed people in the country.

23 TFP growth as a residual as measured here both reflects both the true "technical efficiency" and demand components including capacity utilization together with business and commodity price cycles. Therefore, TFP in this analysis might follow business-cycle more closely than the "true" measure of TFP (Basu et al., 2006) and interpretation of the results should be taken with a grain of salt considering the importance of these demand factors.

24 Decline in investment affects both capital deepening (directly) and TFP growth (indirectly), both of which are the components of labor productivity growth.

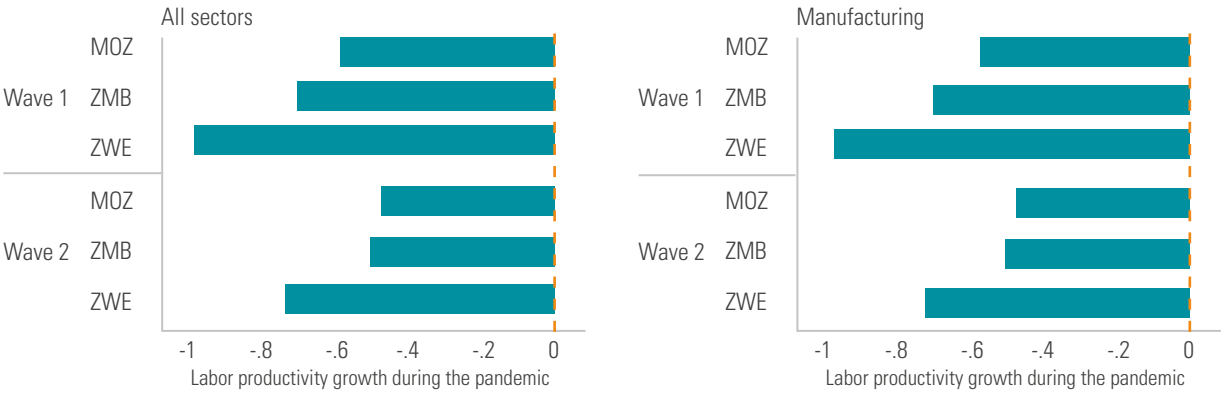
The COVID-19 pandemic further exacerbated Zimbabwe's weak productivity performance at the firm level. The COVID-19 pandemic negatively impacted Zimbabwe's economy more than peer countries in SSA. Stricter lockdown rules helped to contain the pandemic, but significantly disrupted private sector activity. As a result, almost all firms in Zimbabwe experienced large declines in labor productivity growth compared with pre-pandemic levels. This productivity decline was larger than peers in SSA (Figure 2.3), reflecting an economy that was already weak before the pandemic.

3. Sectoral Productivity Trends

There is a significant misallocation of resources between sectors and limited structural transformation at the sectoral level. Considerable labor and capital are allocated to the agriculture sector, despite productivity being the lowest. Experiences from other countries, particularly in East Asia, reveal that the shift of labor from agriculture into the higher-productivity manufacturing and services sectors was a major contributor to rapid productivity growth (Helble et al., 2019). While productivity has improved in the manufacturing and services sectors in Zimbabwe, this has not translated into a significant expansion of these sectors or an increase in formal employment.

Agriculture has been a drag on overall productivity levels in Zimbabwe, despite significant government intervention. Government interventions to support agriculture may also slow economic transformation and diversification of the productive base. Since the start of the land reform program in the early 2000s, the GoZ has supported agriculture through various input schemes, with the latest being command agriculture and presidential input schemes (World Bank, 2020a). However, inefficient use of land and inputs, coupled with limited irrigation, has resulted in low crop yields (Calderón, 2022). Compared with industry, agricultural labor productivity growth increased only marginally by 4.7 percent per year on average over the period of 2010–18 after contracting by 8.5 percent during the recession period (Figure 2.4). Consequently, Zimbabwe's agricultural productivity has fallen behind that of its peers (Figure 2.5). Given the agriculture sector's large share of employment, this has lowered aggregate labor productivity. It is therefore imperative that Zimbabwe

FIGURE 2.3. PRODUCTIVITY DECLINED SHARPLY IN ZIMBABWE RELATIVE TO PEERS DUE TO THE PANDEMIC



Source: World Bank staff calculations based on World Bank Enterprise Survey COVID-19 follow-up surveys.
Note: Firm-level labor productivity growth is defined as the difference between sales and employment growth.

FIGURE 2.4. LABOR PRODUCTIVITY LEVEL ACROSS SECTORS IN ZIMBABWE, 1992–2018

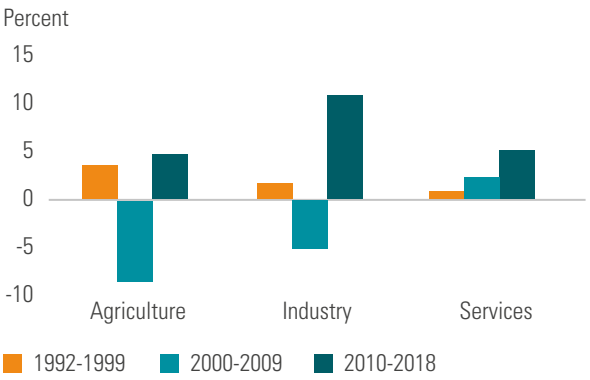
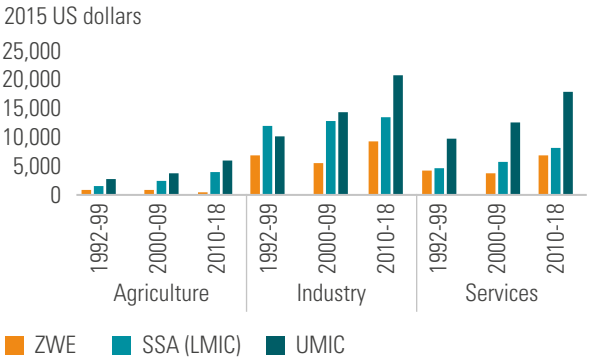


FIGURE 2.5. LABOR PRODUCTIVITY LEVEL IN ZIMBABWE ACROSS SECTORS COMPARED WITH SSA (LMICs) AND UMICs



Source: World Development Indicators, World Bank.
Note: SSA (LMIC) is GDP weighted average of 11 LMICs in the SSA region excluding Zimbabwe. UMIC is GDP weighted average of 31 upper middle-income countries excluding Argentina. Argentina is excluded since it was an outlier among other UMICs.

improves its agricultural productivity through policies to enhance the competitiveness of the sector, as raising productivity in this sector is key to boosting employment in other sectors, raising overall productivity, and reducing poverty. The modernization of agriculture might also help with structural transformation of the country by creating opportunities for diversified agricultural products. As an example, Vietnam increased agricultural productivity through targeted measures that improved infrastructure for the sector, ensuring secure land tenure and promoting access to finance (Dieppe, 2021).

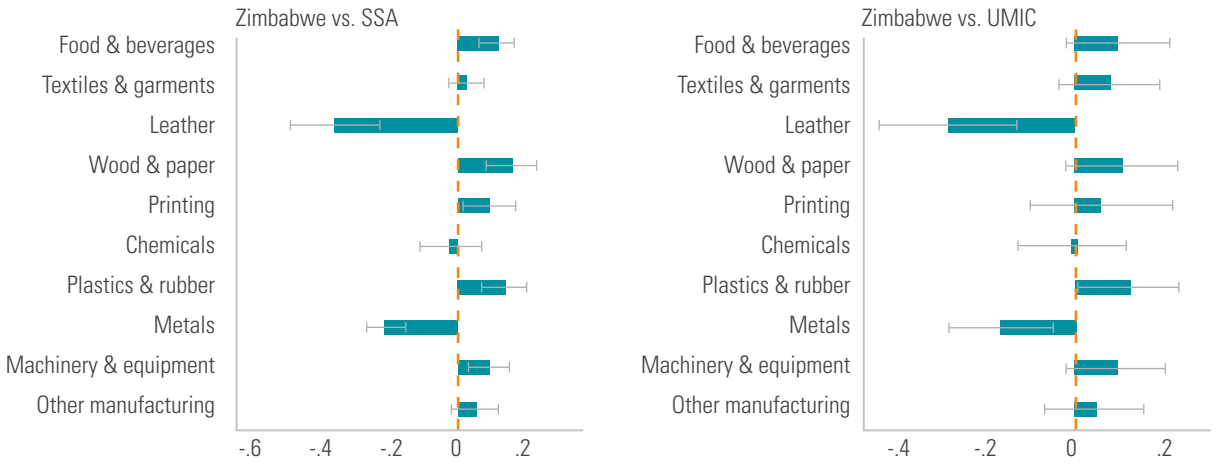
Industry could potentially support productivity convergence to SSA (LMICs) levels. Labor productivity in the industrial sector has increased by 11 percent per year on average since 2010 (Figure 2.4), gradually closing the productivity gaps with LMICs in the SSA region. Despite this growth it is still well below levels of regional peers in SSA (LMICs) and aspirational peers (UMICs). During 2010–14, productivity levels of industry in Zimbabwe achieved 17.9 percent annual growth. Since then, however, productivity growth has slowed, with nearly two-thirds of formal industrial jobs lost over the past decade and economic complexity reduced. The slowdown in productivity was due to an increasingly complex economic environment.[25] Nevertheless, if economic conditions with appropriate policies improve, the industrial sector has the potential to increase overall productivity and increase participation in GVCs.

Productivity of the services sector has accelerated over the past three decades. Labor productivity in the services sector in Zimbabwe declined during the recession period and increased by 72.3 percent cumulatively during the period 2010–18. This improvement in labor productivity has helped Zimbabwe to almost catch up with other peers in the region or LMICs. Following dollarization of the economy in 2009, productivity grew by 9.4 percent per year, before slowing down post-2015. Moving resources from agriculture toward the services sector (especially to high value-added services) would increase aggregate productivity. Country evidence shows that productivity growth in the services sector was the main source of overall productivity growth in emerging market and developing economies (EMDEs) in the period following the global financial crisis, accounting for almost two-thirds of overall productivity growth (Dieppe, 2021).

4. Productivity of Formal Firms

Zimbabwe has the potential to boost productivity growth due to a well-educated and skilled labor force. Production workers in Zimbabwean manufacturing firms are more skilled on average than workers in firms in comparator countries in most subsectors, with the exception of leather and metals (Figure 2.6). In fact, only 6 percent of surveyed firms in Zimbabwe identified an inadequately educated workforce as a major constraint, compared with 16 percent in other SSA countries. The results are supported by the Zimbabwe Human Capital Index (HCI) at 0.47, which is above the SSA average and similar to the level of average UMICs. Zimbabwe's excellent human capital is due to the GoZ's education policy. After independence, education was made more affordable and access was widened. By 1990, the country had virtually met the original Education-for-All (EFA) target of universal primary access and is ranked among those countries in Africa with the highest adult literacy rates (World Bank, 2022).

FIGURE 2.6. ZIMBABWE'S MANUFACTURING FIRMS HAVE A LARGER SHARE OF SKILLED PRODUCTION WORKERS IN MOST SUBSECTORS



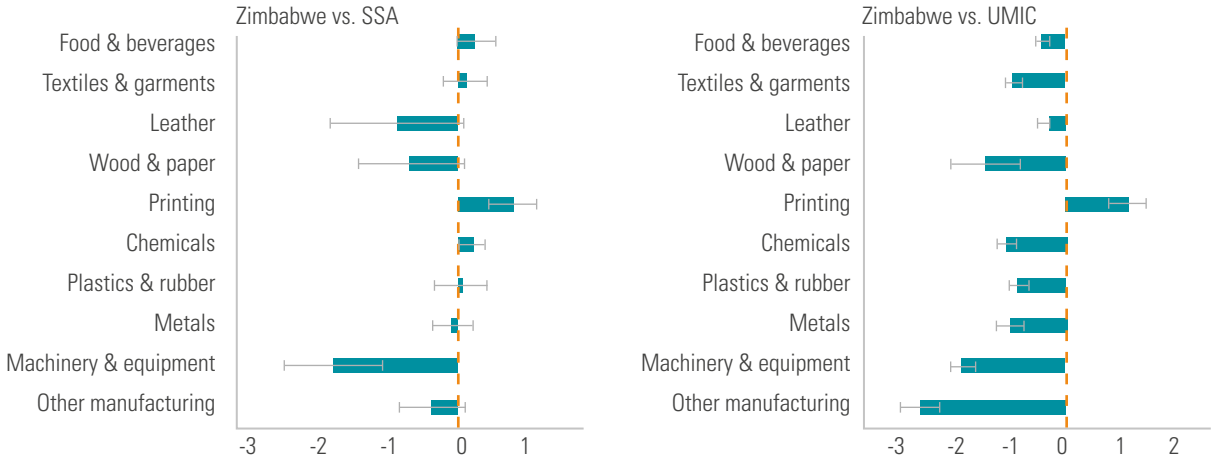
Source: World Bank staff calculations based on the World Bank Enterprise Surveys. Surveys for Zimbabwe were conducted in 2016. A positive number indicates higher share of skilled workers in Zimbabwe relative to comparators.

[25] A complex environment was caused by an overvalued local currency, restrictions to repatriate profits abroad and to pay suppliers, exchange rate policies (blocked funds), higher monetary financing that crowded out investment to the private sector, slow improvements in doing business reforms.

However, productivity in Zimbabwe's formal manufacturing lags that of aspirational comparators (Figure 2.7). Zimbabwe is on a par with its SSA peers in terms of manufacturing productivity in most subsectors. Productivity among Zimbabwean manufacturers is above regional peers in a few subsectors, such as food and chemicals, but behind the UMIC average in all subsectors except printing. The productivity gap with UMICs is more pronounced in skills-intensive and capital-intensive subsectors such as manufacturing of machinery and equipment. Accelerating productivity growth in the formal manufacturing sector is imperative, especially in skills-intensive subsectors where Zimbabwe has untapped potential. However, boosting the productivity of capital-intensive subsectors will require attracting greater FDI and opening the economy up to greater global competition.

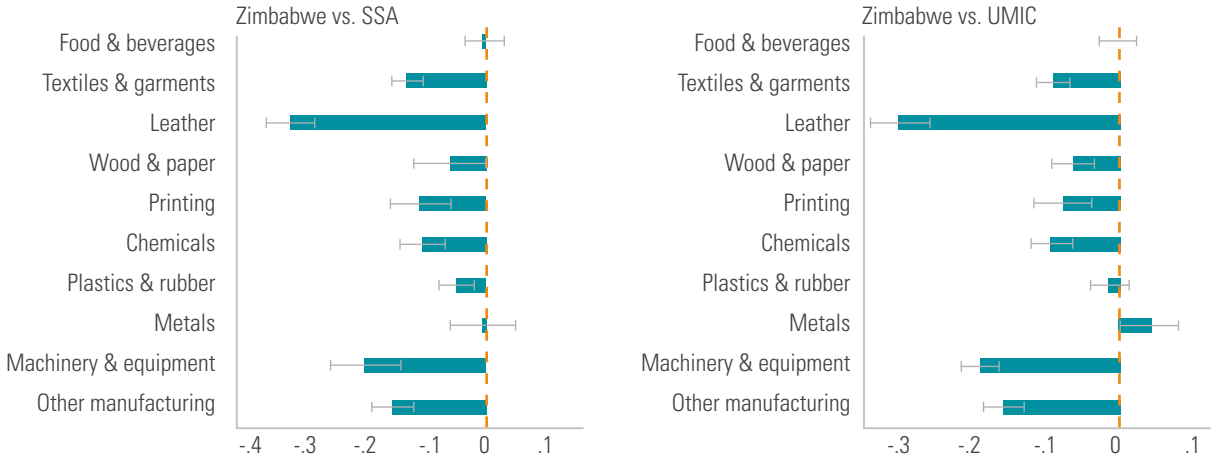
Improving firms' productivity is central to Zimbabwe's commitment to generating more jobs, including expanding the number of high-quality jobs. Low productivity growth has meant that the formal sector has experienced lower employment growth rates than its peers in most subsectors (Figure 2.8). The relative decline in employment growth was most severe in the leather, and machinery and equipment subsectors, where productivity gaps are more pronounced. Creating more and better jobs in the formal sector requires policies that promote productivity growth.

FIGURE 2.7. THE PRODUCTIVITY GAP RELATIVE TO UMICs IS MORE PRONOUNCED IN SKILLS- AND CAPITAL-INTENSIVE SUBSECTORS



Source: World Bank staff calculations based on the World Bank Enterprise Surveys. Surveys for Zimbabwe were conducted in 2016.
Note: The figure shows the point estimates with the corresponding 95 percent confidence intervals from regressing log of firm-level revenue-based total factor productivity (TFPR) on an indicator of whether the firm in Zimbabwe interacted with sectors, controlling for sector and year fixed effects. A negative number indicates lower productivity of Zimbabwean firms compared with the comparators.

FIGURE 2.8. FIRMS IN ZIMBABWE EXPERIENCED A LOWER EMPLOYMENT GROWTH RATE THAN THOSE IN COMPARATOR COUNTRIES



Source: World Bank staff calculations based on the World Bank Enterprise Surveys. Surveys for Zimbabwe were conducted in 2016.
Note: This is annualized growth rate in employment over a three-year period. The negative coefficients indicate a disproportional decline in employment growth in Zimbabwe relative to regional peers and aspirational comparators.

5. Drivers of Firms' Productivity

Zimbabwe's relatively weak productivity performance is due to several factors. This section uses the World Bank Enterprise Surveys (WBES), complemented by data from other sources, to explore the main determinants behind Zimbabwe's lackluster productivity performance. Formal firms face several business environment constraints that limit productivity. Firm-level analysis shows that Zimbabwe underperforms comparators on many business environment indicators, including limited funding to finance new investments, infrastructure gaps, and resource misallocation. Much of the productivity challenge in Zimbabwe can be traced to a weak business environment for firms.

5.1. Lack of productivity-enhancing investment

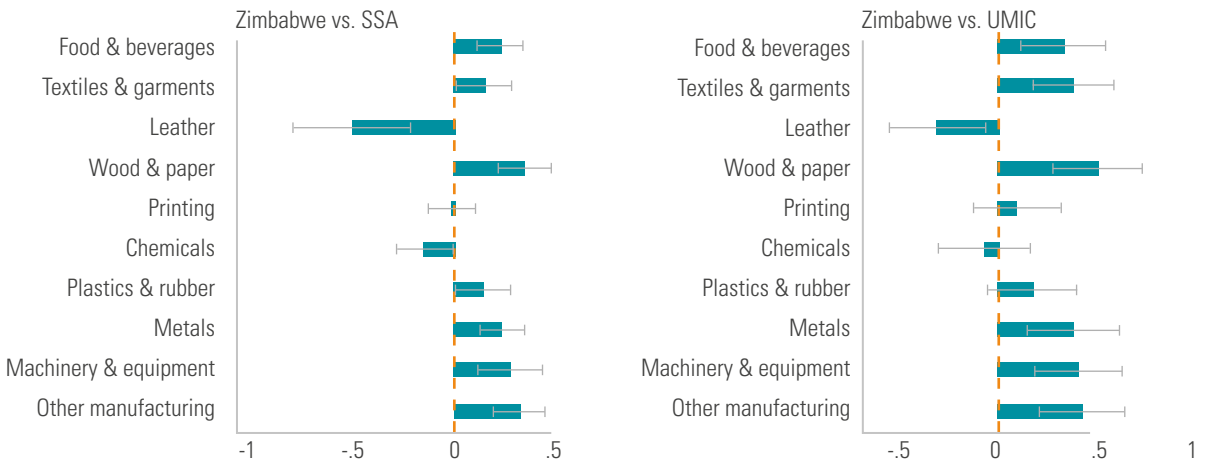
The macroeconomic and policy environments in Zimbabwe undermine productivity-enhancing investment by private firms. Macroeconomic challenges and the misallocation of resources have lowered potential investment. As described in Chapter 1, price and exchange rate volatility have disincentivized domestic and foreign investment, resulting in capital controls deterring FDI and borrowing from abroad. Similarly, access to finance is a longstanding challenge for Zimbabwe. Most credit was directed to the agriculture sector (Chapter 1) and sectors with low productivity levels, while most manufacturing firms remained financially constrained (Figure 2.9). On average, formal firms in Zimbabwe tend to be more financially constrained and less able to make a productive-enhancing investment than firms in peer countries, particularly in capital-intensive sectors (Figure 2.9). Underinvestment in capital-intensive subsectors such as metals, where Zimbabwe has a comparative advantage, and inefficient investment in high-skilled sectors contribute to low TFP of formal manufacturing firms, resulting in the use of obsolete technology in most subsectors. Mining firms have the potential to attract significant FDI to modernize production and beneficiation. However, difficulties in repatriating profits due to macroeconomic conditions and deficiencies in the mineral legislation and mining cadaster have prevented large-scale investment from abroad. In an increasingly competitive environment, Zimbabwe's ability to compete successfully in both domestic and foreign markets requires upgrading and modernizing equipment and technologies.

The COVID-19 pandemic has placed additional pressure on the financial well-being of Zimbabwean formal firms. About 90 percent of firms faced liquidity or cash flow shortages due to the pandemic. Firms required access to finance to overcome deteriorating liquidity and weather the shock. Easing financial conditions will be essential in raising firms' incentives to invest in productivity-enhancing activities.

5.2. Misallocation of resources across firms

Inefficient allocation of productive resources across firms within a sector also drives weak productivity performance. Policies that create distortions lead to a sub-optimal allocation of resources across firms thereby reducing aggregate productivity by discouraging the entry of new potentially productive firms, force productive firms to exit, and allow the survival of less competitive firms (for instance, through subsidized loans/foreign exchange). For example, forex surrender requirements for exporters, coupled with a sizeable parallel market premium in Zimbabwe, could lead to a misallocation of resources across firms and lower overall productivity by allocating resources from more productive exporters to less productive non-exporting firms. This could force incumbent exporters to exit the export market and operate locally, discouraging the entry of new potentially productive firms into the export market.

FIGURE 2.9. ZIMBABWEAN FIRMS ARE MORE FINANCIALLY CONSTRAINED THAN THEIR REGIONAL PEERS AND UMICs

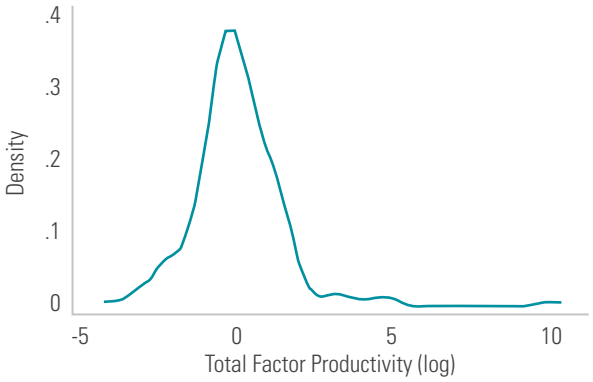


Source: World Bank staff calculations based on the WBES. Surveys for Zimbabwe were conducted in 2016.
Note: Financially constrained firms are those that applied for a loan but were rejected (partially or fully) and those that did not apply for reasons other than having sufficient internal funds (e.g., expected to be refused). A positive number indicates that Zimbabwean firms are more financially constrained compared with its peers.

The misallocation of resources across firms is due to several factors, including credit market distortions, uneven implementation of regulations, price controls, and preferential tax treatment. Recent studies show that the prevalence of politically connected firms lowers aggregate productivity growth by limiting efficient resource allocation. For example, misallocation can be driven by political interference in credit allocation, whereby banks can direct disproportionate amounts of credit to politically connected firms. Khwaja and Mian (2005) show that politically connected firms in Pakistan had greater access to credit (borrowed 45 percent more) and had higher loan default rates (50 percent higher) than non-connected firms, with politically connected firms obtaining exclusive loans from government-owned banks. Another example is the practice of 'zombie' lending in Japan after its financial crisis. This allowed the survival of less competitive firms that would normally have ceased to operate in a competitive market but were kept alive by state support through subsidized loans (Caballero et al., 2008).

Regulations may also protect the interests of politically connected firms. Recent studies using firm-level data show that regulatory barriers to the entry of new firms have been used to protect politically connected incumbents. For example, in Tunisia, during the regime of Ben Ali, an entry regulation was used to shield businesses controlled by the ruling clan from competition (Rijkers, Freund, and Nucifora, 2017). They show that, in more regulated sectors, the gap in profits between connected firms and others is significant. Because of the entry regulation, the mix of firms in the economy was distorted, with inefficient, politically connected firms crowding out more productive firms.

FIGURE 2.10. PRODUCTIVITY DISPERSION ACROSS ZIMBABWEAN FIRMS TENDS TO BE LARGE



Source: World Bank staff calculations based on the WBES data.
Note: Productivity is computed for each firm relative to the four-digit industry average. In the absence of any distortion, the marginal products of each input should be equalized across firms within the four-digit sector.

There is a considerable level of resource misallocation in Zimbabwe, measured by the dispersion of marginal products of inputs across firms. The dispersion in total factor productivity revenue (TFPR) in Zimbabwe is considerable (Figure 2.10). A firm in the 90th percentile of the TFPR distribution is more than 20 times more productive than a firm in the 10th percentile. Inefficient allocation of resources across firms is one of the reasons behind these differences. This suggests that the scope for improving manufacturing productivity by removing distortions that prevent the efficient allocation of resources is significant.

Productivity dispersion could also reflect a poor natural selection process, whereby low productivity firms remain in production and the most productive ones are forced to exit the market. Lack of panel data limits the effort to account for distortions along the entry and exit margins. Zimbabwean firms are almost twice as old as those in other SSA and low-income countries (22 years compared with 15 years in SSA and 12 years in LICs). This could reflect the fact that entry into the formal sector has become less attractive. While Zimbabwe has taken some steps to ease the entry of new firms, including improving online name searches, reducing the Harare Municipality business licensing fee, and the time needed to obtain a business license, the regulatory framework for the entry of new firms remains cumbersome.

There is substantial scope for improving the productivity of the formal manufacturing sector in Zimbabwe by removing firm-specific distortions. Improving manufacturing productivity requires removing or reducing the underlying frictions that prevent the efficient allocation of resources toward more productive producers. Counterfactual evidence suggests that the GoZ can improve manufacturing productivity by at least 200 percent if resources are allocated efficiently.[26]

5.3. High cost of production

Another possible explanation for low TFP is low-capacity utilization, increasing the cost of production. Most Zimbabwean firms operate below their full capacity, with an average utilization of manufacturing capacity of below 50 percent. Capacity utilization in the Zimbabwean manufacturing sector is smaller than in SSA and among UMICs in almost all sectors (Figure 2.11). Several factors may have forced Zimbabwean manufacturers to operate below their full capacity, including uneven access to foreign currency, inflation, financing or working capital issues,

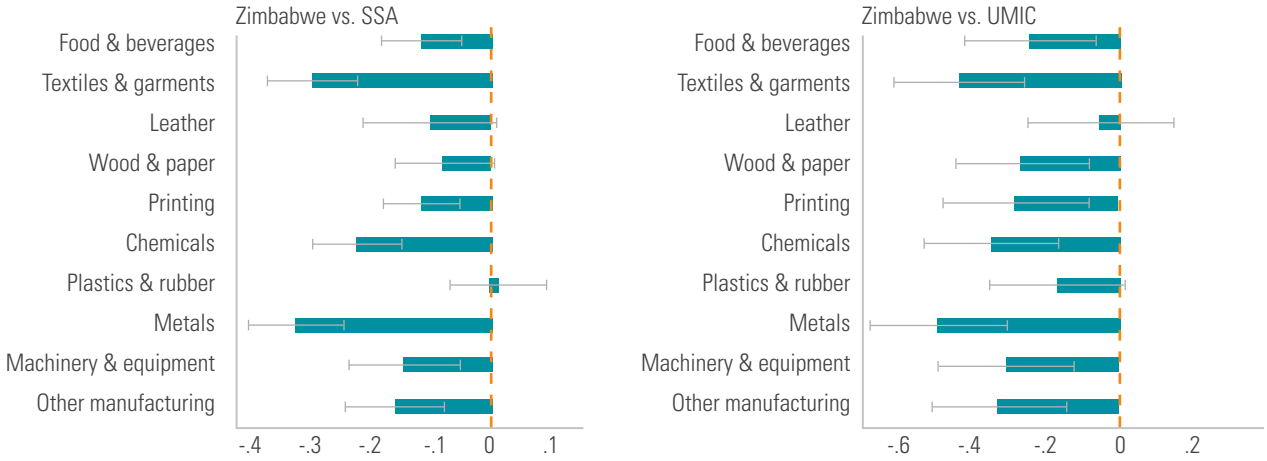
[26] The potential TFP gains are calculated using a framework developed by Hsieh and Klenow (2009). The counterfactual exercise focuses on productivity gains from removing distortions within an industry, abstracting from aggregate TFP gains associated with the reversal of distortions between sectors. Aggregate productivity could be improved further through more efficient allocation of resources across sectors.

obsolete equipment, transport challenges, and water and power shortages (CZI, 2020). The foreign exchange auction provides access to funding for select firms, estimated at about one-third of imports, but delayed payments to the bidders at the auction force importers to source foreign exchange from the parallel market. The large parallel market premium over the auction rate makes production more costly for most importers that rely on the parallel market.

Limited and uneven connectivity has increased production costs in Zimbabwe relative to its peers. Zimbabwe lags UMICs in the region on many measures of infrastructure quality, including transport, electricity, water, and railroads (Figure 2.12). Underinvestment and the low levels of periodic maintenance are the main reasons for the deterioration in the quality of these assets (AFD, 2019). Many firms are forced to invest in generating electricity or supplying water to survive.

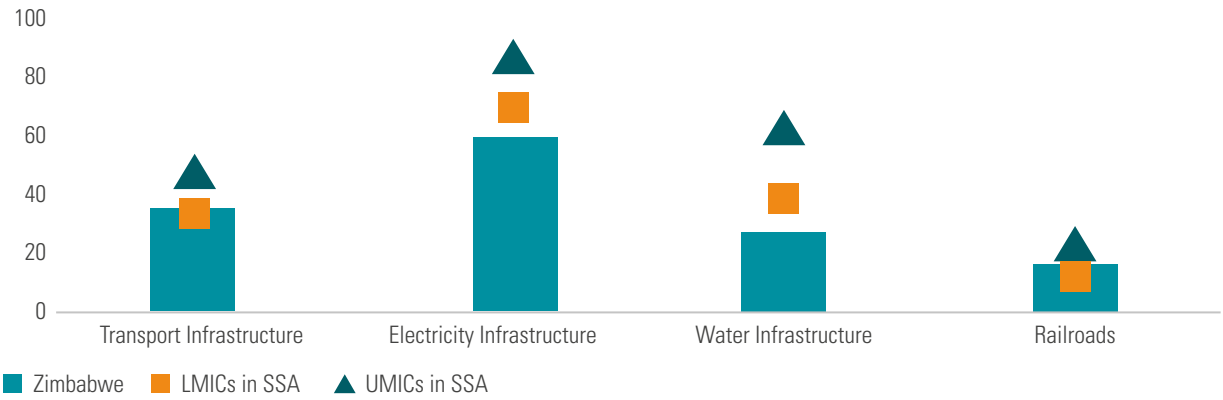
Photograph Credit: Cheryl Khuphe / WorldBank

FIGURE 2.11. CAPACITY UTILIZATION IN THE FORMAL MANUFACTURING SECTOR



Source: World Bank staff calculations based on the WBES. Surveys for Zimbabwe were conducted in 2016.
Note: Productive capacity utilization is defined as the ratio of actual production levels to production levels at full capacity.

FIGURE 2.12. ZIMBABWE LAGS THE UMICs IN THE REGION ON MANY MEASURES OF INFRASTRUCTURE QUALITY



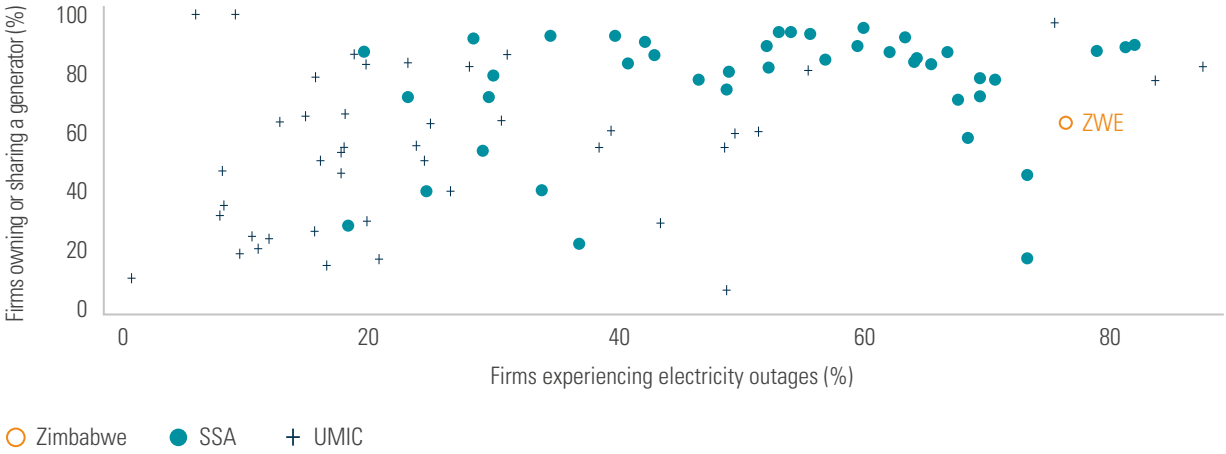
Source: World Economic Forum Global Competitiveness Report.

Inadequate access to electricity and unpredictable outages limit the capacity of formal Zimbabwean firms. More than three-quarters of firms interviewed experience frequent and unpredictable electricity outages, mainly due to aged infrastructure dating back to the 1950s, suffering from underinvestment and a lack of maintenance over the years (AfDB, 2019). Of all the firms interviewed in Zimbabwe, about 60 percent generate their own electricity using generators to insulate themselves from the negative impacts of power outages (Figure 2.13). The cost of self-generated electricity is far higher than the cost of grid electricity, making firms uncompetitive in local and foreign markets. Inadequate access to electricity constrains aggregate productivity in the economy by impeding new firms from entering the modern sector, forcing the exit of more productive firms, and distorting firms' technology decisions, i.e., leading firms to choose less electricity-intensive production processes (Abeberese, 2017). Evidence shows that eliminating power outages leads to a substantial increase in aggregate productivity by shifting entrepreneurs to a more productive modern sector (Fried and Lagakos, 2020).

5.4. Informality

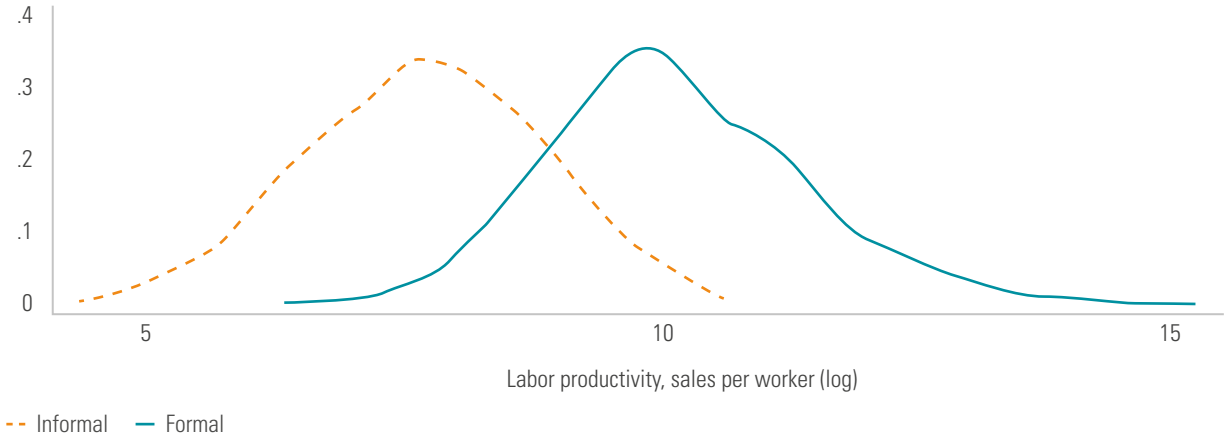
The presence of informal firms drags down overall productivity even further. The potential productivity gain from removing distortions has been abstracted from the gains that might be achieved by reallocating resources between formal and informal firms. Given the enormous productivity gap between formal and informal firms in Zimbabwe (Figure 2.14 and Chapter 3), productivity gains from the reallocation of resources between informal and formal firms are likely to amplify the potential aggregate productivity gains.

FIGURE 2.13. ZIMBABWEAN FIRMS EXPERIENCE FREQUENT POWER OUTAGES



Source: World Bank staff calculations based on the WBES. Surveys for Zimbabwe were conducted in 2016.

FIGURE 2.14. PRODUCTIVITY GAP BETWEEN FORMAL AND INFORMAL FIRMS IN ZIMBABWE

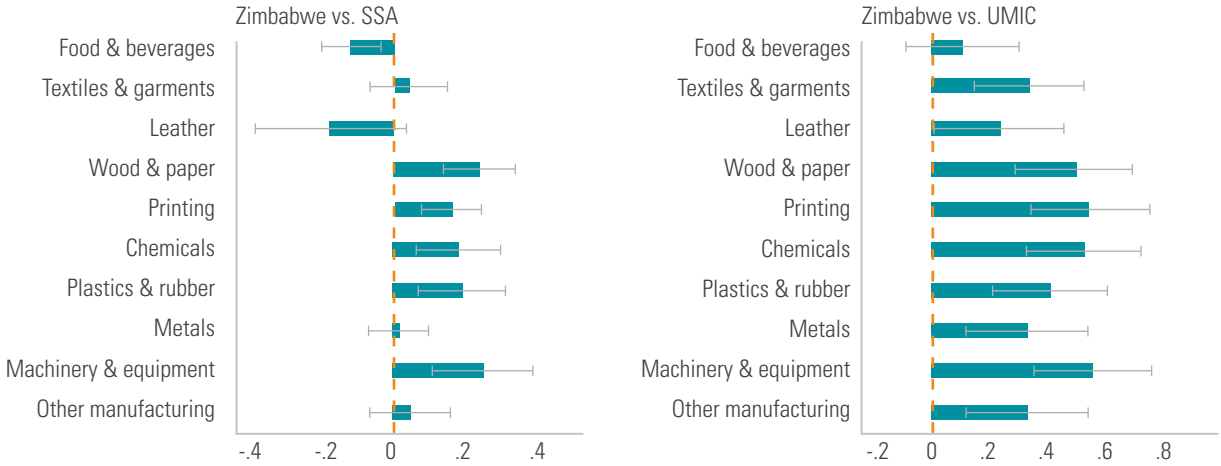


Source: World Bank staff calculations based on the WBES, Microenterprise Surveys (MS), and Informal Sector Business Survey (ISBS).
Note: Since sales for informal businesses are reported as of the last completed month, these sales are multiplied by 12.

Formal firms in Zimbabwe are more likely to face competition from unregistered or informal firms compared with formal firms in other SSA countries (Figure 2.15). While competition from unregistered or informal businesses is common in SSA countries in less capital-intensive sectors, formal Zimbabwean firms tend to face competition from informal firms in more skills-intensive sectors. The practice of the informal sector is the biggest obstacle to business operation in Zimbabwe, by undercutting their formal competitors. More than one-quarter of formal firms identify competition with informal business as the top business constraint.

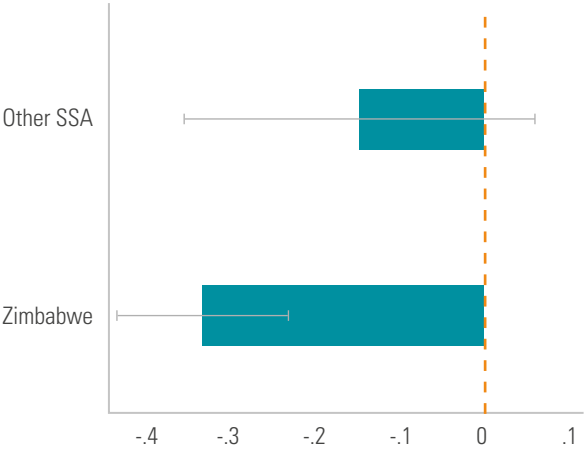
Competition from the informal sector undermines the productivity of formal businesses. Figure 2.16 shows the ordinary least squares (OLS) estimates from regressing firm-level productivity on an indicator of whether firms face competition from unregistered or informal firms, controlling for country-sector-survey year fixed effects. The figure clearly shows that the incidence of informal competition is systematically associated with the lower overall productivity of formal firms in Zimbabwe. Addressing the informality challenge will be critical to improving the overall productivity of the economy. The policy options for tackling the informality challenge are outlined in detail in Chapter 3.

FIGURE 2.15. COMPETITION FROM THE INFORMAL SECTOR IS HIGHER IN ZIMBABWE THAN IN ITS PEERS



Source: World Bank staff calculations based on the WBES.
Note: The figure plots the coefficients and the 95 percent confidence intervals from regression—an indicator of whether the firm faces competition from unregistered or informal firms or not.

FIGURE 2.16. THE PRESENCE OF INFORMAL FIRMS STIFLES THE PRODUCTIVITY OF FORMAL FIRMS



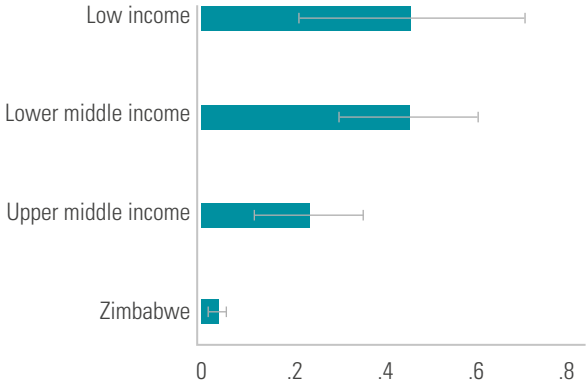
Source: World Bank staff calculations based on the WBES data.
Note: The figure plots the coefficients and the 95 percent confidence intervals from regression firm-level TFP on an indicator of whether the firm faces competition from unregistered or informal firms or not.

Photograph Credit: Captureworld Images / World Bank

5.5. Low learning from international markets

Exporting firms tend to be more productive than non-exporters, but the exporter productivity premium is small in Zimbabwe. The results from regressions that estimate an exporter premium in labor productivity (measured by value-added per worker) are shown in Figure 2.17.[27] Exporters are typically more productive, both in developing and developed countries. However, exporting firms in Zimbabwe only have a 5 percent higher labor productivity than the non-tradeable sector in Zimbabwe, compared with 50 percent in LMICs, on average. There are several explanations for the lower exporter productivity premium. An extensive literature documents firm-level productivity benefits from various aspects of foreign market participation, such as learning-by-exporting. The contribution of these forces to productivity appears to be smaller in Zimbabwe. Another possible explanation for the lower exporter productivity premium is that the return from exporting is smaller in Zimbabwe relative to comparators due to surrender requirements for exporters. Chapter 4 outlines in detail the policy options to boost productivity through trade.

FIGURE 2.17. EXPORTERS TEND TO BE MORE PRODUCTIVE THAN NON-EXPORTERS



Source: World Bank staff calculations based on the WBES data.
Note: The coefficient measures the average percentage by which labor productivity is higher for exporters relative to non-exporters within a given country, industry, and survey year.

6. Pathways to Increasing Productivity

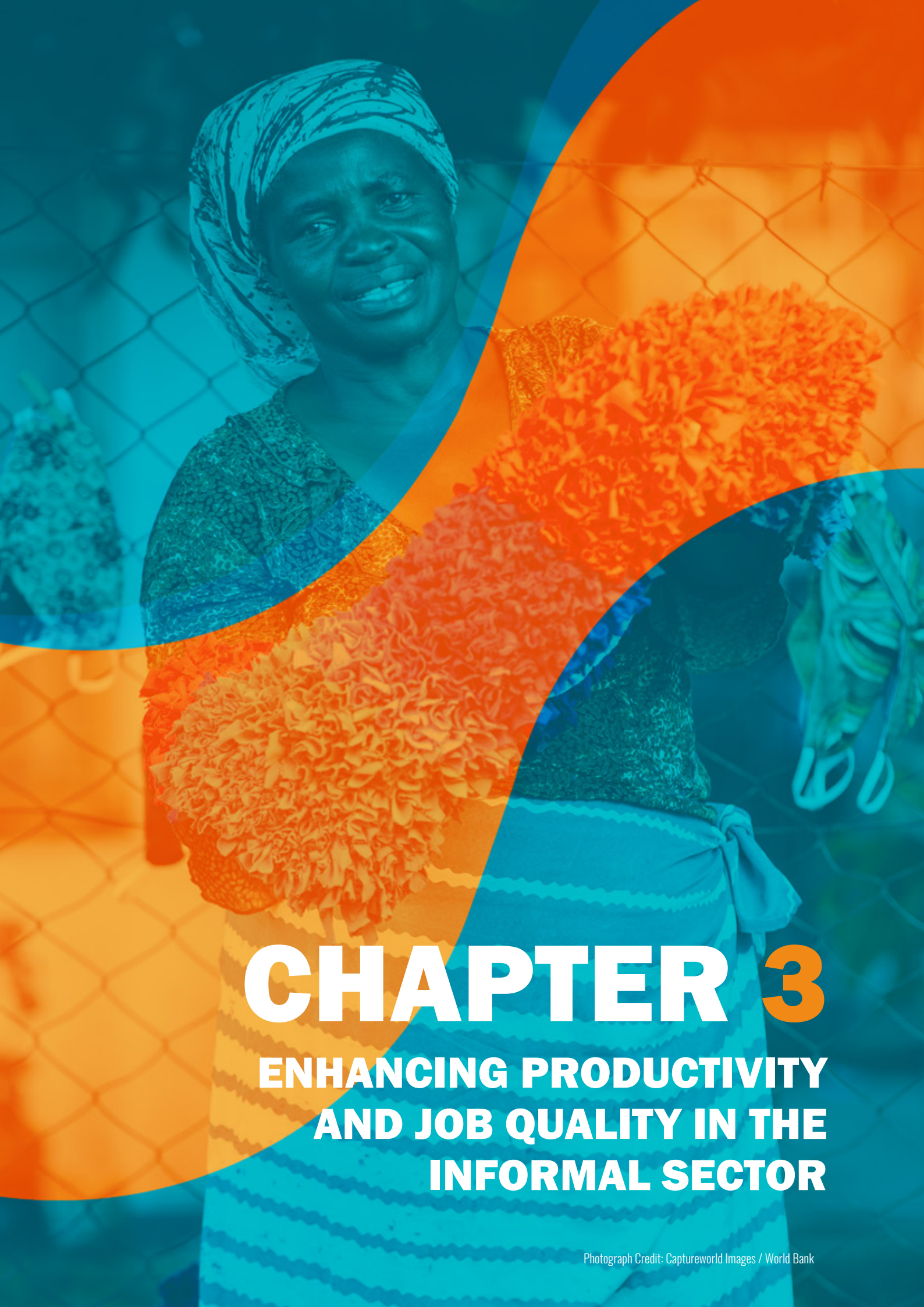
Zimbabwe will need to significantly raise productivity if it is to achieve its vision of becoming a UMIC. Although there has been progress in increasing labor productivity, the country still lags its aspirational peers among UMICs.

The pathways to boosting productivity and quality jobs will need to address the key drivers of low productivity. The CEM proposes six interrelated pathways:

1. **Ensure and sustain macroeconomic stability**—to remove price and exchange rate distortions, and create conditions conducive for productivity-enhancing investments, and to address infrastructure gaps that increase the cost of production.
2. **Remove distortions and misallocation of resources**—to enhance efficient allocation of labor and capital resources across sectors and firms, reduce distortive regulations and enforcement that benefit a few firms at the expense of more productive firms.
3. **Enhance the productivity of the informal sector and linkages with the formal sector**—create conditions for improved productivity of informal firms in the short run.
4. **Encourage the formalization of informal firms**—encourage a shift of informal firms to the formal sector and the establishment of new formal firms.
5. **Support export diversification and participation in GVCs**—develop linkages between downstream and upstream firms through supplier linkage programs.
6. **Take advantage of regional trade integration**—simplify the tariff structure.

The first two pathways provide the foundation for stronger outcomes in the four other pathways. Given their significance, identifying the specific policies will need to be done following a broad consensus for the reform agenda and its implementation. The CEM highlights the expected outcomes of the first two pathways but does not propose specific policy options. The following two chapters provide the rationale for the last four pathways and propose specific policies for consideration.

[27] Following Bernard and Jensen (1999), the exporter productivity premium is estimated as $Y_{ictc} = \beta_{cst} + \rho Ex_{icst} + \epsilon_{icst}$, where i is a firm, c is country, and t is a survey year, Y_{icst} is labor productivity, Ex_{icst} is an exporter indicator variable, β_{cst} is country-industry-year fixed effects. The coefficient of interest $\exp(\rho)$ measures the average percentage by which labor productivity is higher for exporters relative to non-exporters within a given country, industry and year.



CHAPTER 3

ENHANCING PRODUCTIVITY AND JOB QUALITY IN THE INFORMAL SECTOR

Photograph Credit: Captureworld Images / World Bank

1.Introduction

Zimbabwe's growth performance has been challenged by its large informal sector, complicating productivity growth, effectiveness of policies, and long-run development.[28] At the macroeconomic level, pervasive informality limits the tax base and constrains the GoZ's ability to conduct domestic resource mobilization. A larger informal sector is often associated with lower government revenues and, hence, lower government expenditures. In the short term, this constrains the GoZ's ability to provide sufficient and effective fiscal support during economic downturns. In the absence of central bank independence, persistent fiscal deficits may lead to inflation, further threatening macroeconomic stability in Zimbabwe. In the long term, a lack of government spending is often associated with insufficient public investment and limited access to public infrastructure, which can be a further drag on economic development.

Pervasive informality in Zimbabwe also has implications for firms and workers. In Zimbabwe, informal employees are concentrated in critical sectors of the economy—agriculture, mining, and tourism. Despite these sectors' importance to the economy, they present less opportunity for Zimbabwe to move the economy up the value-added chain or provide higher-quality jobs for workers. At the firm level, informality is identified as the main obstacle to doing business in the country. Studies show that formal firms facing informal competition are less productive than formal firms that do not face such competition (World Bank, 2019; Amin and Okou, 2020). Informal firms are also less productive than formal firms, as they usually employ less-skilled workers and have limited access to financing to invest in infrastructure, equipment, and human capital. Informal firms have also been much more affected by the pandemic than formal firms, largely due to the lockdown restrictions and their prevalence in the services sector (Ohnsoge and Yu, 2022). Therefore, policies to boost productivity growth will also need to consider the large informal sector.

Given its critical role in output and employment generation, tackling informality will need to be at the forefront of Zimbabwe's development strategy if it is to attain UMIC status. The high productivity levels needed to reach UMIC status can only be achieved if the productivity of the informal sector also increases sufficiently over the following decade and if there are incentives to shift to the formal sector. Therefore, in the short to medium term, policies and government support should focus on: (i) enhancing the productivity of the informal sector and its linkage with the formal sector; and (ii) making formalization more attractive, rather than penalizing the participants of the informal sector.

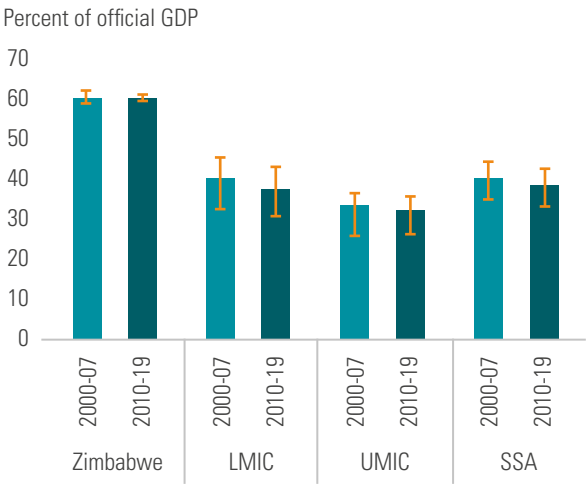
Against this backdrop, this chapter tries to understand the levels and drivers of informality in Zimbabwe and provides policy insights on how to enhance productivity and job quality in the informal sector. This chapter is structured as follows: following this introduction, Section 2 describes the extent and evolution of informality in Zimbabwe over the past two decades and provides a detailed profile of participants in the informal sector; Section 3 identifies the main drivers of the informal sector in Zimbabwe; Section 4 follows with the potential policies that can help tackle the challenges posed by informality; and, lastly, Section 5 concludes and highlights the policy priorities for Zimbabwe to cope with the informal sector over the short to medium term.

2. Understanding Informality in Zimbabwe

2.1 Output informality

Relatively higher output informality has persisted in Zimbabwe over the past three decades, edging up during episodes of macroeconomic instability. During the past three decades, output informality in Zimbabwe fluctuated at around 60 percent of official GDP, staying above the average levels of its peers—LMICs, UMICs, and SSA (Figure 3.1).[29] While output informality in Zimbabwe did not exhibit a downward trend during this period, it declined in both LMICs and UMICs by about 2 percentage

FIGURE 3.1. OUTPUT INFORMALITY IN ZIMBABWE



Source: World Bank staff estimates.
Notes: Output informality is proxied by the multiple indicators and multiple causes model-based (MIMIC) estimates of informal output in percent of official GDP. Bars are medians for corresponding periods and country groups with whiskers showing the interquartile.

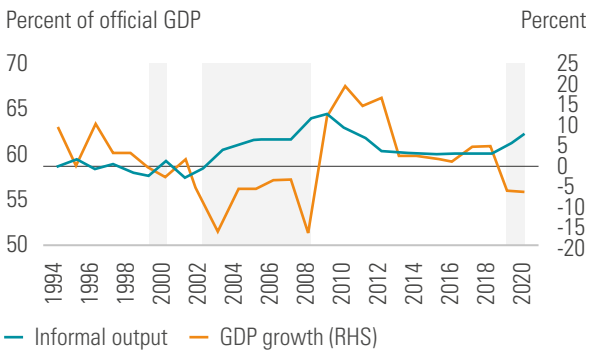
[28] While informality can be driven by poor policies and under-development, it also challenges policymakers by complicating productivity growth, long-run development, and effectiveness of policies. The lack of sustained development and good policies may further support the persistence in informality, creating a vicious cycle.

[29] Here output informality is proxied by the multiple indicators and multiple causes model-based estimates (MIMIC) as a share of official GDP.

points of GDP.[30] Macroeconomic instability seems to have contributed to the persistence of output informality in Zimbabwe, as it edged up during economic downturns during the past two decades. In particular, output contracted as a result of policy missteps and natural disasters during the period 2002–08 (IMF, 2004, 2009, 2022; Chikoto and Sadiq, 2012),[31] resulting in a rise in output informality by about 7 percentage points of GDP (Figure 3.2).

The combination of currency reforms, policy missteps, and severe natural disasters (e.g., the protracted drought and the COVID-19 pandemic) contributed to the increase in output informality during 2019–20. Real GDP contracted by 12 percent during 2019–20, with annual inflation reaching 837 percent by July 2020 (IMF, 2022). High inflation and a lack of growth in the formal sector fueled growth of the informal sector. In addition, QFAs, and frequent policy changes—the introduction of the Zimbabwe dollar (Z$), the dedollarization in 2019, the dollarization in 2020—have contributed to the expansion of the informal sector as the cost of operating in the formal sector increased. The COVID-19 pandemic in 2020 further affected informal workers disproportionally, resulting in output informality rising from 60 percent of GDP in 2018 to 62.2 percent of GDP in 2020.

FIGURE 3.2. OUTPUT INFORMALITY IN ZIMBABWE OVER TIME



Source: World Bank staff estimates.
Notes: Output informality is proxied by the multiple indicators and multiple causes model-based (MIMIC) estimates of informal output in percent of official GDP. The shaded areas are years when GDP growth rates turn negative in Zimbabwe.

In Zimbabwe, it was hard to reverse the rise in informality in the past, raising concerns about reversing the recent increase in informality. During the 2000–08 recession, the informal sector expanded to capture the formal workers that were laid off. However, Zimbabwe was unable to reverse the increase over the following decade, as formal workers laid off during the recession failed to find formal jobs during the recovery afterward. Despite the decline in output informality between 2009 and 2019, output informality in 2019 remained above the level before the recession episode. The difficulty of reversing the expansion of the informal sector is particularly concerning given that there are indications that output informality has been on the rise in Zimbabwe.

2.2 Employment informality

The level of informal employment is also pervasive in Zimbabwe (Figure 3.3).[32] The share of self-employment—a commonly used proxy for employment informality—is also higher in Zimbabwe than in other MICs. Based on ILO estimates, two out of three workers in Zimbabwe are self-employed in 2019, while about one-third of those employed in UMICs were self-employed over the period 2010–19.[33] Informal employment accounted for 80 percent of total employment in Zimbabwe in 2019, higher than the average level in both LMICs and UMICs.[34] In 2021, 1.5 million Zimbabweans were employed in the informal non-agriculture sector, the majority of whom do not have social and health insurance, receive lower wages, and are usually involved in manual activities with little automation.[35] While some workers may choose to work in the informal sector for its flexibility and entrepreneurship, the persistently high level of informal employment seems to indicate a lack of job opportunities in the formal sector.[36]

30 A similar downward trend was seen in other SSA countries, with the average level declining by 1.5 percentage points of GDP between 2000 and 2020.

31 The floods, droughts, and an HIV/AID epidemic between 2001 and 2008 affected millions of people in Zimbabwe (Chikoto and Sadiq, 2012). Economic policies lacked consistency during the period (IMF, 2004), and RBZ's QFAs fueled hyper-inflation (Munoz, 2007; IMF, 2009).

32 Several measures of employment informality have been used in the literature. Self-employment as a share of total employment is used due to its great country and year coverage (La Porta and Shneider, 2014; Maloney, 2004), As defined by the 1993 International Classification of Status in Employment, self-employed workers include four sub-categories of jobs: employers, own-account workers, members of producers' cooperatives, and contributing family workers. Self-employed workers are those who, working on their own account (own-account workers or employers) or with one or a few partners or in a cooperative, hold "self-employment jobs" as defined above. These are jobs where the remuneration is directly dependent upon the profits derived from the goods and services produced. See 17th ICLS guidelines for details (https://www.ilo.org/public/libdoc/ilo/2013/480862.pdf).

33 Here estimates on self-employment reported by Zimbabwe's labor force survey (LFS) and those by the ILO are used. The LFS provides survey-based estimates, while the ILO provides model-based estimates. The latter avoids the potential drawbacks of survey-based estimates but also suffers from some limitations (see Elgin et al., 2021, for details). Here both measures are used to provide a more comprehensive assessment of informal employment in Zimbabwe.

34 In addition to informal employment, the ILO also reports another measure of employment informality: employment outside the formal sector. Whereas employment outside the formal sector is an enterprise-based concept that includes persons employed by informal sector enterprises or in households, informal employment is a job-based concept and has a broader definition. Please see ILO, 2021 (a, b, and c), for detailed definitions of these two measures. In Zimbabwe, employment outside the formal sector also amounted to 71 percent of total employment, exceeding the average level in UMICs over the period 2010–19 by about 28 percentage points of total employment.

35 2021Q3 LFS.

36 See below and Section 3 for details.

Similar to output informality, employment informality has edged up during output recessions over the past three decades (Figure 3.4). A declining trend in self-employment shares was seen in both LMICs and UMICs between 1990 and 2019. However, in Zimbabwe, negative output growth during 1998–2008 was accompanied by an increase in the share of self-employment by about 7 percentage points of employment. The self-employment share did not contract as output growth turned positive between 2009 and 2018 but remained at around 66 percent of employment before rising to 69 percent in 2020. The lack of reversal in employment informality after the two periods of recession points to the additional challenges (such as fiscal weaknesses and lack of productivity growth) faced by the informal sector in Zimbabwe (Ohnsorge and Yu, 2022).

Employment informality is spread across all sectors in Zimbabwe, including in high value-added industries and services (Figure 3.5). In 2019, the top three sectors—the wholesale and retail trade, mining and quarrying, and manufacturing—in total accounted for about three-quarters of total employment in the informal sector. The bottom two sectors—transportation and storage, and high productivity services—captured 5.8 and 3.2 percent of total employment in the informal sector, respectively.

In Zimbabwe, the distribution of those employed across the informal sector differs between male and female workers (Figure 3.5). Female workers are more dominant in trade and services-related industries than their male counterparts in the informal sector. In particular, the wholesale and retail trade sector employed 65 percent of female workers in the informal sector, while capturing less than one-quarter of male workers in the informal sector. In contrast, male workers in the informal sector were more dominant than their female counterparts in the following sectors: mining and quarrying, construction and water supply, and transportation and storage. Furthermore, the 2021Q3 Labor Force Survey (LFS) showed that wholesale and retail trade workers are more likely to lose their jobs than workers in other sectors, indicating that female workers' employment in the informal sector can be more vulnerable than their male counterparts (ZWE QLFS, 2021Q3).

FIGURE 3.3. EMPLOYMENT INFORMALITY IN ZIMBABWE

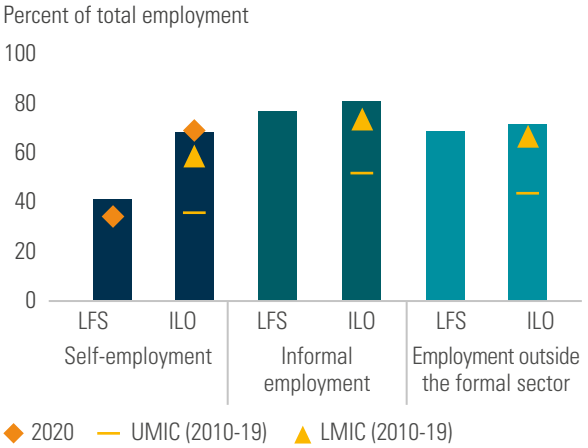
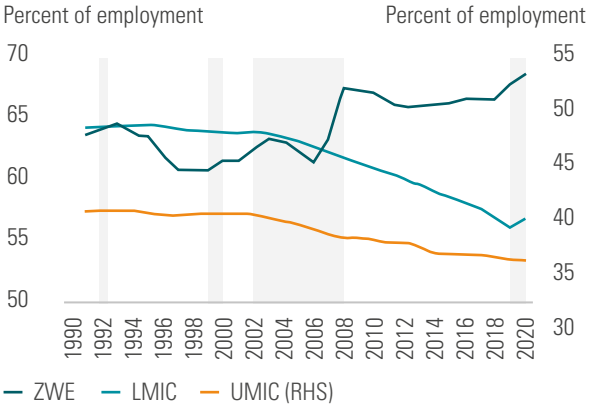


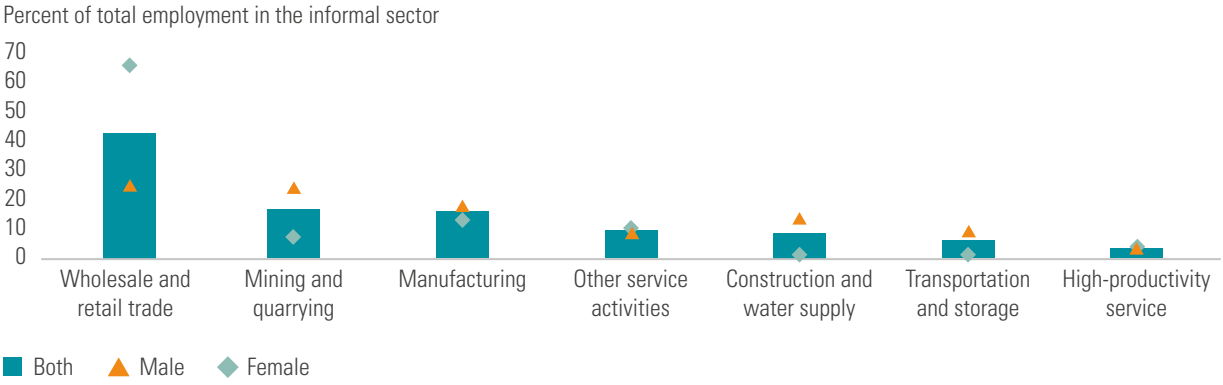
FIGURE 3.4. EMPLOYMENT INFORMALITY IN ZIMBABWE OVER TIME



Source: World Bank staff estimates.

Note: LFS = "Labor Force Survey", and ILO = "estimates from ILO". In Figure 3.3, bars are levels of employment informality in 2019. Diamonds (dash lines) are simple averages for LMICs (UMICs) over the period 2010–19. Orange diamonds show the levels in 2020. In Figure 3.4, employment informality is proxied by the share of self-employment in percent of total employment (ILO model estimates). Lines are simple averages for LMICs and UMICs (RHS). The shaded area captures years where GDP growth rates were negative.

FIGURE 3.5. DISTRIBUTION OF THE EMPLOYED POPULATION AGED 15 YEARS AND ABOVE IN THE INFORMAL SECTOR BY SECTOR AND SEX (ZIMBABWE 2019)

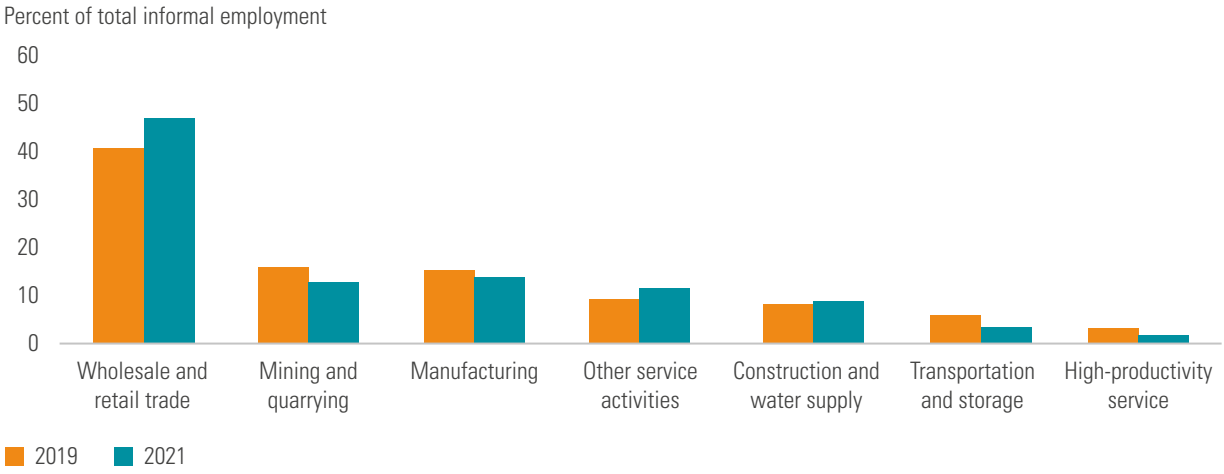


Source: Zimbabwe 2019 LFCLS.

The policy changes and severe natural disasters (e.g., the protracted drought and the COVID-19 pandemic) during 2019–21 triggered changes in the distribution of employment in the informal sector across sectors (Figure 3.6). Employment in the informal sector shifted from those sectors with higher value added, such as mining and quarrying, manufacturing, and high-productivity services, to those sectors with lower value-added, including the wholesale and retail trade, and other services activities. While part of this shift can be attributed to the stringent COVID-19 prevention measures implemented in 2020, it may also be due to the policy missteps that resulted in high inflation, deindustrialization, and de-urbanization in Zimbabwe (see Section 3 for details).

In Zimbabwe, workers in the informal sector are relatively well educated, although they tend to be less educated than their formal counterparts (Figure 3.7). About 98 percent of workers in the informal sector have completed primary school, with more than three-quarters of workers in the informal sector having completed lower secondary school. Only a small share of informal workers has completed vocational (4 percent) and tertiary education (5 percent). There are noticeable differences between workers' educational attainment in the formal and informal sectors. A higher share of workers in the formal sector entered or completed secondary school education than workers in the informal sector (Figure 3.8). Workers in the informal sector are also more likely to have no education or education below primary school level, suggesting that there is still room for improvement in human capital in the informal sector.

FIGURE 3.6. DISTRIBUTION OF THE EMPLOYED POPULATION AGED 15 YEARS AND ABOVE IN THE INFORMAL SECTOR BY SECTOR (ZIMBABWE 2019 VS 2021)



Source: Zimbabwe 2019 and 2021Q3 LFCLS.

FIGURE 3.7. INFORMAL EMPLOYMENT IN ZIMBABWE BY EDUCATIONAL ATTAINMENT, (%)

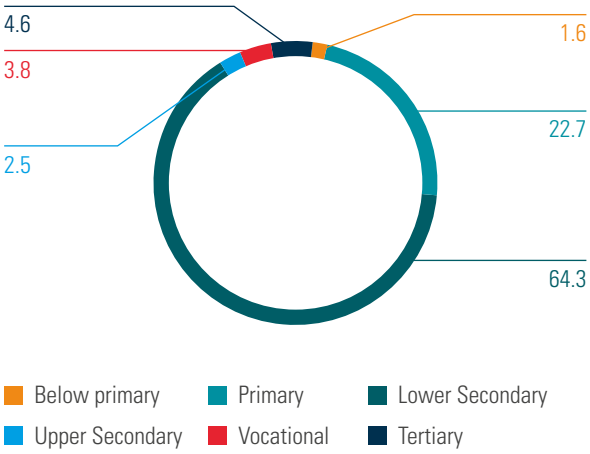
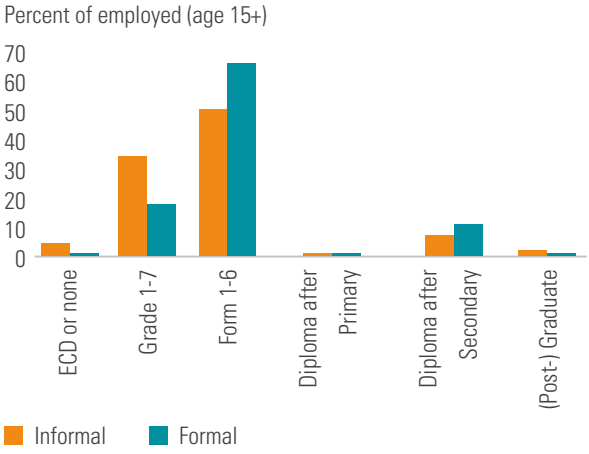


FIGURE 3.8. EMPLOYMENT IN ZIMBABWE BY EDUCATIONAL ATTAINMENT

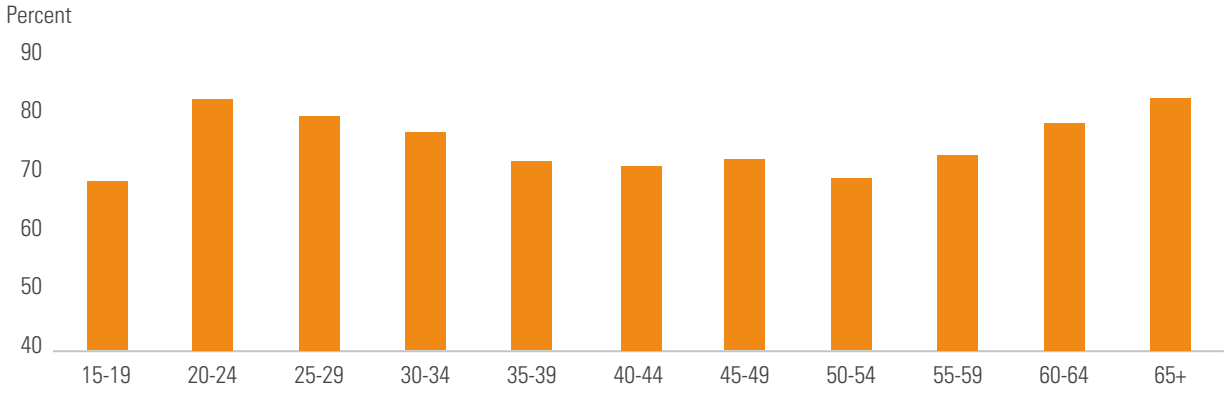


Source: Zimstat. Left = Zimbabwe 2019 LFCLS; right = Zimbabwe 2014 LFCLS.

The share of employed in the informal sector differs across age groups, with it being relatively higher for young and senior workers (Figure 3.9). According to the 2019 Zimbabwe LFS, more than three-quarters of employment was in the informal sector. The fraction of employment in the informal sector rose above 80 percent for the age groups 20–24 and 65+ (i.e., post-retirement age). The informal employment trajectory across the lifecycle was also seen in some Latin American and Caribbean countries (Perry et al., 2007). Young workers have difficulty finding jobs in the formal sector, largely due to a lack of working experience. The probability of being employed in the informal sector was lowest among prime-age workers. Senior workers were less likely to find employment in the formal sector.

Informality is also more common in rural areas than in urban areas. In 2019, about two out of three workers in the formal sector were residing in urban areas. In contrast, more than half of workers in the informal sector were in rural areas (Figure 3.10). Given that access to markets, technology spillovers, and agglomeration effects are more limited in rural than in urban areas, workers in rural areas, where poverty is higher, joined the informal sector less for entrepreneurship and more out of necessity than workers in urban areas. In 2021Q3, most of the employers lived in urban areas (Figure 3.11), while own-account workers and employees were more likely to live in rural areas. About 80 percent of contributing family workers were in rural areas and these workers are more likely to be women and less financially independent (Zimbabwe 2019 LFCLS).

FIGURE 3.9. SHARE OF EMPLOYED IN THE INFORMAL SECTOR IN ZIMBABWE ACROSS AGE GROUPS, 2019



Source: Zimbabwe 2019 LFCLS.

FIGURE 3.10. FORMAL AND INFORMAL EMPLOYMENT IN URBAN AND RURAL AREAS

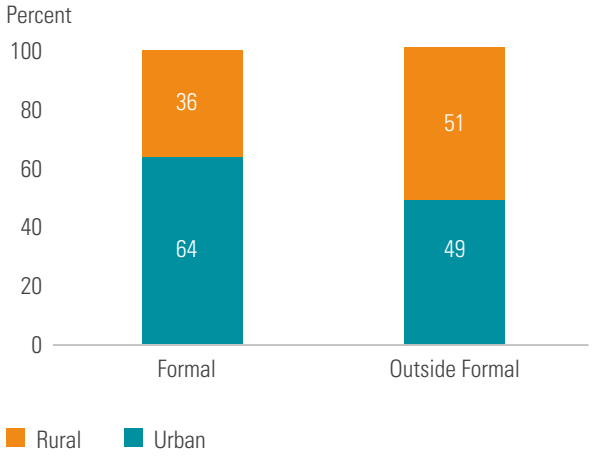
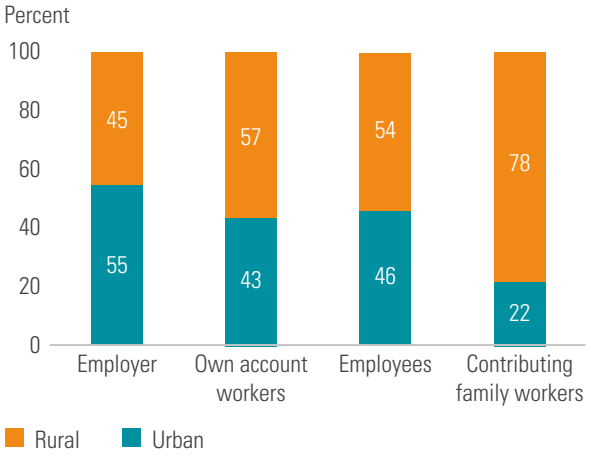


FIGURE 3.11. EMPLOYMENT STATUS IN URBAN AND RURAL AREAS



Source: Zimbabwe Zimstat. Left = Zimbabwe 2019 LFCLS; right = Zimbabwe 2021Q3 LFCLS.

2.3 Firms' informality

The productivity of informal firms in Zimbabwe is only a fraction of the productivity of formal firms. The labor productivity in a median informal firm is only 10 percent of the labor productivity in a median formal firm that is of similar size (Figure 3.12).[37] The labor productivity of informal firms of a sample of EMDEs is estimated to be about one-quarter of the productivity of formal firms (Amin and Okou, 2019). Past literature has shown that, due to their hidden nature, informal firms often lack access to finance, which has limited their ability to scale up and adopt more advanced technology (World Bank, 2019; Ohnsorge and Yu, 2022; Salvatore, Ohnsorge and Yu, 2022).[38]

Moreover, unfair competition from informal firms can lower the productivity of formal firms. As noted in Chapter 2, the level of competition from informal firms in Zimbabwe is higher than in other SSA countries and much higher than in UMICs. Past studies have shown the adverse impact of competition from informal firms on formal firms. Using a sample of EMDEs, it is found that competition from informal firms can lower the productivity of formal firms by 20–24 percent compared with formal firms that do not face such competition (Amin and Okou, 2020).

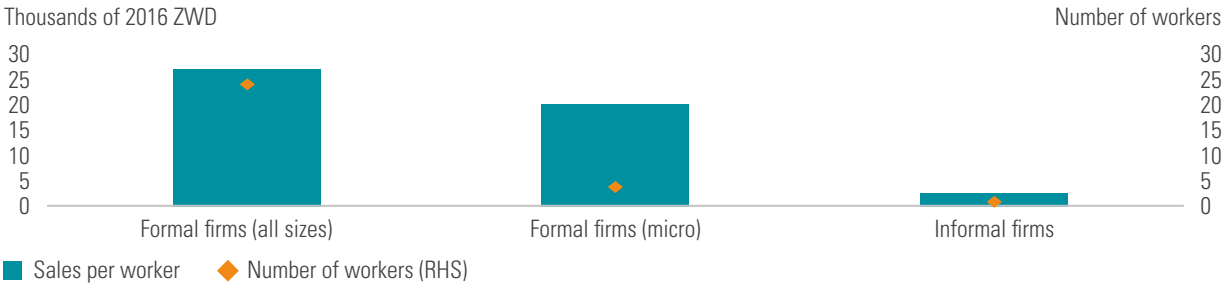
3. Drivers of Informality

This section discusses the specific drivers of informality in Zimbabwe and organizes them into two groups: macroeconomic conditions and institutional conditions (including business climate, regulatory burdens, and governance). It also reviews the existing literature and discusses the theoretical foundations for the various drivers of informality in Box 3.1.

3.1 Macroeconomic performance and conditions

Back-and-forth policies limiting economic development and increasing economic volatility have contributed to pervasive informality in Zimbabwe.[39] The level of informality in Zimbabwe exceeds the level predicted by its GDP per capita income level (Figure 3.13). Economic recessions and hyperinflation during the past two decades had a devastating impact on economic activity and jobs, resulting in a rise in output and employment informality (Figure 3.14). However, as shown before, Zimbabwe was not able to reverse the increase over the following decade: both output and employment informality remained high during the economic growth period of 2009–18.

FIGURE 3.12. LABOR PRODUCTIVITY IN FORMAL AND INFORMAL FIRMS



Source: WBES, 2016; WBMES, 2016; and WBIES, 2017. Notes: Bars and diamonds are medians.

FIGURE 3.13. OUTPUT INFORMALITY AND ECONOMIC DEVELOPMENT LEVEL

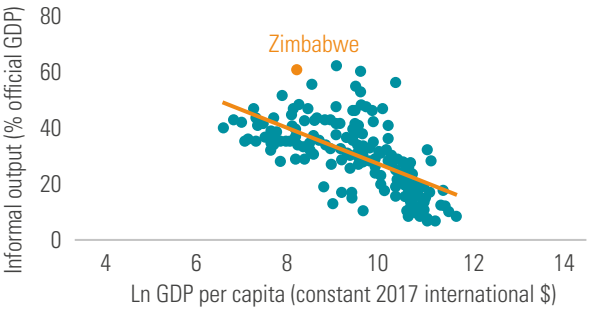
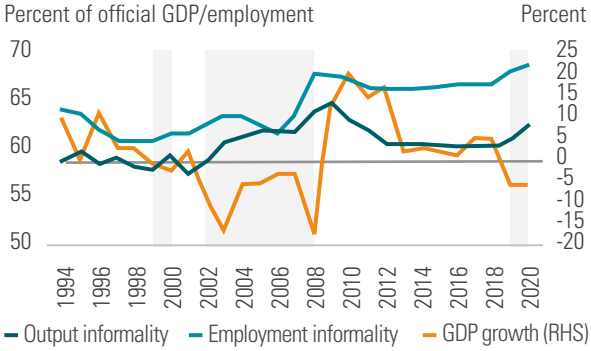


FIGURE 3.14. RECESSIONS AND INFORMALITY IN ZIMBABWE



Source: World Bank staff estimates, WDI. No: In Figure 3.13, data are from 2019. The dot in red captures Zimbabwe. In Figure 3.14, output informality is proxied by the multiple indicators and multiple causes model-based (MIMIC) estimates and expressed in percent of official GDP. Employment informality is proxied by the share of self-employment in percent of total employment. The shaded area captures years where GDP growth rates were negative.

[37] Informal firms are of a much smaller size than formal firms. A median informal firm hires only one worker, while a median formal firm employs about 25 workers (formally and informally).

[38] Given the positive linkage between pervasive informality and heavy regulatory burdens (and poor governance), it is also possible that heavy regulatory burdens and poor governance are driving both informality and lower productivity.

[39] There is ample empirical evidence linking informality with a lack of economic development.

BOX 3.1. DRIVERS OF INFORMALITY: THEORETICAL FOUNDATIONS

Theoretical models have often presented underdevelopment as one of the main causes of informality. This reflects the inability of an urban modern formal sector to absorb rural migrants during the urbanization process (Harris and Todaro, 1970; Fields, 1975; Loayza, 2016). Development can further shrink the informal sector because households tend to shift away from agricultural and informal sector goods as their incomes grow (Saracoglu, 2008). Limited access to credit, often associated with less development, constrains the ability of informal firms to overcome barriers to entry into the formal sector (Ferreira-Tiyaki, 2008; D'Erasmo and Moscoso Boedo, 2012; Capasso and Jappelli, 2013). Finally, in the short run, the size of the informal sector can respond both pro- and counter-cyclically to a productivity shock, depending on whether the shock affects mostly the informal or formal sector (Loayza and Rigolini 2011).[40] Some of these linkages are supported by the macro-level data below.

Past theoretical works have also shown heavy-handed regulations and poor governance as the main causes of informality. It was shown that higher taxation and heavy-handed regulation increase firms' incentives to reduce taxation or the cost of regulatory compliance by remaining informal (Ihrig and Moe, 2004; Amaral and Quintin, 2006; D'Erasmo and Moscoso Boedo, 2012; Auriol and Warlters, 2005; Prado 2011; Kanbur 2017; Dabla-Norris et al., 2018; Ulyssea, 2018). Excessive labor regulations encourage informal employment by increasing the cost of formal employment (Rauch, 1991; Loayza, 2016). Corruption and rent-seeking bureaucracies increase firms' incentives to avoid interaction with the state by remaining informal (Sarte, 2000; Choi and Jum, 2005; Freidman et al., 2000).

Finally, theoretical works also show a poor business climate as a driver for informality. For instance, access to productivity-enhancing public goods, such as access to electricity or a functioning court system, can lead to an increase in the share of formal production (Mendicino and Prado, 2014). The lack of access to credit restricts the ability of firms to invest in productivity-enhancing new technologies and constrains the ability of households to absorb external shocks or start a business in the formal sector (see Capasso, Ohnsorge, and Yu, 2022 for a review; Ferreira-Tiyaki, 2008; D'Erasmo, 2016; Capasso and Jappelli, 2013; World Bank, 2020).

Lack of urbanization has also contributed to high informality. Empirical evidence shows a strong link between informality and a lack of urbanization, especially in EMDEs.[41] Zimbabwe is at the early stage of urbanization where many workers are still in the rudimentary informal sector, the rural-urban migrant workers tend to join the urban informal sector (mostly in the low-productivity services sector), and the level of informality is high. If urbanization is sufficiently fast and accompanied by an expansion of the urban formal sector (mostly in urban manufacturing), workers will gradually move to the cities and join the urban formal sector, eventually leading to a fall in informality. However, in Zimbabwe, there has been slow progress toward urbanization, reflected by limited growth in the urban formal sector and even reverse urbanization in the 2000s and 2010s (Figure 3.15).

Limited jobs in the urban formal sector (mostly in the manufacturing sector) also fuel informality. As mentioned by Loayza (2016), rural-urban migration may lead to a rise in informality when there are insufficient jobs in the urban formal sector (mostly manufacturing jobs) to absorb rural migrant workers. During the past few decades, employment in industry has dropped from 12 percent of total employment in the early 1990s to around 7 percent in recent years, while employment in the agriculture and services sectors has increased. These shifts in sectoral structure reflect a reversal in urbanization and industrialization in Zimbabwe, which

[40] In theory, the cyclical relationship between informal and formal sectors is ambiguous (see Chapter 3 of Ohnsorge and Yu 2022 for a short review). In Loyaza and Rigolini (2011), it was shown that in the short run, informal employment behaves counter-cyclically, indicating that it acts primarily as a safety net. The degree of counter-cyclicality, however, varies inversely with the size of informal labor itself.

[41] As shown in Loayza (2016), a developing economy passes through three stages of development as it becomes richer, and urbanization progresses. In the first phase, modern informal employment expands as the falling relative cost of urban living encourages rural workers (in the rudimentary informal sector) to migrate to cities. In the second phase, rural-urban migration slows, the relative shares of the modern informal and formal sectors stabilize, but the relative size of the rudimentary informal sector shrinks. In the third phase, modern informal employment declines as rural-urban migration stalls and a rising capital-labor ratio reduces the relative (and absolute) size of the modern informal sector.

was accompanied by an increase in both output and employment informality (Figure 3.16).

Price and exchange rate distortions in Zimbabwe have been identified as an important driver of informality. Savings eroded by high inflation have limited the ability of firms to scale up and increase productivity, reducing their ability to join the formal sector. Forex shortages in the formal market and undervalued official exchange rates have resulted in a significant parallel exchange rate market that has provided easier access to forex to informal firms. The surrender requirements for exporters and domestic transactions in US dollars have imposed additional operational costs on firms, motivating them to under-report sales and move to the informal sector.[42] The US dollar revenues collected from the surrender requirements were used to ensure access to preferential exchange rates to certain groups of importers and portfolio investors, misallocating resources away from productive sectors and encouraging informality and deindustrialization. Meanwhile, import licenses increase the cost of imports and provide incentives for the smuggling of imported goods.

Limited access to finance in Zimbabwe has resulted in a lack of motivation for firms to join the formal sector. In 2016, less than 8 percent of firms (4 percent for small firms) had a line of credit or a loan from a financial institution, while the rate was between 20 and 30 percent in Côte d'Ivoire and Kenya (World Bank, 2021d). Also, about half of the population in Zimbabwe did not own an account at a financial institution or with a mobile-money service provider in 2017. While two banks were established to provide loans to small and medium enterprises (SMEs), youth, and women, lending to these groups remains low. The limited availability of credit reflects relatively high exposure of the banking sector to government debt and agriculture, the short-term character of deposits, and constrained financing from abroad. The lack of access to financial services and credit restricts the ability of firms to invest in productivity-enhancing new technologies and constrains the ability of households to absorb external shocks or start a business (Ferreira-Tiyaki, 2008; D'Erasmo, 2016; Capasso and Jappelli, 2013; World Bank, 2020a). In addition to a lack of financial development, participants of the informal sector often have no access to bank credit due to a lack of collateral, unclear land property rights, and high costs of capital.

3.2 Business climate, regulatory burdens, and governance as drivers for informality

Limited financial development can also pose challenges to firms' operations in the informal sector. As documented in Ohnsorge and Yu (2022), about one-third of firms in EMDEs with above-median informality identified access to finance as a major constraint for their business operations. In Zimbabwe, three-quarters of informal firms considered limited access to finance or loans as the biggest problem facing their businesses, notably above the average level in EMDEs with high informality (Figure 3.17).

Burdensome business regulations have also contributed to pervasive informality in Zimbabwe. Heavy regulatory burdens, ranging from firms' start-up costs to day-to-day operational costs, increase firms' cost of joining the formal sector and motivate firms to hide from the authorities (Loyaza, 2018; World Bank, 2019; Schneider et al., 2010). Legal barriers to business entry and various licensing

FIGURE 3.15. URBANIZATION AND INFORMALITY

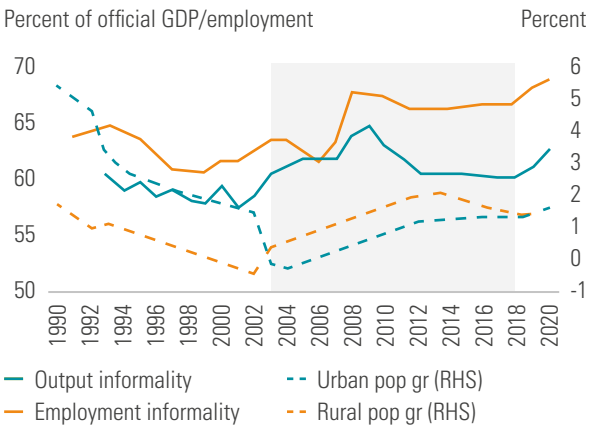
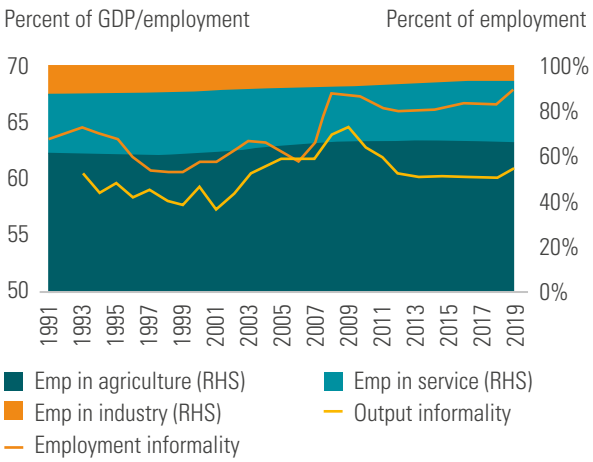


FIGURE 3.16. COMPOSITION OF INDUSTRIES AND INFORMALITY



Source: World Bank staff estimates, WDI.

Notes: Data are for 1990–2020. Output informality is proxied by the MIMIC estimates on informal output in percent of GDP, while employment informality is proxied by self-employment in percent of total employment. In Figure 3.15, the shaded area highlights the years where rural population growth exceeded urban population growth.

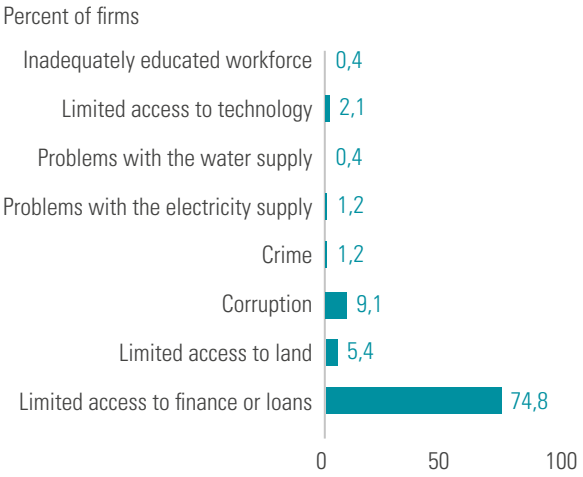
[42] In particular, high inflation and multiple exchange rates can push traders into the informal sector by making it more profitable to export informally and harder for unconnected importers to access forex at the official rate.

requirements to start operation remain particularly cumbersome in Zimbabwe (World Bank, 2022a and 2022b). On average, it took about 75 days to start up a new business in Zimbabwe during the period 2010–19, while firms in an average MIC spent 35 days to become registered. In the meantime, the average cost of business start-up procedures amounted to 127 percent of GNI in Zimbabwe compared with only 20 percent of GNI in an average UMIC. Based on the 2017 World Bank Enterprise Survey (WBES), about four out of five informal firms were not registered due to time, fees, and paperwork involved in registration and high tax burdens (Figure 3.18). Half of the informal firms suggested that costly government inspections and meetings with officials were the main reason for them remaining unregistered.

Poor governance and restricted public services can also contribute to the pervasive informal sector in Zimbabwe. Firms and households can be deterred from interacting with the authorities when facing red tape, bribery requests, and a dysfunctional judicial system. Cross-country evidence shows that greater corruption, less effective government, and weaker rule of law have been associated with a more sizeable informal sector in EMDEs (Ohnsorge and Yu, 2022; World Bank, 2019). According to Worldwide Governance Indicators, Zimbabwe lags far behind other LMICs in terms of government effectiveness, control of corruption, and regulatory quality.

In addition, firms prefer to stay informal due to the perceived limited benefits associated with registration in Zimbabwe. The 2017 WBES showed that half of the informal firms in Zimbabwe were not registered because of a lack of benefits associated with registration (Figure 3.19). Only half of the informal firms suggested that they would have better access to finance and raw materials if they were registered (Figure 3.19). In addition, many informal firms in Zimbabwe responded that registration would not lead to fewer bribes or better linkages with the formal sector. The lack of benefits associated with registration is often identified as a common driver for informality across countries (Loayza, 2018).

FIGURE 3.17. OBSTACLES FACING INFORMAL FIRMS



Source: World Bank Informal Enterprise Surveys, 2017.

FIGURE 3.18. REASONS FOR FIRMS BEING UNREGISTERED

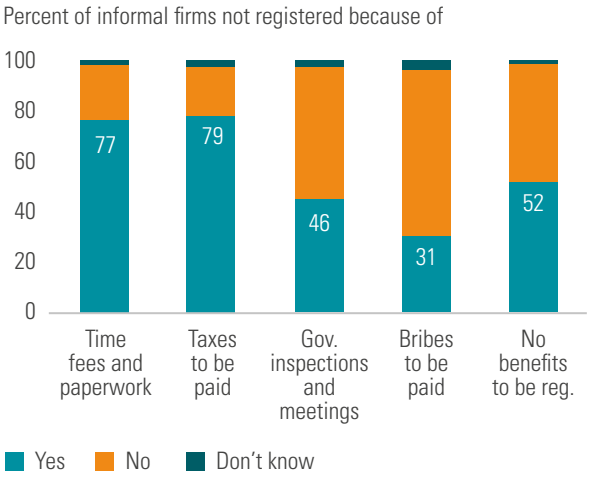
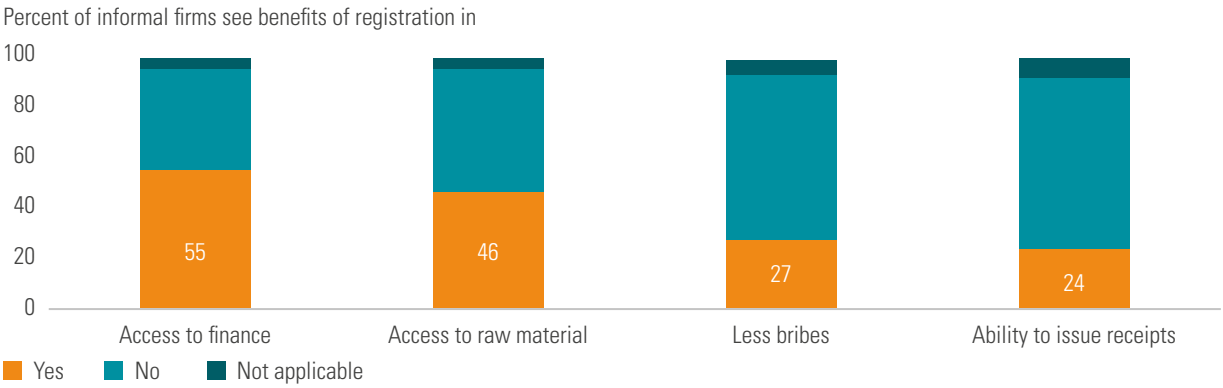


FIGURE 3.19. OBSTACLES FACING INFORMAL FIRMS



Source: World Bank Informal Enterprise Surveys, 2017.

Informal workers and firms are often less protected against economic shocks, due to their limited access to social safety nets and savings. Economic downturns have been frequent and severe in Zimbabwe during the past three decades, adversely affecting the incomes and livelihoods of participants in the informal workers. At the same time, coverage of social protection has been limited and dependent on foreign aid, forcing many into informal employment as a survival mechanism (World Bank, 2022c). Social protection programs financed by the GoZ and development partners provided coverage to less than half of the extremely poor in Zimbabwe in early 2019, and the adequacy of these programs has been limited. As a result, workers and firms in the informal sector remain trapped in informality even after output has recovered from those downturns (see Section 2 for details).

4. Tackling Informality

Dealing with the challenges of informality requires sustained economic growth, and a comprehensive and consistent policy package that tackles the root causes and consequences of informality. In the NDS1, the GoZ prioritizes facilitating the transition from the informal sector to the formal sector as a strategy to increase the number of high-quality jobs. As a follow-up, the GoZ is developing a formalization strategy based on broad consultations with all stakeholders. To have a long-lasting impact, it is critical that such a strategy acknowledges the macroeconomic and microeconomic drivers of informality and has a longer-term perspective that considers the different stages of economic development. The CEM offers two pathways to tackle informality while placing priorities on removing policy distortions and regulatory burdens in the short run: (i) enhance productivity of the informal sector and its linkages with the formal sector; and (ii) encourage formalization by encouraging the transition of informal firms to the formal sector and the establishment of new formal firms.

Removing or reducing price and exchange rate distortions that exist in Zimbabwe is a precondition for the success of all other proposed policies. As noted during consultations with multiple stakeholders, price and exchange rate distortions have driven firms to move into the informal sector. Therefore, tackling these distortions will need to include the control of inflation.

4.1 Policies to enhance the productivity of the informal sector and linkages with the formal sector

Better access to finance may help firms boost their productivity. The lack of access to finance often limits the ability of informal firms to adopt better technology or scale up, limiting their ability to improve their productivity. Better access to credit or banking services may help informal firms improve their performance. So far, cross-country evidence shows that training programs accompanied by seed funds can help boost firms' performance (see Box 3.2).

Efforts should be made to enhance access to information, training, markets, infrastructure, and general support for enterprises.[43] Based on global experience, better access to information, training, markets, public goods and services (such as education and infrastructure), and government support are perceived as being among the main benefits of being formal, which can also be associated with improvements in business performance, productivity, or formalization (Loayza, 2018; Oviedo, Jomas, and Karakurum-Ozdemir, 2009; World Bank, 2019).

It is worth noting that programs with only better access to information are often insufficient to boost firms' performance and encourage formalization. Training or information programs are likely to succeed when the provision of informality is offered with tax mediation services, funding, or individualized training (De Mel et al., 2013; Benhassine et al., 2018; Zucco et al., 2020).

Lastly, sector-specific and gender-specific policies should be considered. In Zimbabwe, several such policies have already been implemented. For instance, small-scale artisanal miners were allowed to sell gold to Fidelity Printers in return for US dollars. This significantly increased the volumes of purchased gold and exports of gold, although the delay in payments should be avoided. Training programs have been designed and carried out for informal traders. Specific banks and banking services (such as the Zimbabwe Women's Microfinance Bank) have been extended to serve female participants, especially those in the informal sector. Going forward, programs to close the digital gender divide should be considered. Such policies and programs can help improve the working and living conditions of vulnerable groups participating in the informal sector.

Photograph Credit: Captureworld Images / World Bank

[43] See World Bank (2022b) for more detailed suggestions on how to improve access to market and finance for firms.

BOX 3.2. HOW TO MAKE GOVERNMENT PROGRAMS MORE EFFECTIVE?

Training programs. Existing evidence suggests that some training programs can lead to better performance or formalization when they provide the opportunity to reconsider participants' original business plans, the demystification of tax procedures, and access to seed capital. For instance, in Peru, formalization increased by 20–25 percentage points two years after participating in a business training program, which provided seed funding to those with the best business plans (Barron and Belso-Matinez, 2020). In the case of Nigeria, business plan competitions among small-scale entrepreneurs were effective in boosting long-term sales and profits in firms with the highest potential, although at the expense of short-term costs for the participants (McKenzie, 2017). Such business plan competitions help entrepreneurs to improve their original business plans, have better access to market information, and gain seed capital by winning prizes. In Zimbabwe, training programs have been designed and carried out for informal traders. The design and implementation of such programs should be evaluated concerning whether there is sufficient support for informal traders in other areas where informal traders face obstacles to improving their productivity.

Access to finance. Past country experiences suggest that training programs accompanied by seed funds can better boost firms' sales and entrepreneurs' incomes. For instance, in Uganda, a skills-training program paired with 150 financial packages aimed at women was found to have a persistent and positive effect on their incomes (Blattman et al., 2016). In Tanzania, it was found that a training program targeted at small-scale entrepreneurs was followed by improvement in sales and projects only when training participants also received seed capital (Berge et al., 2015). In Zimbabwe, access to banking services and training programs have been enhanced separately during the past decade. Going forward, the complementary between access to finance and skills-training programs should be considered. Moreover, given the digital potential of Zimbabwe, the adoption of digital financial services should be promoted to help firms gain better access to finance. Such programs include those aimed at increasing the affordability of digital technologies, facilitating access to digital financial inclusion, and having targeted training programs for female entrepreneurs (World Bank, 2022b).

Information sessions. Programs with only better access to information are often insufficient to boost firms' performance and encourage formalization. For instance, in Benin, a randomized experiment around the introduction of an entrepreneur's legal status is used to study how government can enhance the presumed benefits of formalizing (Benhassine et al., 2018). Few firms register when just given information about the new regime, but the full package of supplementary efforts (including the provision of business services and training and assistance in opening a bank account) was able to boost formalization by 16.3 percentage points. The results suggest that information sessions are more likely to facilitate formalization when such sessions are complemented with other services, such as mediation services, funding, or individualized training, to lower the costs of formalizing and enhance the benefits of registration.

4.2 Policies to encourage the formalization of informal firms

Given the developmental challenges associated with informality, policies to encourage productive informal participants to move to the formal sector should be considered in the long term. A coherent reform strategy calls for well-integrated reforms that complement each other and address the complexity of informality (Loayza, 2018). Cross-country experience also highlights the importance of a country-specific implementation plan: each reform component requires a diagnosis of the country's current situation, followed by specific reforms to address the main weaknesses associated with the underlying sources of informality (Loayza, 2018). In the long run, the GoZ should consider providing better public infrastructure and government services, including digital infrastructure, so that informal firms or workers can have better access to markets and feel that their tax dollars are spent judiciously.

Based on global experience and Zimbabwe's specific drivers of informality, the following policy changes should be prioritized:

- First, given the excessive costs associated with firms' registration in Zimbabwe, efforts should be made to

simplify business start-up formalities.[44] Cross-country evidence shows that simplified business registration procedures tend to be linked with a rise in firms' registration (Box 3.3). In Zimbabwe, improvements in factors related to business registration (such as creating business networks, improving business registration processes, and reducing problems with authorities) have been shown to positively increase the probability of informal entrepreneurs´ willingness to formalize their enterprises (Mukorera, 2019). However, legal barriers to business entry remain particularly cumbersome in Zimbabwe. The One Stop Investment Services Centre (OSISC) under Section 5 of the ZIDA Act was established in 2020, but its impacts on the speed and cost of business registration remain unclear (World Bank, 2022b).

- Second, better access to finance to formal firms will increase the attractiveness of formality. Stabilizing prices and exchange rates and reducing the misallocation of resources to politically connected firms will enable better access to credit to formal firms (pathways 1 and 2).

- Third, efforts should be made to lower the tax burden, compliance costs, and red tape to reduce the costs of joining the formal sector. For instance, tax simplification and tax cuts were associated with lower informality in India, the Russian Federation, Georgia, and Mexico, in the form of greater formal firm registration (India, Brazil, Georgia), greater income reporting (Brazil, the Russian Federation), or a greater share of formal employment (Brazil, the Russian Federation) (World Bank, 2019c). In particular, the reforms were followed by an increase in the number of registered firms by about 5 percent in Brazil and by 18–30 percent in Georgia (Bruhn and Loeprick, 2014; Fajnzylber, Maloney, and Montes-Rojas, 2011). In addition, new digital technologies can help facilitate tax filing, strengthen tax administration, and improve government service delivery (Akitoby et al., 2018; Awasthi and Engelschalk, 2018; Gupta et al., 2017; Kraiser et al., 2019; Peixoto and Steinberg, 2019). Lastly, the design of tax and social security systems should avoid unintended incentives that shift activities from the formal to the informal sector, and level the playing field for both formal and informal sectors (Perry et al., 2007; Loayza, 2018).

- Fourth, in the long term, digitalization should be promoted to help both lower government administrative costs (as suggested above) and improve productivity in the informal sector. For example, new technologies can also help improve access to finance, including by improving the ability to assess creditworthiness (Capasso, Monferra, and Sampagnaro, 2018). Digitalization can lower regulatory burdens, thus reducing the cost of operating in the formal economy. For example, Costa Rica reduced the time required to register a business by digitizing tax registration records and company books in 2009 (Doing Business, 2009). This was followed by a drop in the share of informal employment by 4 percentage points of total employment and a fall in the share of informal output by about 2 percentage points of official GDP during 2009–16. Similar reforms have been carried out in Guyana (2010) and Kenya (2011) (Doing Business 2010, 2011). Among Zimbabwe's key strengths is the widely used digital payment system, through which 96 percent of all transactions in the country are transacted, and which the GoZ uses extensively for its core business (World Bank, 2021b).[45] While demonstrating great potential in the use of digital technology, Zimbabwe presently has no legislation, guidelines, or regulations dealing with such transactions, presenting areas for improvement (World Bank, 2022a).

- Fourth, improving governance and the provision of public sector services (via less rent-seeking behavior, better enforcement of laws and regulations, and better access to public infrastructure) can foster greater tax morality and formalization in the long term. Higher tax morale, reflecting the perception that tax dollars are spent judiciously (for the appropriate objectives and in the correct way), can encourage greater tax compliance and lessen informality (Sung, Awasthi, and Lee, 2017). Measures to cultivate better tax morality include appeals to people to declare their activities, campaigns to encourage a culture of commitment to declaration, and efforts to change perceptions of the fairness of the tax system (Williams and Schneider, 2016). Tax systems that create an unlevel playing field for different types of firms (e.g., size-dependent tax) should be avoided.

- Fifth, building government capacity and awareness of the relevance of formalization is important. The authorities should also take advantage of the existing clusters of informal firms in Zimbabwe to provide more effective support to boost their productivity and obtain feedback on the current policy framework.

[44] See World Bank (2022b) for some detailed suggestions on reforms that can reduce the business registration (and licensing) costs.

[45] Zimbabwe presently has no legislation, guidelines, or regulations dealing with transactions, presenting areas for improvement (World Bank, 2022a).

BOX 3.3. BARRIERS TO BUSINESS ENTRY: CROSS-COUNTRY EVIDENCE AND THE CONTEXT OF ZIMBABWE

Cross-country evidence has shown a rise in firm registration or revenue collection following simplified business procedures. For instance, post-2000 regulatory reforms that simplified business licensing in Uganda increased registrations by 43 percent in Entebbe municipality (Ladegaard, Lundkvist, and Kamkhaji, 2018; USAID, 2005). In Kenya, a one-stop registration process implemented in 2000–07 led to a 40 percent increase in licensing revenue collection for local authorities (Devas and Kelly, 2001; Joshi, Prichard, and Heady, 2014). In the case of Estonia, "virtual one-stop shops" for e-Business register provided an advanced and secure platform for registering businesses online without going to a notary or other officials (termed as "e-formality"; Chacaltana and Leung, 2019; ILO, 2021). As governments around the world are trying to implement information technology (IT) systems to improve their services, many countries have moved to the implementation of Unique Business Identifiers (UBIs), which provide the foundational information related to legal entities, enabling government and business to uniquely identify legal entities in various transactions and regulatory interactions (World Bank, 2022a).

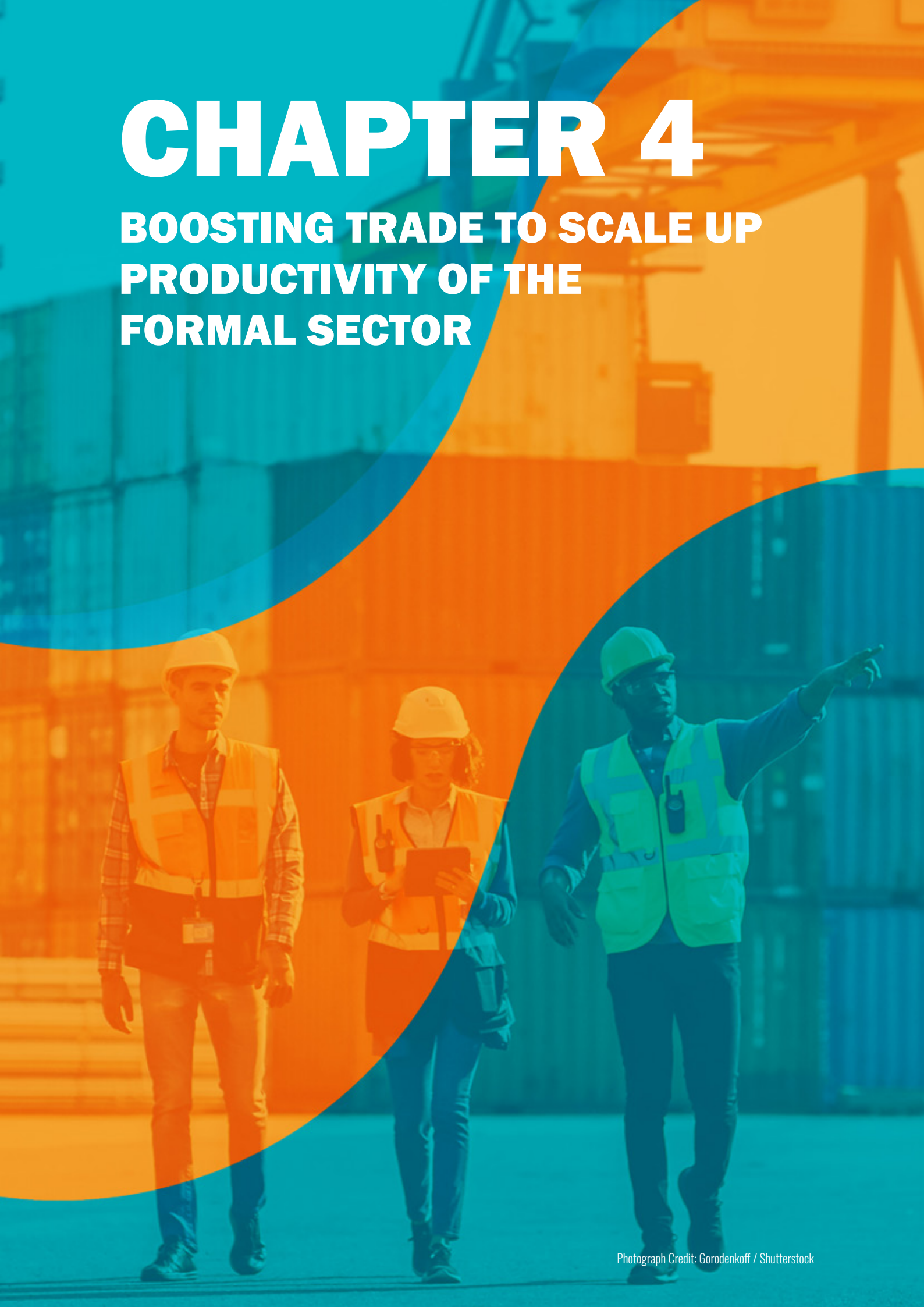
Despite some progress during the past decade, barriers to business entry remain cumbersome in Zimbabwe (see World Bank 2022a for a detailed discussion). The registration of a company in Zimbabwe needs to be done directly at the Deeds, Companies and Intellectual Property (DCIP) by meeting certain requirements. The DCIP's main headquarters are in the capital, Harare. Enterprise owners are required to physically visit Harare to apply for registration, thus making it cumbersome to formalize. A business registration platform has been put in place recently, but it does not yet work properly. The DCIP expects to have a fully operational system in place by June 2022. Currently, 10 percent of the applications are submitted online, while 90 percent of the applications are still submitted manually.

After registration with the DCIP, additional procedures must be followed for a company to operate in Zimbabwe. More specifically, two important additional registrations are required: with the Zimbabwe Revenue Authority (ZIMRA) and the National Social Security Authority (NSSA). In addition to registration, there is a need to obtain certain operating licenses before firms can start operations in Zimbabwe. Firms suggest that licenses are a real problem in Zimbabwe, not only because of the amount of time and associated costs, but also because of the discretion, lack of transparency, and corruption practices that are identified around the licensing system.

To reduce the barriers to business entry, the following recommendations should be considered in the short run (see World Bank 2022a for details): (i) consolidate the online registration process so that firms have the option of not making physical visits to the Register of Companies; (ii) consider the adoption of a Unique Business Identifier (UBI) and the strengthening of the legal framework for e-transactions; (iii) increase transparency by making all requirements and processing timelines for business registration/ licensing publicly available on a single government portal; and (iv) continue with capacity building and awareness raising on the relevance of formalization. In the medium to long run, governments should consider the possibility of setting up a One-Stop Shop for the start-up of business operations and revise legal frameworks related to business licenses to streamline and update them accordingly.

CHAPTER 4

BOOSTING TRADE TO SCALE UP PRODUCTIVITY OF THE FORMAL SECTOR



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1. Introduction

Trade can be a driver of economic diversification, productivity, and faster economic growth. It is well documented in the literature that countries with a strong export performance are more likely to experience faster economic growth and rising living standards (Lewer and Van den Berg, 2003). This is because firms that both export and import are deeply engaged in the international division of labor, and employ inputs based on frontier knowledge and technology in the production process, which increases their productivity and success in exports markets (Anderson et al., 2008). As new growth drivers are starting to emerge, notably through the expansion of services and participating in GVCs, accelerating growth will depend on how Zimbabwe is able to leverage trade to scale up productivity in the formal sector. Cross-country evidence, particularly from Bangladesh, Ethiopia, Mexico, and Vietnam, demonstrates how participation in GVCs has supported economic growth and structural change (World Bank, 2020b).

Zimbabwe's reliance on commodity exports has limited formal firms' participation in foreign markets. The country has relied on exporting extractive commodities globally to meet its import requirements. Zimbabwe produces precious metals such as gold and platinum, and also diamonds, and is one of the largest exporters of platinum in the world. In 2020, mineral exports accounted for more than 70 percent of exports from Zimbabwe and contributed around 11 percent of the country's GDP. The dependence on extractive commodities exports, as well as worsening of the allocation of resources across manufacturing firms (Oosterndorp et al., 2018), has continued to stifle the development of the more productive manufacturing and services sectors.

Zimbabwe has great potential to expand trade in the formal sector. There are significant opportunities for developing Zimbabwean firms to integrate into regional value chains and GVCs, given the structural changes in the global economy over the past decade. The recent restructuring of the global economy due to the COVID-19 pandemic gives Zimbabwean firms a chance to integrate into existing value chains, as well as tap into sophisticated services such as telecommunications, business processes outsourcing, and software development. In addition, Zimbabwe has a young population, with stronger human capital resources than its peer countries in the region.[46]

However macroeconomic instability, price and exchange rate distortions, and cumbersome regulations have inhibited the performance of Zimbabwean firms. A policy matrix to boost trade in the formal sector is therefore complex, wide-ranging, and diverse given the current macroeconomic and business environments in Zimbabwe. This chapter examines Zimbabwe's trade performance and prospects from the perspective of comparative advantage, GVC participation, and the potential for trade policy reforms and new opportunities.

2. Zimbabwe's Export Performance

While exports of goods and services as a percentage of GDP have recently improved, the overall trend shows that Zimbabwe has been underperforming over the past two decades. Exports of goods and services declined from an average of 33 percent between 2002 and 2009 to 25 percent a decade later (2010–19). In 2020, Zimbabwe's ratio of exports of goods and services to GDP improved more than comparator countries such as Mauritius, Namibia, and South Africa (Figure 4.1). The recent improvements in export performance are attributable to rising commodity prices, as well as changes in legislation on artisan gold mining that have improved gold deliveries and production.

As mentioned in Chapter 2, the export productivity premium for Zimbabwe is strikingly low by regional standards (Figure 4.2). The lower exporter productivity premium suggests that markets are not functioning well in

FIGURE 4.1. EXPORTS OF GOODS AND SERVICES AS A % OF GDP, ZIMBABWE AND COMPARATORS

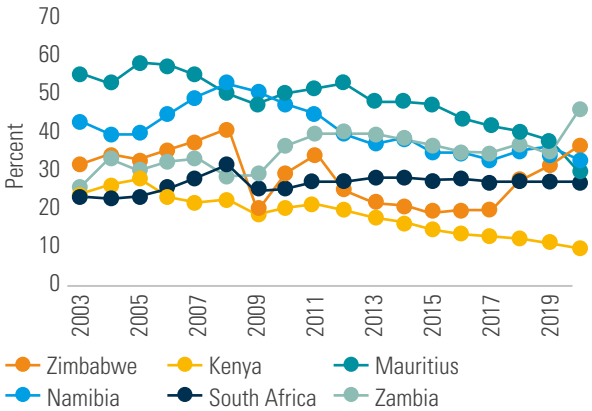
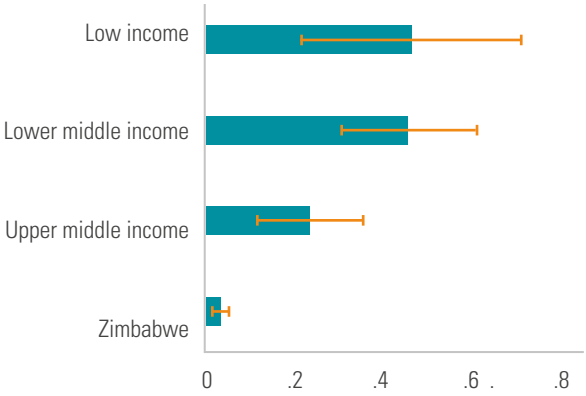


FIGURE 4.2. EXPORTING PRODUCTIVITY PREMIUM, ZIMBABWE AND COMPARATOR GROUP



Source: World Bank staff calculations based on World Development Indicators and WBES data.

46 In 2020, the World Bank placed Zimbabwe (0.5) above Zambia (0.4), Namibia (0.4), Botswana (0.4), Malawi (0.4) and South Africa (0.4) according to its HCI.

terms of reallocating resources from low to high productivity firms. Oosterndorp et al. (2018) show that the allocation of resources toward high-productive firms has become less efficient across all manufacturing subsectors in Zimbabwe, affecting the aggregate productivity of manufacturing firms. Macroeconomic instability, limited competition, cumbersome regulations, and heavy-handed enforcement can explain the lower gains from exports in Zimbabwe.

Primary commodities, particularly mining products, dominate the export basket. Exports of goods have become more concentrated on primary products, with gold, raw tobacco, and other metals and minerals accounting for almost 85 percent of total exports in 2020 (Figure 4.3). Gold exports more than doubled during the past decade, from 10 percent of total exports in 2010 to 46 percent in 2020, and still account for the country's most exported item. Other metals and minerals, such as platinum and nickel, continue to perform well on the back of higher commodity prices in recent years. Zimbabwe can export more metals and minerals if key factors impeding production, such as foreign currency shortages, surrender requirements for export proceeds, and the fragile power supply, are addressed by the authorities (Zimbabwe Chamber of Mines, 2022).

Diversification in goods exports has been limited, with fewer new products being exported every year. In the early 2000s, Zimbabwe used to introduce a considerable number of new products in the export basket. The rate of discovery (exports of previously un-exported products), however, has been declining (Figure 4.4). The decline is mainly due to macroeconomic challenges and other market distortions that have continued to suppress the performance of firms after the 2008/09 global financial crisis. Price instability and currency issues have eroded firms' investments and stifled productivity growth limiting the number of products exported. As mentioned in Chapter 1, over the past two decades, Zimbabwe has experienced episodes of high inflation,[47] and this has led to firms' closures and downsizing as the value of firms' bank holdings was eroded by inflation (Masiyandima and Edwards, 2018). The volatile macroeconomic environment created persistent exchange rate distortions, an overvalued local currency, and a high parallel market premium, which suppressed productivity growth of the formal sector. In addition, Zimbabwe's high consolidated public sector debt, as well as large arrears, makes the country vulnerable to capital volatility and capital flight, with negative impacts on domestic investment and growth.

Photograph Credit: Krunja / Shutterstock

FIGURE 4.3. ZIMBABWE'S EXPORTS OF GOODS BY PRODUCT TYPE (US$ BILLION)

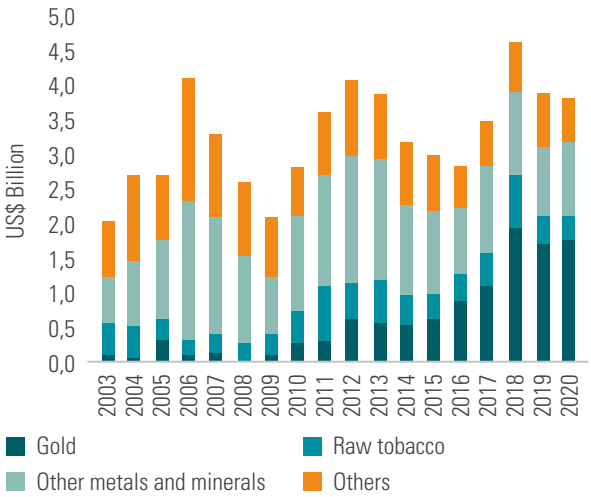
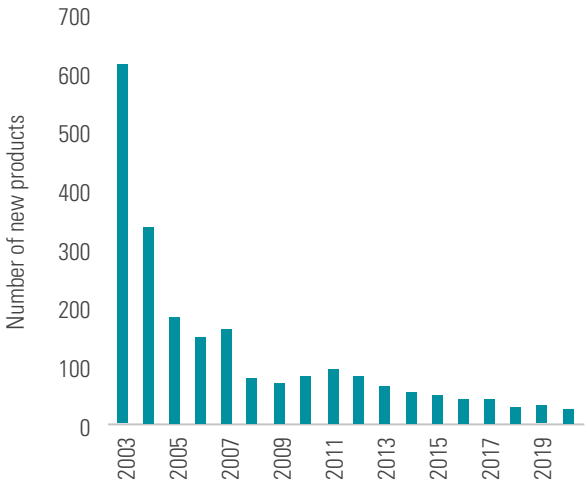


FIGURE 4.4. NEW PRODUCT DISCOVERIES (HS6), NUMBER



Source: World Bank staff calculations based on BACI.
Notes: BACI is a French acronym of "Base pour l' Analyse du Commerce International": Database for International Trade Analysis (see Gaulier and Zignago, 2010).

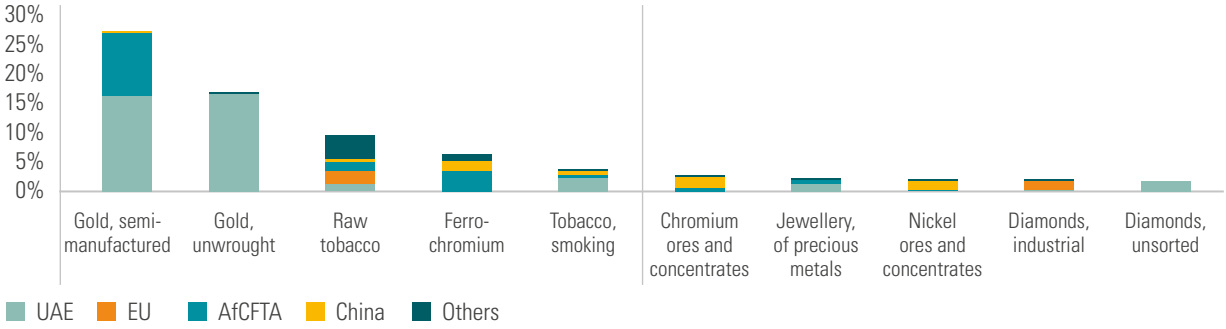
[47] According to Nyawo and Rankin (2020), Zimbabwe experienced daily inflation rates of close to 100 percent during 2008.

Merchandise exports are driven by a few products, increasingly concentrated in just a few destination markets. The top ten exported products are mainly extractives, accounting for almost 75 percent of total exports. In fact, the top five export products accounted for more than two-thirds of total exports in 2019. In terms of geographical concentration, the United Arab Emirates (UAE) is currently Zimbabwe's main export destination, accounting for almost 40 percent of Zimbabwe's total exports in 2019. Exports to the UAE consist of mainly gold. Other important destinations include South Africa and Mozambique (Figure 4.5).

Zimbabwe has export potential for non-primary products to other African countries. The export basket for Zimbabwe is diverse if primary products are excluded, with several products destined within Africa. The most important non-primary export products are oil cakes, sweet biscuits, orange juice, and plastic bottles and flasks (Figure 4.6). However, it is important to note that the share of non-primary export products in total exports is very small, at only 3 percent in 2020, down from 13 percent in 2003 (Figure 4.7). This shows that Zimbabwe used to have a significant share of non-primary export products and has significant untapped potential to export non-primary products within Africa.

Photograph Credit: optimarc / Shutterstock

FIGURE 4.5. TOP TEN EXPORT PRODUCTS, 2019 (% OF TOTAL EXPORTS)



Source: World Bank staff calculations based on BACI.

FIGURE 4.6. TOP TEN NON-PRIMARY EXPORT PRODUCTS BY DESTINATION, 2019 (US$ MILLION)

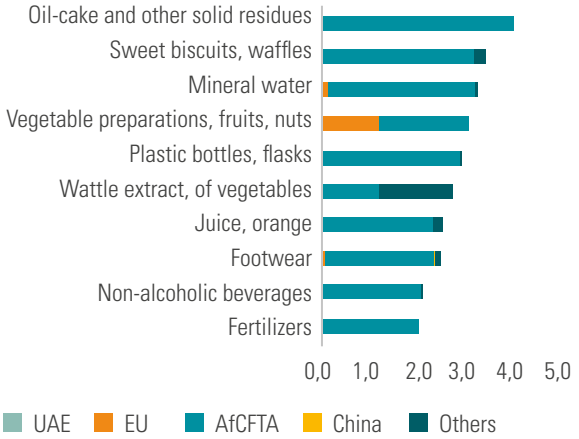
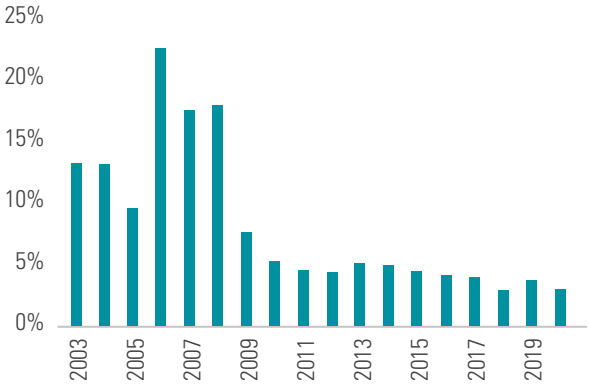


FIGURE 4.7. ZIMBABWE, SHARE OF NON-PRIMARY PRODUCTS IN TOTAL EXPORTS BY YEAR, 2003–20 (%)



Source: World Bank staff calculations based on BACI.
Note: The left panel shows the top ten exports by values, while the right panel shows the shares of non-primary products by year.

Zimbabwe is lagging its regional peers in services export growth. Services trade exports in Zimbabwe grew by a mere 3 percent annually on average between 2005 and 2019. The expansion of services exports has been substantially smaller than in comparator countries, such as Kenya, Zambia, Namibia, and Mauritius (Figure 4.8). Zimbabwe's growth in services exports has been driven by the tourism sector, which accounted for nearly all of Zimbabwe's services exports. In 2019, travel (including tourism) accounted for 91 percent of Zimbabwe's services exports and transport accounted for 7 percent (Figure 4.9).

The expansion and complexity of exported services remain limited, as the country has been unable to export services beyond tourism (travel) and transport. Despite its well-educated labor force, Zimbabwe has seen little diversification of its services exports over the past decade, particularly in modern services. In 2019, other commercial services exports (excluding tourism and transport) accounted for less than 2 percent of total services exports. Modern services include telecommunications, computer and information services, insurance and pension services, finance and banking, business processes outsourcing, knowledge processes outsourcing, and education. Other business services, such as those provided by lawyers and accountants, were larger in South Africa (18 percent of total services exports) and Mauritius (16 percent of total services exports).

The dominance of SOEs in key enabling services subsectors has hampered the emergence of modern services exports. Telecommunications and other internet-based services are crucial to the development of exports and productivity growth in general. The presence of SOEs in telecommunications, as well as in energy and transportation, has limited the development of modern services in Zimbabwe. In telecommunications, for example, the lack of competition continues to hamper growth in the sector. TelOne, an SOE, is the largest internet service provider and monopolizes wire services. As a result, consumers face high internet fees and poor-quality services. Similarly, services have three cellular service operators, one private operator (Econet), one that is 60 percent state-owned Telecel, and the state-owned NetOne.

The COVID-19 pandemic is reshaping the services trade, which presents new opportunities for countries such as Zimbabwe. Structural changes over the past decade, and more recently during the COVID-19 pandemic, have already started shifting the pattern of services toward digitally delivered services, such as telecommunications, business processes outsourcing, and software development. Multinational corporations are increasingly unbundling their corporate functions, such as human resource management, customer support, accounting, finance, and procurement operations, and offshoring these activities. The outsourcing of such services reduces the burden of support activities, allowing firms to focus on their core business. India and Chile are good examples of countries that are creating knowledge behind products. India exports pharmaceuticals research and development to multinational corporations, while Chile exports engineering services related to mining (Gereffi and Fernandez-Stark, 2016). The new developments present opportunities for countries such as Zimbabwe to advance into more sophisticated services exports, with its large and well-educated young working force compared to LMICs and UMICs in the region. Zimbabwe has substantial room for tapping into services exports beyond tourism and transport, such as telecommunications, and computer and information services, as well as business processing outsourcing in sectors such as accounting and IT services.

FIGURE 4.8. GROWTH IN COMMERCIAL SERVICE EXPORTS (2005=100)

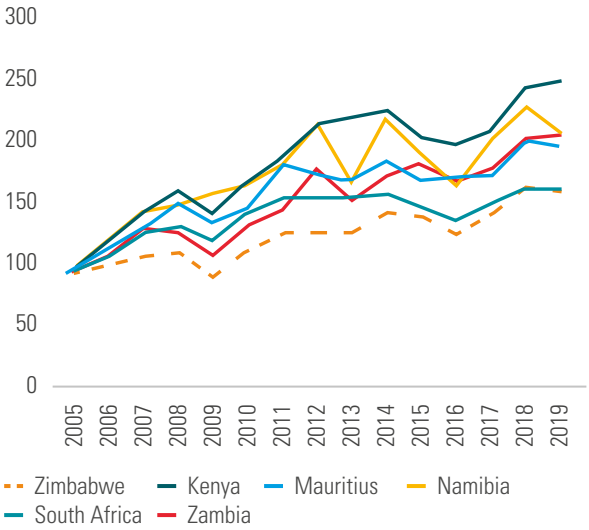
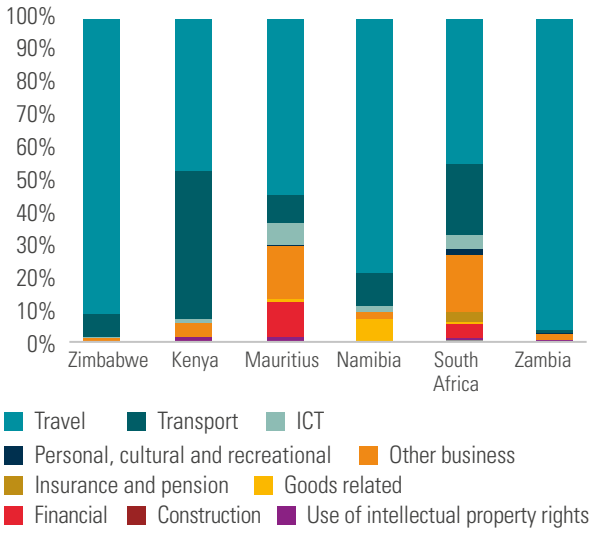


FIGURE 4.9. COMMERCIAL SERVICE EXPORTS COMPOSITION, ZIMBABWE AND PEER COUNTRIES



Source: World Bank staff calculations based on WTO-OECD BATIS database. Data in Figure 4.9 refer to 2019.

3. Searching for Comparative Advantage in Merchandise Exports

There is little evidence that Zimbabwe's comparative advantage in the manufacturing sector has grown over time. The country's comparative advantage has barely changed over the past decade. Zimbabwe has maintained its comparative advantage in primary products such as raw tobacco, metals, minerals, and hides and skins over the past decade, but it has lost its manufacturing sector comparative advantage in textiles and clothing, where it previously had a comparative advantage in 2003–08 (Table 4.1). The results are consistent with the findings from the USITPC ITPD-E database (see Appendix 2). The poor performance in the manufacturing sector's comparative advantage is attributed to across-the-board constraints that are stifling those subsectors that could catalyze Zimbabwe into a successful exporter.

Integrating into GVCs is important for exploiting economies of scale, but Zimbabwe is yet to successfully achieve this. Empirical evidence suggests that participating in GVCs boosts productivity and income and supports poverty reduction beyond what countries can achieve through one-way trade (World Bank, 2020b).[48] Bangladesh, Ethiopia, Mexico, and Vietnam are examples of how countries that integrated into GVCs increased firms' productivity, created employment, and boosted economic growth (see Box 4.1). An analysis by manufacturing subsectors indicates little growth in Zimbabwe's GVC participation over the past decade in previously large export sectors, such as apparels, footwear, and textiles. In fact, between 2002 and 2010, GVC participation declined faster across all GVC sectors[49] (Figure 4.10). Ten years later, broad sector GVC participation remains at its lowest. For a country such as Zimbabwe that specializes in exporting primary commodities, transitioning into limited manufacturing requires substantive efforts in addressing the investment climate, and establishing simple procedures for registering foreign investors, as well as giving priority to improving trade-related infrastructure.

TABLE 4.1. SECTORAL COMPOSITION AND REVEALED COMPARATIVE ADVANTAGE

	AVERAGE 2003–08		AVERAGE 2009–14			AVERAGE 2015–20		
	Value	RCA	Value	RCA	Contribution to growth	Value	RCA	Contribution to growth
Animal	31.9	0.5	28.0	0.18	-0.1	24.6	0.17	-0.1
Vegetable	251.6	**5.91**	155.5	0.98	-3.3	153.1	0.59	-0.1
Foodstuffs & tobacco	508.9	**5.31**	807.5	**7.37**	10.2	706.8	**7.89**	-3.1
Minerals	471.9	**1.8**	313.7	0.62	-5.4	416.5	**1.17**	3.1
Chemicals	89.2	0.34	23.8	0.05	-2.2	17.5	0.04	-0.2
Plastic / Rubber	15.8	0.11	15.0	0.07	0.0	8.2	0.04	-0.2
Hides, Skins	26.3	0.85	41.6	**1.42**	0.5	50.7	**1.56**	0.3
Wood	70.8	0.84	42.7	0.45	-1.0	44.0	0.35	0.0
Textiles, Clothing	231.6	**1.84**	239.7	**1.28**	0.3	76.9	0.43	-4.9
Footwear	4.8	0.19	4.0	0.13	0.0	4.2	0.13	0.0
Stone / Glass	13.4	0.34	5.0	0.09	-0.3	10.6	0.1	0.2
Metals	945.6	**2.07**	1546.6	**4.1**	20.5	2055.9	**4.73**	15.4
Mach/Elec	61.9	0.08	38.4	0.04	-0.8	35.6	0.04	-0.1
Transportation	100.4	0.31	18.8	0.04	-2.8	12.6	0.04	-0.2
Miscellaneous	102.4	0.9	19.6	0.15	-2.8	11.0	0.09	-0.3
	2,926.45		3,300.10		12.8	3,628.16		9.9

Source: World Bank staff calculations based on BACI.
Note: A positive RCA index above one indicates that the country's share of exports in that sector exceeds the same sector's global export share in the same period. If so, we infer that the country has a comparative advantage in that sector. The contribution to export growth is computed as the compound annual growth rate multiplied by the share of total exports, and it indicates the importance of observed sectoral-level export changes to overall export performance. The contribution to export growth refers to changes between our periods of analysis. Export value is in millions of US dollars. It is worth noting that foodstuff includes tobacco exports, which is one of Zimbabwe's main exports.

[48] A 1 percent increase in GVC participation is associated with more than a 1 percent increase in per capita income in the long term.

[49] Gross trade data disaggregate which portion of a country's exports is in final or intermediate goods. Sturgeon and Memedovic (2010) focus on three major GVCs, namely apparel and footwear, electronics, and vehicles. Drawing on their classification of underlying goods into final and intermediate goods, the World Bank recently published the GVC Dashboard. The three GVCs differentiate between intermediate and final goods, while apparel and footwear additionally breaks out textiles as a third product type.

BOX 4.1. PARTICIPATION IN GVCS CAN LEAD TO HIGHER PRODUCTIVITY, EMPLOYMENT, AND ECONOMIC GROWTH

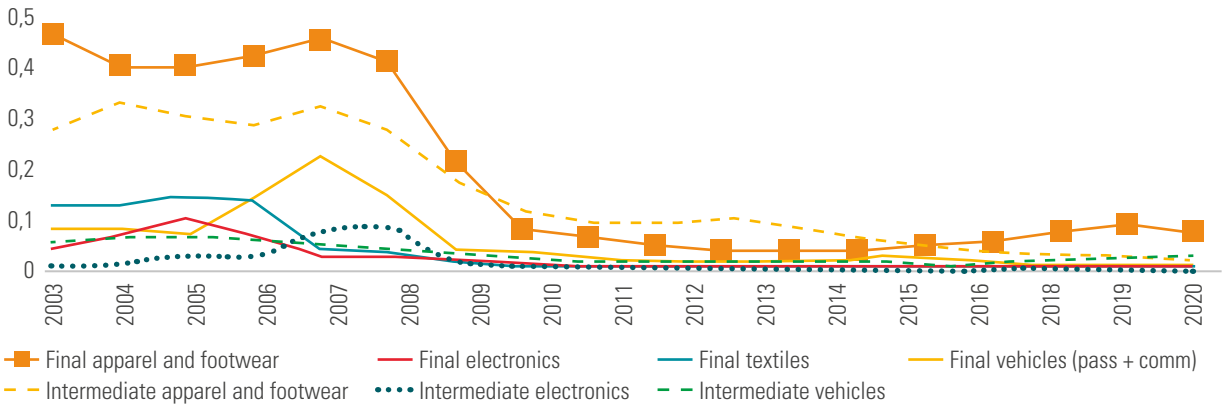
Cross-country evidence, such as in Bangladesh, Turkey, Ethiopia, Lesotho, and Mexico, shows how participation in GVCs has supported economic growth and structural change. Bangladesh's exports of apparel increased from less than 1 percent of global trade in 1988 to nearly 7 percent in 2020. The apparel sector currently employs more than 3.6 million workers, of which 55 percent are female. Turkey saw phenomenal growth in the 2000s as economic reforms ushered in new FDI and GVCs expanded with firms increasing their productivity. From 2001 to 2017, income per capita doubled in real terms and exports of goods and services increased from 20 to 206 percent of GDP. In Ethiopia, firms that both import and export are more capital-intensive and increased their labor force faster than other firms (Chol, Fukase and Zeufack, 2019). Employment from the manufacturing sector expanded between 2000 and 2014, with GVC firms accounting for an increasing share of manufacturing employment. Similarly, Lesotho's integration into GVCs in the global apparel sector accounted for 10 percent of the country's workforce and half of manufacturing employment in 2009. Between 2004 and 2014, provinces in Mexico that became more GVC-intensive experienced faster growth and employment, with net job creation exceeding 12 million workers.

Source: World Bank, 2020b, 2021.

There are opportunities to reboot Zimbabwe's participation in GVCs. The NDS1 outlines its ambitions to double the contribution of value-added exports to total exports from US$0.7 billion in 2020 to US$1.3 billion in 2025. Higher participation in GVCs is expected to be driven by improved performance of the manufacturing sector through value addition. The NDS1 prioritizes agro-based value chains, pharmaceuticals, bus and truck assembly, iron and steel, and plastic waste value chains. While these subsectors have untapped potential and need significant investment, a quicker way to foster economic diversification and upgrading is to create and strengthen linkages between GVC actors and local suppliers. Zimbabwe's food and beverages subsector, as well as tourism and transport, depends more strongly on domestic upstream sectors, showing potential to strengthen linkages between agriculture, food processing, and the hospitality industry. In addition, the recently signed African Continental Free Trade Area (AfCFTA) aims to improve market access for Zimbabwe's products.

Photograph Credit: Captureworld Images / World Bank

FIGURE 4.10. ZIMBABWE'S GVCS EXPORTS, 2003–20 (% OF GDP)



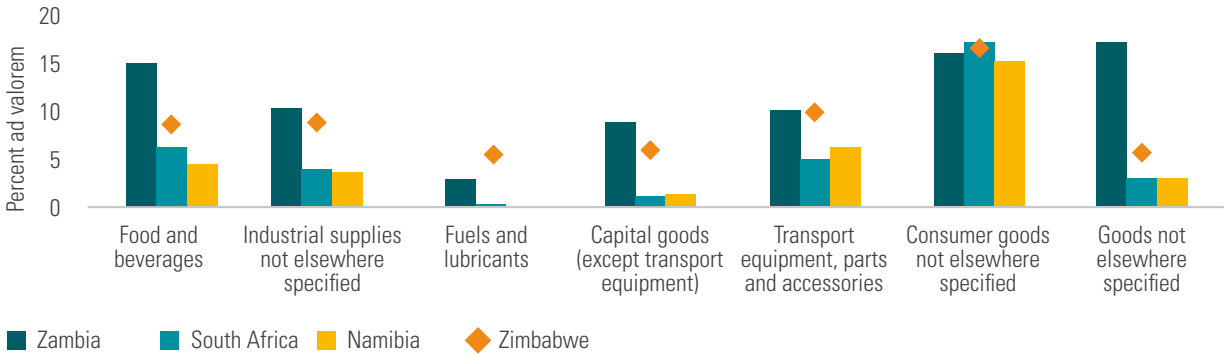
Source: World Bank staff calculations based on the World Bank GVCs dashboard.

4. Trade Integration and Opportunities

Zimbabwe is a signatory to numerous regional trade agreements, but trade remains constrained by relatively higher tariffs, and hurdles in access to foreign currency and trade facilitation. Zimbabwe continues to levy significantly high and increasing tariffs, with a simple average tariff rate of 15.8 percent in 2019—an increase from 15.4 percent in 2017 (WTO, 2020). Between 2017 and 2020, customs and other import duties contributed an average of 8.5 percent of Zimbabwe's total tax revenue, which is significantly higher than peer countries such as Zambia (6.8 percent), Kenya (6.8 percent), South Africa (3.9 percent) and Mauritius (1.4 percent). Tariffs on intermediate inputs and capital goods are high, hindering value addition and technology adoption. When compared with peer countries in the region, Zimbabwe has a higher average tariff rate, with several duty concessions in the manufacturing sector. These duty concessions, introduced as investment drivers, include clothing manufacturers' rebates, electricals manufacturers' rebates, rebates on duty for goods for the mining industry, furniture manufacturers' rebates, and textiles manufacturers' rebates. Thus, the country's tariff schedule is more likely to cause distortions in economic incentives and to encourage traders to engage in tax evasion and misreporting than other countries in the region. Figure 4.11 shows average effectively applied tariff rates for each sector. Zimbabwe's tariffs are the highest in fuels and lubricants compared with peer countries in the region. They are second highest (after Zambia) on food and beverages, industrial supplies, capital goods, and transport equipment and parts. Tariffs are highest among the sample for consumer goods, a common trend for most developing countries.

Weak performance on trade facilitation and border management hinders Zimbabwe from becoming a major player in regional trade and gain from the AfCFTA. Zimbabwe underperforms in almost every aspect of movement across borders (Figure 4.12). Significant gaps in trade facilitation are seen in automation, information availability, documents, and governance and impartiality. Substantial improvements in border management operations and logistics infrastructure could help Zimbabwe to connect with regional markets in a more effective and efficient manner. There are opportunities for investments in transport and logistics infrastructure to support the development of regional economic linkages and value chains. Zimbabwe could become a regional transit hub given its geographic position in the Southern Africa region. Although landlocked, Zimbabwe is a key transit zone for Zambia, Malawi, and the Democratic Republic of Congo. Zimbabwe could offer services such as trucking services, bonded warehouses, and value-added services such as consolidation, light assembly, or processing.

FIGURE 4.11. AVERAGE EFFECTIVELY APPLIED TARIFFS, LATEST AVAILABLE YEAR (% AD VALOREM)



Source: World Bank staff calculations based on UNCTAD-TRAINS (Trade Analysis and Information Systems) database.

FIGURE 4.12. TRADE FACILITATION PERFORMANCE BY PILLAR, 2019

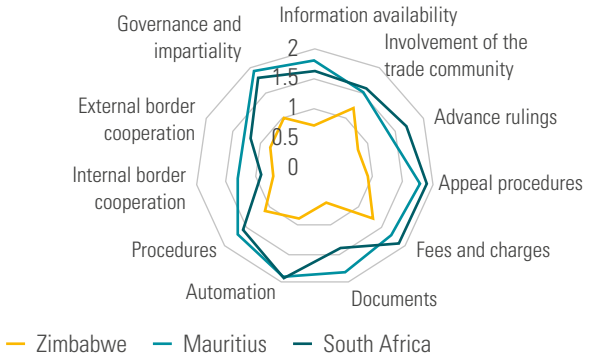
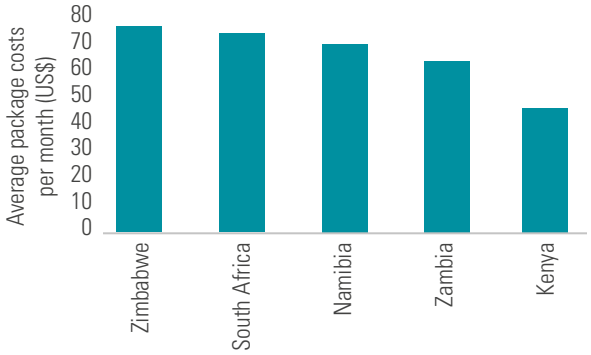


FIGURE 4.13. AVERAGE BROADBAND PACKAGE COST, PER MONTH



Source: World Bank staff calculations based on OECD Trade Facilitation Indicators; Cable.
Note: Data on average broadband package costs per month are extracted from https://www.cable.co.uk/broadband/pricing/worldwide-comparison/

Investing in digital infrastructure will strengthen Zimbabwe's adaptability to embrace technological change, thereby increasing competitiveness. Zimbabwe is still lagging in terms of the quality of trade-related infrastructure, such as certification systems and border risk management. Fully implementing the WTO Trade Facilitation Agreement would have positive provisions that could be leveraged to improve trade-related infrastructure. New technologies will have a huge impact on how these trade-related services are delivered. Costa Rica and Colombia are examples of how leveraging digital technologies reduced corruption cases, while at the same time increasing tariff revenues. Improving digital infrastructure, such as broadband/4G and making it affordable, would further improve the enabling environment for modern services.

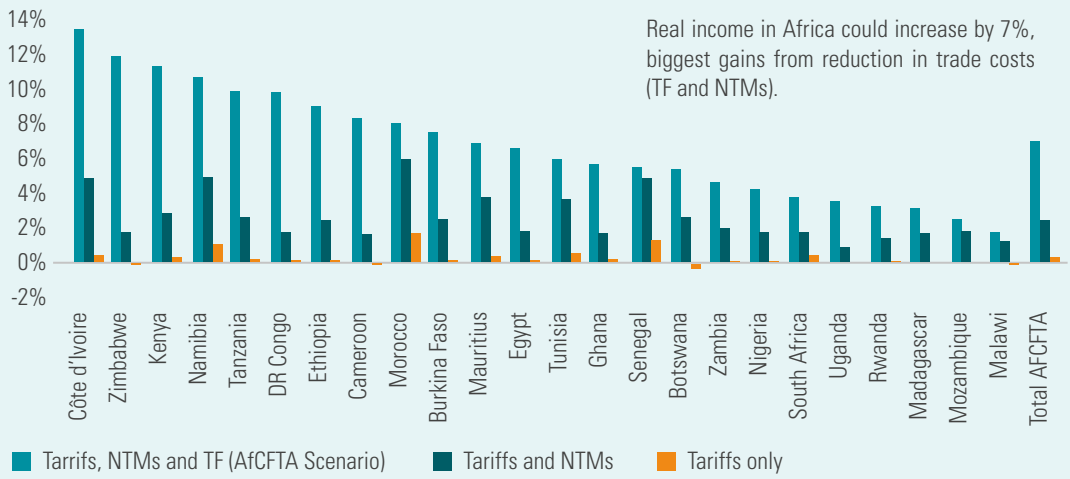
Zimbabwe charges significantly higher broadband prices than comparator countries. If Zimbabwe is to move up the value chain and focus on advanced manufacturing and services, the authorities need to address restrictive services such as unaffordable internet access. Zimbabwe's average broadband package cost per month is among the most expensive in the region compared with Kenya, Zambia, Namibia, and South Africa (Figure 4.13). Countries that have managed to succeed in outsourcing modern services, such as India, had an average broadband package cost of below US$20 per month. In 2019, the World Economic Forum ranked Zimbabwe as the most expensive country in which to purchase mobile data.[50] Countries such as India, that have experienced significant growth in services exports, recorded the cheapest average data cost per gigabyte.

The benefits of joining the AfCFTA are estimated to be significant for Zimbabwe. Intra-AfCFTA trade is predicted to increase with the full implementation of the trade agreement. Zimbabwe's exports of processed foods, agricultural products, and manufactured goods stand to gain the most in terms of exports to AfCFTA partners (World Bank, 2019c). Faster expansion of selected sectors, such as agriculture, food processing, construction, and trade in services, is expected with the full implementation of the AfCFTA due to lower trade costs and better access to markets within Africa (see Box 4.2).

BOX 4.2. REDUCTION OF TARIFF AND NON-TARIFF MEASURES, AND THE IMPLEMENTATION OF TRADE FACILITATION MEASURES ARE KEY TO REALIZING GAINS FROM THE AFCFTA

According to the World Bank (2020b), Zimbabwe is one of the countries, after Côte d'Ivoire, that stands to gain the most from the full implementation of the AfCFTA. Zimbabwe has highest non-tariff measures (NTMs) in minerals, chemicals, and business services. Reductions of these NTMs and the implementation of trade facilitation measures are key to realizing gains from the AfCFTA. A reduction in tariffs, NTMs, and improved trade facilitation are expected to boost real income by 12 percent and increase exports by 47 percent by 2035 relative to the baseline. Exports of processed foods, energy intensive goods, textiles, and manufactured goods stand to gain the most in terms of total exports. Wages of unskilled and female workers should grow fastest, but all workers are expected to benefit.

REAL INCOME (WELFARE) IMPLICATIONS
(2035, % relative to the baseline)



Source: World Bank, 2020.

[50] https://www.weforum.org/agenda/2019/09/which-country-offers-mobile-data-cheapest-india-zimbabwe-ukraine-rwanda/

5. Proposed Policies to Boost Productivity of Formal Firms through Trade

What should be the desired state of trade in Zimbabwe if the country is to achieve UMIC status? Countries such as Algeria, Armenia, and Botswana that transitioned from LMIC to UMIC status saw a significant expansion of exports of 10 or more percentage points of GDP. Zimbabwe could achieve this too if there is fast growing exports of non-extractive goods and services. We provide two pathways through which Zimbabwe can use trade to scale up productivity in the formal sector by: (i) supporting export diversification, upgrading, and integrating into GVCs; and (ii) trade policy and regional integration reforms. Maximizing the benefits of the proposed policy options will require addressing as a priority the macroeconomic challenges and ensuring a level playing field for private sector-led growth (the first and second pathways identified in Chapter 2).

5.1. Support export diversification, upgrading and integrating into GVCs

Develop linkages between domestic SMEs and leading GVC firms through supplier linkage programs. The GoZ, through ZimTrade,[51] can facilitate and strengthen the supplier linkage programs between domestic SMEs and large-scale firms that are already involved in exporting. Currently, Zimtrade's mandate is to assist Zimbabwean exporters, including first-time exporters and potential exporters, to develop, promote and facilitate the export of their goods and services to the rest of the world. Zimtrade[52] can expand its mandate by coordinating local supplies and providing access to information and supply opportunities through developing an online portal and a digital application to offer basic matchmaking services between foreign firms and domestic producers. Supplier linkage programs have proven successful in Chile and the Gambia in mining, Kenya and Mozambique in agriculture, and the Czech Republic in the electronics and automotive sectors (Farole and Winkler, 2014; World Bank, 2020).

The authorities need to address restrictions that hamper the trade in services. So far, Zimbabwe's trade in services has been largely limited to tourism and transport. Improving competitiveness of other services sectors, such as accounting and information technology, would help boost productivity and exports. A key area of reform will be to improve access to affordable data. Modern services require easy access to affordable internet. Zimbabwe may need to create conditions for a competitive broadband package if it is to participate in outsourcing modern services globally. In addition, reforms in sectors still dominated by SOEs should be prioritized to allow greater private sector participation. The authorities should open sectors such as post and telecommunications, media, transport, and energy to the private sector to allow greater competition. These sectors are required to operate efficiently if Zimbabwe is to harness modern services, such as business processes outsourcing, IT, accounting, and financial services. Addressing these restrictions to trade in services is likely to boost GVC participation and expand exports.

5.2. Trade Policy and Regional Integration Reforms

Tariff reductions and the zero-rating of tariffs on intermediate and capital goods will help enhance GVC participation. An immediate policy step that Zimbabwe could take is to simplify its tariff structure by eliminating duty concessions, such as rebates, and by zero-rating capital and intermediate goods used in the production process. For example, a large unilateral tariff reduction by Peru in the first decade of the 2000s led to lower input costs, faster productivity growth, and expansion and diversification of GVC exports (World Bank, 2020b). A simplified tariff schedule with a few basic rates will also likely reduce economic distortions.

The authorities should update the current National Export Strategy and the National Industrial Development Policy with an explicit productivity lens aligned with AfCFTA implementation. The policies should include a road map for AfCFTA implementation that is aligned with industrialization and sector strategies. In addition, there is need to develop a monitoring and evaluation framework that goes beyond ticking boxes for legal compliance to implementation, and instead be designed to ensure that feedback on emerging negative impacts on firms is captured, and then mobilizes support for interventions to address these impacts. New sources of information could be leveraged from direct and regular feedback from selected representatives of firms and through the analysis of new data sources.

Improving trade facilitation measures can also help to reboot trade. Zimbabwe has substantially reformed its trade facilitation system over the past few years, but further improvements will help consolidate the current gains. A good start is to review and benchmark the customs modernization strategy in the context of AfCFTA implementation, and then design a clear trade facilitation action plan. Key areas to focus on are as follows:

i. *Automation:* Fully automating all agencies participating in trade will be critical to reducing time and costs, as well as revenue losses due to leakages. These include all government departments that give export licenses and permits, such as the Ministry of Lands, Agriculture and Rural Settlement, the Ministry of Industry and Commerce, and the Ministry of Environment/ Environment Management Agency. Currently, exporters are required to visit these agencies in person and must complete paper application forms to obtain permits or licenses.

[51] ZimTrade is the National Trade Development and Promotion Organization of Zimbabwe, established in 1991.

[52] ZimTrade has facilitated a technical interventions program with PUM of the Netherlands and SES of Germany to facilitate trade.

ii. *Streamlining procedures and going paperless in all customs clearance procedures:* Currently, the Zimbabwe Revenue Authority (ZIMRA) requires paperwork that must be stamped and marked off for onward clearance. Not only is this burdensome to traders, but it is also costly and time-consuming. Replacing paper-based documentation with electronic-based documentation should be prioritized.

There is a clear need to boost competitiveness in manufacturing and commercial services. Reforming areas that support export diversification, upgrading, and integration into GVCs, as well as simplifying tariffs and trade facilitation, requires a coherent strategy, as well as well-defined responsibilities among government agencies.

TABLE 4.2. PRIORITY POLICY RECOMMENDATIONS FOR REVIVING TRADE IN ZIMBABWE

AREA	SHORT TERM	MEDIUM TERM
Export diversification and integrating in GVCs	Develop linkages between downstream and upstream firms through supplier linkage programs.	Draft a policy that allows R&D expenditures to be offset against taxes.
Tariffs	Simplify the tariff structure by adopting efficient and lower tariffs. Zero rate tariffs on capital goods and intermediate inputs, rendering the current duty concessions unnecessary.	Implement the tariff reductions required within the AfCFTA agreement.
Trade in services	Improve access to affordable internet data by reducing the average cost of a broadband package.	Promote private sector participation in sectors such as post and telecommunications, media, transport, and energy.
Trade facilitation	Fully automate all agencies that provide export licenses and permits, such as the Ministry of Lands, Agriculture and Rural Settlement, the Ministry of Industry and Commerce, and the Environmental Management Agency. Reduce the number of inspections, including by replacing paper-based documentation with electronic-based documentation.	Use the WTO TFA as guidelines for developing ambitious trade facilitation reforms.
Vision and coordination	Update the current National Export Strategy and the National Industrial Development Policy with an explicit productivity lens aligned with full AfCFTA implementation. Establish well-defined lines of responsibility across all government agencies and the private sector.	Fast track the implementation of the AfCFTA agreement. Develop a monitoring and evaluation framework that ensures feedback on emerging negative impacts on firms and then mobilizes support to address these impacts.

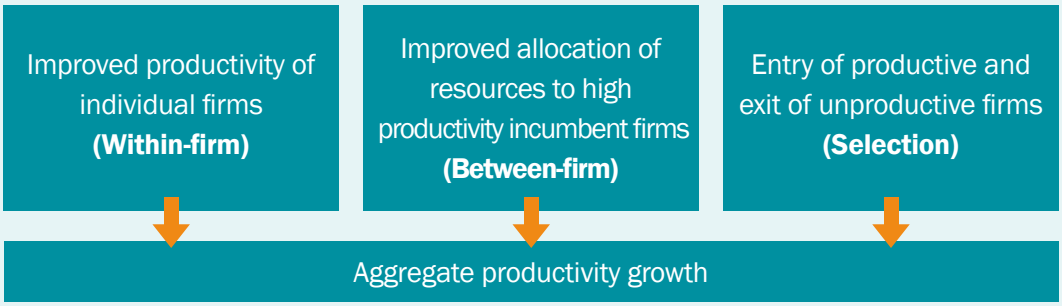
APPENDICES

APPENDIX 1. DECOMPOSING AGGREGATE PRODUCTIVITY GROWTH AND SOURCES OF MISALLOCATION

APPENDIX BOX 1.1. DECOMPOSING AGGREGATE PRODUCTIVITY GROWTH

Aggregate productivity can increase over time, through an improvement in the productivity of individual firms, allocating more resources to more productive firms, and the entry of more productive firms and the exit of less productive ones. Countries can improve aggregate productivity in three distinct but interrelated ways. The first is by promoting factors that increase the productivity of individual firms, which depends on their capabilities, such as the use and adoption of better technologies, the introduction of new products, and the use of better management practices. This is the so-called "within-firm" channel. The second is through improved reallocation of productive resources from low-productivity firms to more productive incumbent firms. The "between" captures this effect. Aggregate productivity can also be improved to the extent that the economy favors the entry of more productive firms and the exit of those that are less productive, allowing resources to be reallocated toward more productive firms. In a frictionless market, non-productive firms are supposed to be eliminated and productive ones to expand through selection. This is called the "selection channel".

APPENDIX FIGURE 1.1: COMPONENTS OF PRODUCTIVITY GROWTH



APPENDIX BOX 1.2. FIRM-LEVEL MISALLOCATION: AN ILLUSTRATIVE EXAMPLE

Aggregate productivity in an economy depends not only on the level of productivity of individual firms, but also on the allocation of productive resources (e.g., capital and labor) across these firms. A simple example illustrates how misallocation can reduce aggregate productivity. Consider an economy composed of two firms with different productivity levels, where each firm is producing using only capital input $Y_i = A_i K_i^{\alpha}$, where Y is value added, and K is capital input. Let the price of output be normalized to one, and the cost of capital in the absence of distortion be R. Also assume that the firms are facing a tax on their capital input, τ_{ki} (where $\tau_{ki} > 0$ is a tax and $\tau_{ki} < 0$ is a subsidy). One operates at low productivity but manages to survive thanks to preferential treatment it receives from the government at a very low interest rate τ_{kf} (favored firm (f)) because of its political connection, whereas the unfavored (u) one must borrow at a higher interest rate τ_{ku}, i.e., $\tau_{kf} < \tau_{uk}$ The firms maximize their profit by choosing the capital input, K. That is $\pi_i = Y_i - (1 + \tau_{ki})\, RK_i$. The first order condition for profit maximization gives:

$$MRPK_i \equiv \alpha\, A_i\, K_i^{\alpha-1} = (1 + \tau_i)\, R \qquad (1)$$

The optimal demand for capital input is given by:

$$K_i(A_i, \tau_{ki}) = \left(\frac{A_i\, \alpha}{(1 + \tau_{ki})\, \mathrm{R}}\right)^{\frac{1}{\alpha-1}} \qquad (2)$$

If the technological parameter (α) and undistorted cost of capital (R) is common for all firms, the demand for capital input increases with firms' productivity A but decreases with the level of distortion or tax τ_k.

In undistorted economy, where firms face the same distortion, i.e., $\tau_{fk} = \tau_{uk}$ allocation of capital is based solely on the relative productivity of firms, i.e.,

$$\frac{K_f^*}{K_u} = k^* = \left(\frac{A_f}{K_u}\right)^{\frac{1}{\alpha-1}}$$

Each firm uses an optimal level of capital input and the total output in this economy is just an aggregate of individual firms.

In a distorted economy, however, the ratio of capital between the two firms is $\frac{K_f}{K_u} \equiv k = \left(\frac{A_f}{A_u}\frac{1+\tau_{kf}}{1+\tau_{kf}}\right)^{\frac{1}{\alpha-1}}$ the allocation of resources depends not only on relative firm productivity levels, but also on the firm-specific (idiosyncratic) distortions. A higher fraction of the demand for capital stock by a favored firm is more than that justified by its productivity level. On the other hand, the unfavored firm does not employ as much capital input as it would be without the distortion. If firms receiving preferential treatment are the inefficient ones, i.e., $A_f < A_u$, the productivity losses associated with that policy would even be larger (Restuccia & Rogerson, 2013). Hence, aggregate productivity depends on not only on the productivity of individual firms but also on the share of resources allocated to each firm.

How is resource misallocation measured?

To empirically measure the extent of misallocation, this chapter uses the methodology of Hsieh and Klenow (2009). The underlying assumption behind this approach is that, if input and output markets are functioning well, the marginal revenue products of inputs should be equal across firms. To the extent capital allocation is driven by τ_k rather than A, there will be differences in the marginal product of capital across firms.

Given firm-level data on productivity A_i and capital input K_i for each firm, we can use equation (1) to infer the capital distortion, i.e., $\frac{\alpha\, A_i\, K_i^{\alpha-1}}{R} - 1 = \tau_{ki}$

APPENDIX 2. ESTIMATING COMPARATIVE ADVANTAGE USING THE USITC ITPD-E DATABASE

APPENDIX BOX 2.1. ESTIMATING COMPARATIVE ADVANTAGE USING THE USITC ITPD-E DATABASE

Costinot et al. (2012) develop a Ricardian model of trade, extending the work of Eaton and Kortum (2002).[53] Their objective is to quantify the importance of productivity differences as a driver of trade. But as a by-product of their investigation, they develop a simple method for analyzing patterns of comparative advantage that is fully consistent with their theoretical setup. Similar to many models of trade, theirs can be reduced to a gravity-like relation. Specifically, their theory predicts that bilateral trade flows by sector should satisfy the following relation:

$$(1)\ X_{ij} = b_{ij} f_j^k z_i^{k^\theta} e_{ij}^k$$

Where X_{ij}^k is exports from country i to country j in sector k; b_{ij} is a country pair fixed effect capturing structural features of the model, such as trade costs; f_j^k groups together importer-sector factors in a fixed effect; θ is a parameter from the theory capturing intra-industry heterogeneity in productivity; z_i^k is the fundamental productivity of country i in sector k, taking account of factors like climate, infrastructure, and institutions that affect all producers within a country; and e_{ij}^k is an error term satisfying standard assumptions. As suggested by the use of a parameter such as this, the objective of the exercise is to quantify comparative advantage, not to uncover its sources as in models such as Chor (2010), applied to services by van der Marel (2012).

Costinot et al. (2012) initially estimate (1) directly, using productivity estimates drawn from available data. However, such an approach is not practical for application to a wide range of countries, particularly developing ones, as such estimates are not readily available on a comparable basis. As the authors note, they are also subject to significant concerns regarding measurement error.

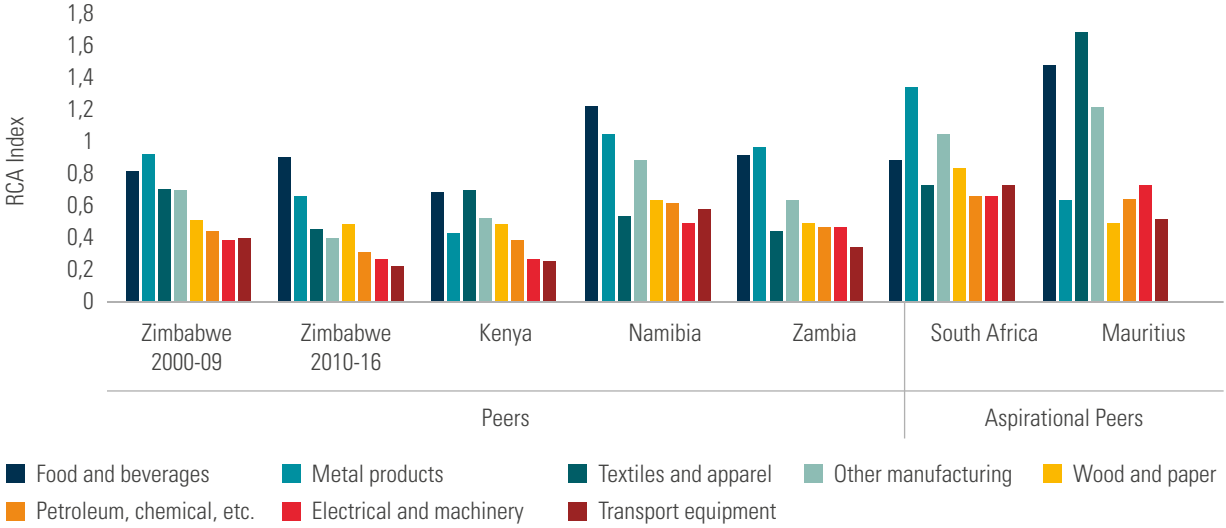
An alternative approach is therefore to replace the productivity variable with an exporter-sector fixed effect d:

$$(2)\ X_{ij}^k = b_{ij} f_j^k d_i^{k^\theta} e_{ij}^k$$

The standard PPML estimate will produce consistent estimates of the exporter-sector fixed effects. Once the estimates have been obtained, a value of θ from the literature can be used to construct revealed productivity measures by exponentiation, i.e., $Z_i = \exp\left(d_i^{k\,\theta} / \theta\right)$ where the numerator is simply the PPML estimate of the exporter-sector fixed effect. There are important advantages to proceeding in this way. First, the only limit on application is the availability of trade data. Second, the revealed productivity measure can be interpreted, as the authors do, in terms of a theoretical revealed comparative advantage measure by scaling it relative to a baseline country (the United States) and a baseline sector in each country (agriculture). The theory-consistent measure of comparative advantage has several advantages over the Balassa measure that is more commonly used. First, the Balassa measure is not informative about comparative advantage in a world with varying trade costs (French, 2017), whereas the measure here explicitly controls for the impact of trade costs. Second, the modification used here takes account of domestic production, which arguably is closer to the core idea of comparative advantage than a measure based on trade only, as is the case of the Balassa measure. Third, the measure does not have an artificial cutoff but is instead continuous (Costinot et al., 2012).

[53] The original source uses a log-linearized model. The presentation here retains the nonlinear form for the reasons set out in Santos Silva and Tenreyro (2006). Estimation is therefore by Poisson Pseudo-Maximum Likelihood (PPML) rather than Ordinary Least Squares (OLS). Similarly, internal trade is included in line with now-standard practice in gravity modeling, and as implied by theory (Yotov et al., 2016). Estimation uses the PPMLHDFE package (Correia et al., 2019).

APPENDIX FIGURE 2.1. REVEALED COMPARATIVE ADVANTAGE, ZIMBABWE AND PEER COUNTRIES



Source: World Bank staff calculations based on USITC ITPD-E database.
Note: Revealed comparative advantage (RCA) index is calculated as an average for 2000–09 and 2010–16 for Zimbabwe. For peer countries, the RCA index is the average for the period 2010–16.

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