Is Dollarisation the Panacea for Zimbabwe's Economic Challenges?

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Abstract

This paper is a bird's eye view on the pros and cons of dollarisation on the Zimbabwean economy. On January 29, 2009 Zimbabwe fully legalised the use of foreign currency for domestic transactions releasing the economy from the grip of the Reserve Bank which had printed enough money to drive the country into hyperinflation. At the height of hyperinflation in November 2008 prices were doubling every 24.7 hours or an equivalent daily inflation of 98%. Dollarisation which was underlined by political accommodation had the immediate effect of stopping hyperinflation and the country entered deflation leading to the decline of consumer prices. However, a major problem the country is facing despite dollarisation is that of being locked in a liquidity crunch making it difficult to justify the country's economic asset pricing. Moreover, the benefits of dollarisation remain invisible to the majority since 80% of the people are unemployed. Despite these challenges the stabilisation of the political system through the formation of the coalition government and the commencement of sound economic policies meant that Zimbabwe has begun a crucial reconstruction phase.

Key words: Dollarisation, multi- currency system, hyperinflation, foreign currency, economic stabilisation.

Introduction

The collapse of the Zimbabwean economy in 2008 led to the dollarisation of the economy and to some 'petrolisation' of the economy because of the re-emergence of barter trade (Doran 2009, Kwidini 2009). This was because some employees were paid with fuel coupons which they exchanged for groceries. In 2008, Zimbabwe experienced record inflation and this made it difficult for businesses and other institutions to plan ahead as the rate of inflation peaked at 231 million percent by July 2008 (Makochekanwa, 2010, Makochekanwa 2009). However, Zimbabwe failed to break Hungary's 1946 world record for hyper-inflation, but it claimed second place in world records for hyper-inflation (Hanke 2009). This was behind a backdrop in which prices were doubling every 24,7 hours or an equivalent daily inflation rate of 98% in November 2008 which was lower than Hungary's daily record of 15,6 hours in 1946 (Table 1).

Table1. World Records in Inflation

Country	Month with highest inflation rate	Highest monthly inflation rate	Equivalent daily inflation rate	Time required for prices to double
Hungary	July 1946	1.30x1016 %	195%	15.6 hours
Zimbabwe	November 2008	79600000000%	98%	24.7 hours
Yugoslavia	January 1994	313000000%	64.6%	1.4 days
Germany	October 1923	29500%	20.9%	3.7 days
Greece	November 1994	11300%	17.1%	4.5 days
China	May 1949	42%	13.4%	5.6 days

Source: Hanke (February 2009)

On November 14, 1997 the Zimbabwe dollar crushed and lost up to 75% of its value against the US dollar on a single day that has popularly been referred to as the ' Black Friday' in Zimbabwean economic history (Bond 1999). This also resulted in the plummeting of Zimbabwe Stock market and the index fell by 46% by the end of the day from the peak August levels (Kairiza 2009). The exchange rate henceforth responded by depreciating rapidly- setting the tone for a long slump in the real economy. The economic meltdown in Zimbabwe became rapid and rather explosive and so socially harmful. The trend of the macro-economic events that resulted in the meltdown is shown in Table 2. The rate of inflation increased from 47% in 1998 to qualify the Cagan's (1956) hyper-inflation definition when it reached 7 982% in 2007 to 231 million% in July 2008. The cause of inflation was the huge money expansion that was 66 659% annually in 2007. This was exacerbated by the reduction in production as well as the depreciation in the exchange rate (Makochekanwa 2007, Kairiza 2009, Ndlela 2008).

Table 2 Macro-economic indicators in Zimbabwe 1998-2007

Year	GDP growth rate %	Annual inflation %
1998	-0.8	47
1999	-2.1	57
2000	-7	55
2001	-3	112
2002	-4	199
2003	-10	599
2004	-2	133
2005	-4	586
2006	-3	1281
2007	-6	7982

Source: Kairiza (2009)

On January 29 the Government of Zimbabwe gave in to economic pressure and henceforth deregularised the economy after years of ignoring fundamentals on the ground (Financial Gazette 2009). The first quarter of 2009 saw a marked shift in the country's economic policy and this had the effect of transforming the hitherto gloomy business outlook to one of hope and optimism. This shift in policy saw its roots in the 2009 national budget that was presented to Parliament on January 29 by the Acting Minister of Finance and this was reviewed on March 8 by the new Minister of Finance and the Reserve Bank Governor presented a supportive monetory statement on the budget.

The Minister of Finance revoked Statutory Instrument No. 5 of 2009 to ensure that there was full and official dollarisation in Zimbabwe. This was through the government's realisation that the Zimbabwe dollar had lost all its commercial value and the United States dollar became the reference currency. Initially it was the Rand that had been made the reference currency, but the strict exchange regulations in South Africa delayed the implementation of the national payment systems that were to be based on the rand.

Zimbabwe's severe and chaotic hyperinflation trend in the new millennium and especially from the year 2000 to the end of January 2009 led the country to voluntarily abandon one of its sovereign symbols, its monetary currency, the Zimbabwean dollar (Z$) by adopting the use of other foreign currencies as means of payments, unit of account, store of value and standard of deferred payments (Makochekanwa 2010). This was the inception of dollarization era in Zimbabwe. Dollarisation does not necessarily mean that one currency is used, although generally, that is the case (Muponda 2008). In the case of Zimbabwe, dollarization as been manifested in the use of multi-currencies and these are mainly the US dollar, the South African Rand and the Botswana Pula. Until as recent as a decade ago, dollarisation received no attention because it was considered politically impossible. However, it has gained prominence after several countries have considered and implemented it as official currency. The most important officially dollarised economies as of June 2002 were Ecuador (since 2000), El Salvador (since 2001) and Panama (since 1904). As of August 2005 the US dollar, the Euro, New Zealand dollar Swiss Franc, Indian Rupee and the Australian dollar were the only currencies used by other countries for official dollarisation. Other countries that have adopted dollarisation as their exchange regime include Liberia, Monaco, Puerto Rico and Greenland (Hudgins and Yoskowitz 2004, Hira and Dean 2004, Gutierrez 2008. Erasmus and Menkalan 2009).

The positive effects of dollarisation

The use of the US dollar, the Rand and the Pula had the immediate effect of stopping the hyperinflation and henceforth deflation took effect and the consumer price index was -2.34% and -3.26% at the end of January and February 2009 respectively and as a result for the first time in 10 years aid from bilateral donors trickled in (Ministry of Finance 2009, RSS Feed 2009). Relations with the Bretton Woods institutions have yet to normalise though the International Monetary Fund (IMF) has approved targeted technical assistance in areas of tax policy and administration, payment systems, lender-of-last-resort operations and banking supervision, central bank governance and accounting. The conditions that were put forward in order to resume full co-operation included an improvement in Zimbabwe's economic policies and the clearing of the country's arrears (IMF 2009). On the other hand the World Bank is of the view that the conditions for its re-establishing full-fledged economic development programmes with Zimbabwe have not yet been met and more efforts need to be made in order to make this feasible (World Bank 2009).

The use of the US dollar resulted in the continued movement towards price equalisation with those of the region especially the South African Rand. Any price differentials between the South Africa and Zimbabwe that were outside such costs as transport, insuarance and reasonable price mark-ups would result in people shopping directly in South Africa (Financial Gazette 2009). Local businesses thus needed to be competitive enough to stay in business, a situation which seemed very unlikely given the decade long de-industrialisation that had been hitherto taking place in Zimbabwe. Thus dollarisation was meant to help keep the economy afloat through the resultant stabilisation emanating from the authorities' inability to monetise its deficit.

The challenges associated with dollarisation

The stabilisation of the political environment through the formation of the inclusive government and the commencement of the implementation of sound economic policies meant that Zimbabwe had just begun a crucial reconstruction phase, reconstructing its wealth which had been destroyed through the death of the Zimbabwe dollar. Furthermore, unlike in the pre-industrial period when the country operated as an autarky, free from the risky vagaries of international markets and economic developments, dollarisation has brought Zimbabwe closer to developments. Against this background the global financial crisis was unlikely to spare Zimbabwe, either directly or indirectly though a fall in prices of commodities or indirectly through its effect on the other countries that Zimbabwe traded with especially South Africa. An example is the case of Zimbabwe's largest nickel producer, Bindura Nickel Corporation that was likely to remain under care and maintenance for a while as international nickel prices have remained subdued.

According to Mambondiani (2008) the economic benefits of dollarisation to the general population of Zimbabwe have been seen by other authorities to be empirically questionable. With and estimated unemployment estimated at 80%, the foreign earnings capacity is less than 5% of the population. Besides remittances from the diaspora, there is no evidence to suggest that the majority of Zimbabweans have access to forex. The result has been the natural and legitimate demand for higher salaries by teachers and other civil servants. Takunda(2009) also argued as an economist that dollarisation of the economy was going to encounter problems in the sense that there was not enough forex in US dollar terms to justify the asset valuations within the economy. This was proven true when property prices which were extremely inflated in US$ terms did not take into account the available liquidity in valuation suddenly collapsed. Further price collapse was possible given that liquidity remains tight since significant forex inflows were required to justify the valuations within the Zimbabwe stock and capital markets. The true test for Zimbabwe would be a capital raising exercise by a listed company where an auction would demonstrate the market's liquidity position. The inability of the Ministry of Finance to pay higher salaries explains that there are not enough US$ in Zimbabwe to justify the economy's asset pricing. Zimbabwe is locked in a liquidity crunch and unlike before when the Reserve Bank of Zimbabwe solved the problem by printing more money, the RBZ cannot print the US$ to solve the problem and thus herein begins the new debate for the re-introduction of the Zimbabwean dollar. The economy still has some speculators. Although domestic output has increased there has been no significant shift in exports which is what is required to get the forex into the country. Before such underlying issues are addressed there can be no monetary solution to Zimbabwe's economy.

Way forward

The issue of liquidity and price distortions is self correcting. As liquidity dries up deflation will kick in and people will re-align their price expectations and the price of assets will reflect the money available in the country. A number assets in Zimbabwe have been over-inflated in anticipation of significant capital inflows into the country, however, the expected inflows have not materialised hence the market has begun a self correction and property prices are falling.

The adoption of a new currency won't solve the underlying problems. Most international currencies use some form of nominal anchor as a constraint on the value of domestic money. The challenge for the Reserve Bank of Zimbabwe will always be price stability. In the last few years the country engaged in price fixing and this has had its own weaknesses. The premature re-introduction of the Zimbabwe dollar will not achieve the stability the country needs, but it needs a local currency and a serious monetary policy. The Zimbabwe dollar was worthless because people did not simply believe in its value.

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