

1.0 Summary of Economic highlights

a) The Zimbabwe Stock Exchange plummets

The majority of trading companies trading at the Zimbabwe Stock Exchange are feeling the blow of the interventionist policies by the government. The industrial index plunged by 20% on the 5th of June 2007. Retailers such as OK Zimbabwe failed to trade on the day as the organisation's share per unit crashed from ZWD \$1 500 to ZWD \$1000 by the closure of business yesterday. Econet also failed to trade any shares after the government slashed the telephone rates. The company's shares crashed from ZWD \$245 000 to ZWD \$180 000 per unit. Innscor Africa crashed from ZWD \$ 70 000 to ZWD \$ 25 000. Dairiboard Zimbabwe failed to trade as their share price crashed from ZWD \$ 85 000 to ZWD \$36 000 after the government imposed the new price ceilings on the industrialists. Of the 71 mainstream traders, only Seed Co recorded a positive transaction[1].

b) Retailers and manufacturers run out of commodities

The Weekly Economic Bulletin team this morning visited the majority of retail and manufacturing outlets and noted the pace at which basic commodities are fast disappearing from the shelves as consumers respond impulsively to price slashes by the government. The team predicts that the rate at which the market has panicked in response to the irrational price cuts by the government will give birth to food shortages before the end of this month, July 2007.

The price controls by the state are neither viable nor sustainable for the businesses to keep on producing goods and services. The price cuts were made indiscriminative of the costs of production for the organisations. Zimbabwe is regarded as one of the countries charging the most expensive interest rates on capital in the whole continent ranked in the same brackets with the likes of Iraq. If the government was concerned with the inflation regime prevailing in the country it could have applied scientific methodologies and tools to employ the most effective management of the inflation level noted below:

- Adoption of contractionary monetary and fiscal policies
- Reduction in government expenditure as a control of the annual budget deficits which has been an albatross on the neck of the government for the past quarter century.
- Boost foreign direct investment by improving investor confidence

In contrary, the militant approach to the macro-economic policies distorts the market mechanisms of demand and supply negatively. The intervention will discourage suppliers from producing as the goods will not recoup the cost of production and replenishment of stocks for the retailers and manufacturers respectively.

2.0 Introduction

In line with the shift by the government from the market mechanism pricing policy to price controls, we are going to make an analysis of the effects of price controls and the unfolding effects thereof. We also propose solutions to the retrogressive policies.

What happens when the centre fails to hold?

The economic role of any government worth its salt in the world is to create an environment which is viable for the various business sectors to create goods and services with minimal state intervention. Its cardinal roles include the following:

- Allocation role[2]
- regulation[3]
- distribution[4]
- stabilisation[5]

However, the Zimbabwean situation is best defined and captured by Chinua Achebe in the classical novel *Things Fall Apart*. In the Zimbabwean economic environment, the government is the alienating centre which is failing to hold. In so doing, the respect of property rights has suffered detrimentally, the business no longer operate independently to reach the common cause of operation which is profit maximisation and improving the standards of lives for both the households and the firms which generates the wealth for the country.

The recent policy compulsion exhibited by the government of Zimbabwe marks far reaching effects which will be set to affect the populace for decades to come. Firms, the majority of which have been operating below 30% will soon shut down their operations as it will make no economic sense to produce. There is also no more incentive for retailers and wholesalers to practise entrepreneurship. Under functional economic environment, the reward for entrepreneurship is profit. However the government is making such a reward a crime which will lead to imprisonment, confiscation of the enterprise or both.

The usual situation is that when the government sets price ceilings in the economy, the government has a role to cater for the difference between the initial price which was prevailing in the market and the new price which the government would have set out through subsidies. The incumbent government however does not have the capacity to subsidise the firms as it is currently battling with its foreign and domestic debts pegged at US\$3.9 billion whilst the internal debt stands at US\$208 million[6].

Zimbabwe unlike Russia, does not have the capacity to be turned into a communist economy. Russia managed to sustain the communist economy through a conventional force of human resources as its main capital which is the opposite in the country as the majority of the skilled personnel have the joined the brain drain escapade into the region and overseas.

The price slashes are not sustainable. The Weekly Economic Bulletin team holds that after a month in such an abyss, either the government or the business will have to give in. In this case the government will have to give in, failure to do so will result in food riots as goods will be scarce in shops.

The second alternative is that of the government lifting off the ceilings. This will not mean that goods will return to the normal prices which were prevailing before state intervention. They would rise approximately three to four times. This is explained by the current interest rates which are pegged at 700%. Implied is that the cost of capital of borrowing in Zimbabwe is 700% of the amount borrowed. As we write firms are heavily borrowed. Taking a closer look at the food shortages, retailers have now run out of stock because wholesalers do not have commodities due to non production by manufacturers. Sadly, the distortions in the chain of distribution have other blind effects which we alluded to. Capital borrowed is not a variable cost which is determined by the additional marginal unit of production but rather is a fixed cost. The banks will keep on charging interest of 700% on the firms' overdrafts. The state actions will also imply that the organisations will fail to meet their contractual time of paying back their debt. This will entail that the banks will charge interest penalties till the firms start producing again. When the price ceilings are finally lifted the interest costs would have accrued and the only way of recouping them is through factoring the costs on the final goods.

This would trigger a vicious spiral of wage-price increases which is very inflationary. However, the lifting of the price controls will not mean business as usual. The business confidence would have been shaken. This has been exacerbated by the recently gazetted Indigenisation and Economic Empowerment Bill which will be passed as law latter this year. The bill is the government's declaration of intent to nationalise the economic property being privately owned by grabbing 51% of the share holding. The effects can not be over emphasised as they can be drawn from how the agricultural sector plunged into abysmal failure after the state sponsored invasions took place. The effects in agriculture are summed up by the diagram below:

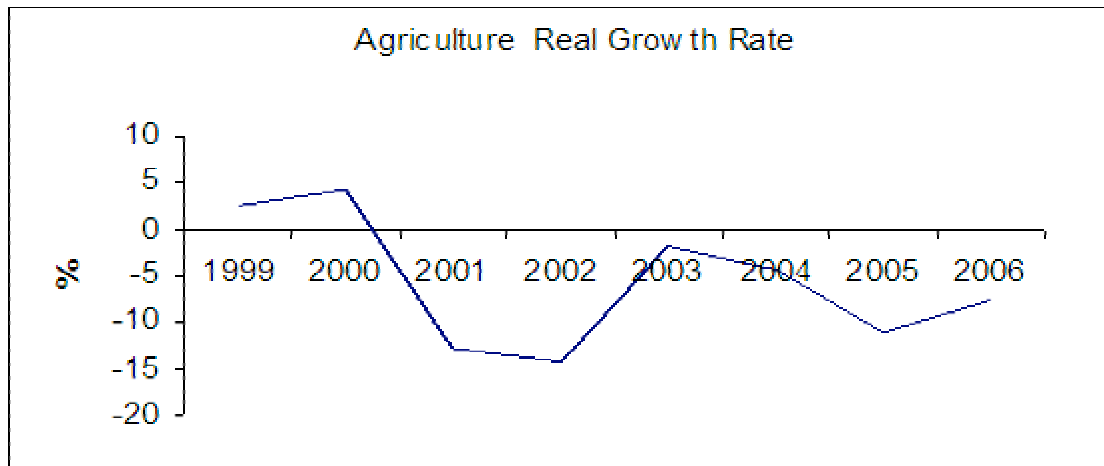


Diagram – Andy Hodges 2007

The effects of the state intervention in agriculture were cross cut in the economy which led to Zimbabwe experiencing negative economic growth rates since the year 2000 as noted by the diagram below:

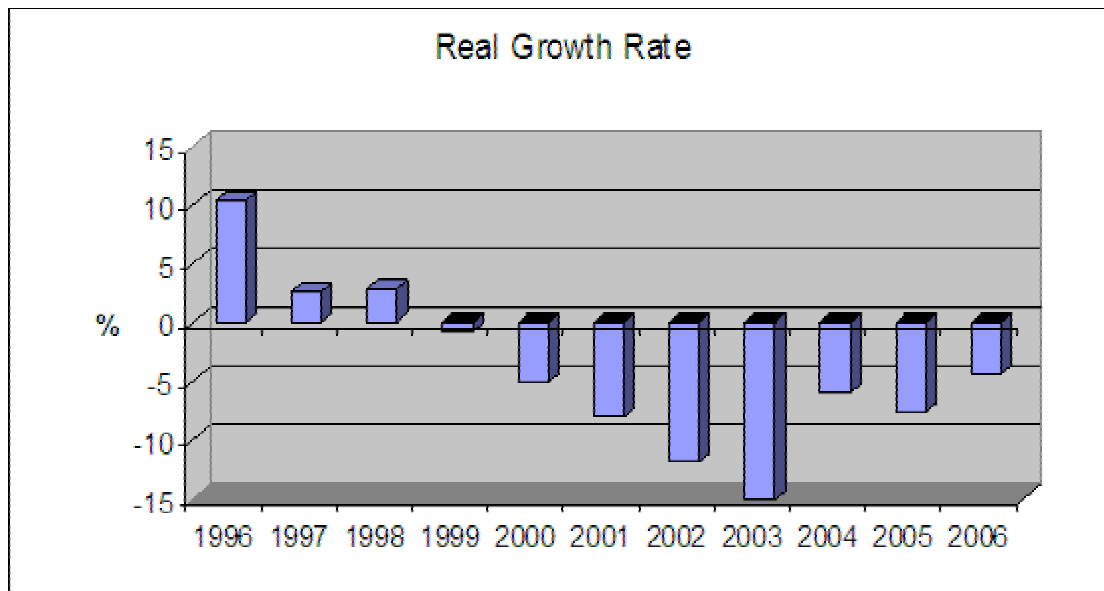


Diagram – ibid 2007

The bill will definitely come as a blow to the economy which has been defined by the Lonrho executive chairman as operating at a “Zero base”. The economy needs capital infusion as oxygen for its revival. This is found in the form of increased foreign direct investment; building investor confidence; economic stability management; respect of property rights and policy consistency. The government must also reduce its expenditure models as it is very inflationary.

It is only then that the economy could be rescued from the current environment which is characterised by the following factors:

- Low capacity utilization
- Shortage of critical inputs
- Depressed agricultural output
- Lack of Foreign Direct Investment
- Depressed demand
- Expectations

- Energy shortages
- Heavy regulatory mechanism (price controls and nationalization of privately owned property)

We therefore call upon the government to immediately remove the price controls as they are stop gap measure to macro-economic management. In the long run they bring suffering to the majority of the poor people in the country. The president of Zimbabwe must decline to sign the Indigenisation and Economic Empowerment Bill since it is a negation of economic growth.

References

[1] The Zimbabwe Independent June 6 to 12, 2007; p2

[2] It refers to the role of government in achieving an efficient allocation of resources or public goods and externalities (as opposed to the government officials primitively accumulating the resources such as farms.)

[3] The legislation and other measures aimed at ensuring that efficiency and certain minimum standards (rather than criminalizing the business community)

[4] Steps taken by the government to achieve a more equitable distribution of income (farm workers are earning ZWD \$96 000 per month which has been referred to as legalized slavery by the Zimbabwe Lawyers for Human Rights [ZLHR]! 85% of the populace is leaving below the poverty datum line.)

[5] It refers to monetary, fiscal and other measures to promote macroeconomic stability (the price slashes by the state are a violation of maintaining and performing the role as it has led to economic destabilization in the broader economic scheme of things, as noted in the introductory phrase, things fall apart as the center fails to hold.)

[6] Reserve Bank of Zimbabwe Report 2006