SAE./No.85/September 2017

Studies in Applied Economics

ZIMBABWE'S UNORTHODOX DOLLARIZATION

Erik Bostrom

Johns Hopkins Institute for Applied Economics, Global Health, and the Study of Business Enterprise

Zimbabwe's Unorthodox Dollarization

By Erik Bostrom

About the Series

The Studies in Applied Economics series is under the general direction of Professor Steve H. Hanke, Co-Director of The Johns Hopkins Institute for Applied Economics, Global Health and the Study of Business Enterprise (hanke@jhu.edu). The author is mainly a student at The Johns Hopkins University in Baltimore. Some of his work was performed as research assistant at the Institute.

About the Author

Erik Bostrom (ebostro1@jhu.edu) is a student at The Johns Hopkins University in Baltimore, Maryland and is also a student in the BA/MA program at the Paul H. Nitze School of Advanced International Studies (SAIS) in Washington, D.C. Erik is a junior pursuing a Bachelor's in International Studies and Economics and a Master's in International Economics and Strategic Studies. He wrote this paper as an undergraduate researcher at the Institute for Applied Economics, Global Health, and the Study of Business Enterprise during Summer 2017. Erik will graduate in May 2019 from Johns Hopkins University and in May 2020 from SAIS.

Abstract

From 2007-2009 Zimbabwe underwent a hyperinflation that culminated in an annual inflation rate of 89.7 sextillion (10^21) percent. Consequently, the government abandoned the local Zimbabwean dollar and adopted a multi-currency system in which several foreign currencies were accepted as legal tender. The most prevalent currency in that system is the U.S. dollar. Without official recognition of dollarization, however, the government enacted laws allowing Zimbabwe to evade the budgetary discipline required from dollarized economy, exposing itself to more potential monetary crises. This paper highlights important Zimbabwean government actions post-April 2009 and analyzes their effects on the Zimbabwean economy. It also explains Zimbabwe's general financial situation and the major reforms needed to avoid another crisis.

Acknowledgments

I thank Professor Steve H. Hanke for his advice and guidance.

Keywords: Zimbabwe, hyperinflation, dollarization, government finance
JEL codes: E59, O23

Introduction

The Zimbabwean economy over the last two decades has suffered tremendous hardship, starting in 2000 with the Fast Tract Land Reform Program (FTLRP), which legalized government seizures of land from farmers. This land was primarily redistributed to government cronies and war veterans who, in many cases, knew nothing about farming and let the land go fallow. Inflationary problems emerged at the end of the FTLRP in 2004 in conjuncture with unaccounted-for expenditures from Zimbabwe's participation in the Second Congo War and inflationary remedies pursued by the Reserve Bank of Zimbabwe (RBZ). These policies culminated in hyperinflation between February 2007 until November 2008. As inflation rose, foreign currencies increasingly displaced the use of the Zimbabwe dollar, despite being illegal. Eventually, the government finally ceased issuing Zimbabwe dollars in April 2009 and adopted the U.S. dollar.

The process of dollarization, however, was not a straightforward attempt to adopt one specific currency, like Ecuador's dollarization in 2000. Despite allowing foreign currencies to be legal tender in January 2009, the government also attempted to replace the third Zimbabwe dollar with the fourth Zimbabwean dollar on February 2, 2009. (Successive Zimbabwe dollars had a number of zeros chopped off compared to their predecessors to make calculation easier, at least until they, too, succumbed to high inflation.) Quickly this new dollar was devalued, like its predecessors, and was officially suspended on April 12, 2009 as legal tender. The government subsequently built upon the legal and growing multicurrency regime introduced in January 2009 that allowed foreign currencies as legal tender in Zimbabwe. These included, most noticeably, the euro, South African rand, Botswana pula, British pound, U.S. dollar, Japanese yen, and Chinese yuan. Other currencies were also used unofficially, such as the Zambian kwacha. The two most popular were the South African rand, due to Zimbabwe's proximity to rand-using countries, and the U.S. dollar, due to its internationally accepted stability.[1]

Contrary to popular opinion at the time, which favored the rand, the Zimbabwean government decided to adopt the U.S. dollar (USD) for conducting official business. The decision had a noticeable effect on currency prevalence, as fiscal spending plays a large role in the Zimbabwean economy. In 2009, government spending equaled 14 percent of total GDP and by 2016, it had increased to 30 percent. This move was the major factor supporting the rise of the USD as a de facto currency. In consequence, there was a dollarization of Zimbabwe, rather than a "randization" as some had speculated.

The adoption of the USD created an interesting scenario for Zimbabwe, due to the limited number of dollars available in the country. Although the USD was presumably chosen for its reputation as a stable unit of account, liquidity challenges have hindered Zimbabwean's ability to gain access to dollars for everyday transactions.

[1] The next few paragraphs draw heavily from Noko (2011).

This paper will explain how certain government policies have impeded the formalization of a successful dollarized economy. Each section will cover a different unorthodox policy choice of the Zimbabwean government and analyze the observed or potential effects. An appendix at the end of the paper lists the relevant legislation enacted by the government of Zimbabwe up to July 2017.

Table 1 – Zimbabwe's Hyperinflationary Problems 2007-2008

HYPERINFLATION IN ZIMBABWE, 2007–2008

Date	Monthly Inflation Rate (%)	Annual Inflation Rate (%)
March 2007	50.54	2,200.20
April 2007	100.70	3,713.90
May 2007	55.40	4,530.00
June 2007	86.20	7,251.10
July 2007	31.60	7,634.80
August 2007	11.80	6,592.80
September 2007	38.70	7,982.10
October 2007	135.62	14,840.65
November 2007	131.42	26,470.78
December 2007	240.06	66,212.30
January 2008	120.83	100,580.16
February 2008	125.86	164,900.29
March 2008	281.29	417,823.13
April 2008	212.54	650,599.00
May 2008	433.40	2,233,713.43
June 2008	839.30	11,268,758.90
July 2008	2,600.24	231,150,888.87
August 2008	3,190.00	9,690,000,000.00
September 2008	12,400.00	471,000,000,000.00
October 2008	690,000,000.00	3,840,000,000,000,000,000.00
14 November 2008	79,600,000,000.00	89,700,000,000,000,000,000,000.00

SOURCE: Hanke and Kwok (2009: 355).

Definition of an Orthodox Dollarized Economy

Zimbabwe can be classified as a dollarized economy due to the prevalence and priority given to the U.S. dollar by the Zimbabwean government. Although Zimbabwe has followed many of the steps required for complete dollarization, three broad areas still stand out as problematic, resulting in Zimbabwe's unorthodox dollarization status. In order to achieve the solid economic growth and stable inflation that accompany dollarization, the three following requirements must be fulfilled: Full financial integration into the world market, Reform and reorganization of government agencies to comply with new monetary arrangements, and responsible curbing of government deficits.

Full financial integration on the world market is a broad term, yet crucial for effective dollarization. For Zimbabwe, this will “occur when the law allows financial institutions extensive freedom of action to compete and does not discriminate against foreign institutions.” More specifically, it requires Zimbabwe to allow foreign financial institutions to “establish branches, accept deposits and make loans, obtain full ownership of domestic institutions, and move funds freely into and out of the country” (Hanke 2008, 10).

Adhering to these principles could allow Zimbabwe to access a large amount of liquid international funds. For example, with an internationally integrated financial system in place, banks would be able to easily give loans in Zimbabwe while deposits could be held in another country entirely. Zimbabwe would become part of an expansive dollar zone where funds could be exchanged without risk between Zimbabwe and the United States. This would reduce the risk of volatile business cycles, while stabilizing real exchange rates. In short, financial integration increases reliability and liquidity for domestic interbank markets due to an easy influx of foreign capital (Hanke, 2008, 10; see also Moreno-Villalaz 1999, 2005 on Panama’s highly satisfactory experience with financial integration under dollarization).

The second major area where Zimbabwe has fallen short of complete dollarization is in reforming government organizations that manage fiscal and monetary policy. Following any case of dollarization, the first thing that should be reformed or eliminated is the central bank. In the case of Zimbabwe, the components of the Reserve Bank of Zimbabwe (RBZ) should have been reorganized into separate organizations focusing on statistics, economic analysis, and financial institutions. Although alternatives exist, the most important point to doing this is that the RBZ would cease to exist as an entity that could enact monetary policy for Zimbabwe. This ensures dollarization is adhered to and that back-door currency attempts cannot be made by the RBZ, let alone at the request of the government.

The last aspect that needs to be addressed for Zimbabwe’s dollarization is the curbing of government deficits. For dollarization to be effective, the government must operate on a sustainable budget, as once its dollar reserves have dwindled, liquidity will start to become an issue in repaying government debts. If debts cannot be repaid in U.S. dollars, people will begin to doubt the government’s ability to support the large wage network government spending sustains. Therefore, if the government does not adhere to a “hard budget constraint,” dollarization will last only until the government runs out of foreign reserves, at which point Zimbabwe might turn to the creation of faux or worthless local currency again to increase liquidity.

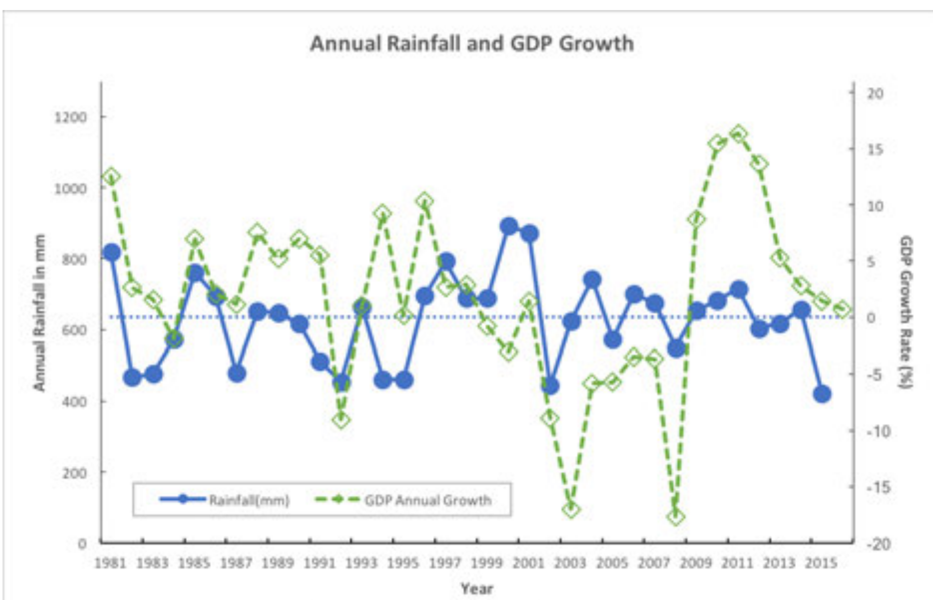
Once these areas are addressed, dollarization can achieve its full potential to benefit Zimbabwe’s economy. Until then, Zimbabwe will feel the effects of an unorthodoxly dollarized economy that is constrained by policies posing risks to economic development.

Financial Integration

The two most influential polices preventing the government of Zimbabwe from achieving full financial integration for the country's dollarized economy are the Indigenization and Empowerment Act of 2007 (IEEA) and the Fast Track Land Reform Program of 2000 (FTLRP). Although they were enacted before the economy went into free-fall in 2007, they have both proved to be daunting hurdles for Zimbabwe's economy to overcome.

The FTLRP between 2000 and 2003 established an unstable economic environment that has hindered the country's ability to develop for over a decade. What set Zimbabwe's Land Reform Program apart from other countries' land reform programs was the lack of compensation for seized land and the use of seized land as a tool of political patronage. The voiding of Zimbabweans' property rights set a dangerous precedent and was the major driver of economic downturn in the early 2000s (Richardson, 2005). The Program changed the structure of the economy, of which, in 2000, 60 percent was based on or dependent upon agriculture. (Richardson, 2005) Unsurprisingly, economic growth fell post-land reform, and GDP was longer was correlated with rainfall as had been the case pre-2002 (see Figure 1). Furthermore, even though the FTLRP was ruled unconstitutional by the High Court of Zimbabwe, the policies of the Fast Track Land Reform Program have not been reversed. As a result, land reform has drastically hurt GDP growth both because of its direct effects on agriculture and because of its indirect effect as a signal that the government might not respect future property rights (Richardson, 2005).

Figure 1 – Rainfall vs. Annual GDP Growth

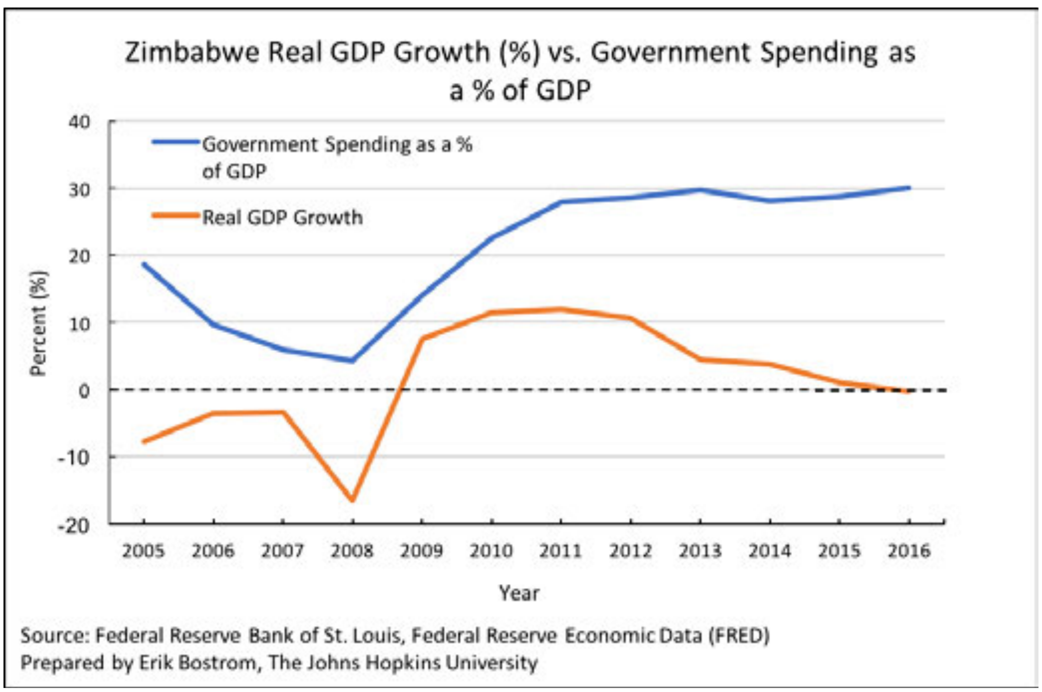


Source: World Bank and Meterological Serives Department of Zimbabwe
Prepared by Erik Bostrom, The Johns Hopkins University

Secondly, the Indigenization and Economic Empowerment Act (IEEA) in 2007 created problems of its own for financial integration. The act states that "at least fifty-one *per centum* of the shares of every public company and any other business shall be owned by indigenous Zimbabweans" (Part 2, Section 3: 1a). The term "indigenous Zimbabwean" is legally defined as "any person who, before the 18th April, 1980, was disadvantaged by unfair discrimination on the grounds of his or her race, and any descendant of such person, and includes any company, association, syndicate or partnership of which indigenous Zimbabweans form the majority of the members or hold the controlling interest" (Part 1, Section 2). In practice, the act prevents foreigners, as well as Zimbabweans who benefitted under British colonization and the quasi-state of Rhodesia, from owning a majority stake in business.

This Act has effectively isolated Zimbabwe by hindering direct foreign investment. However, since 2009 Zimbabwe's economy seems to have rebounded, despite the Indigenization and Economic Empowerment Act. The reason why, however, is more nuanced as the economy had hit rock bottom in late 2008, and GDP growth was goosed by a large and unsustainable increase in government spending (Figure 2).

Figure 2 – Government Spending as a Percentage of Real GDP

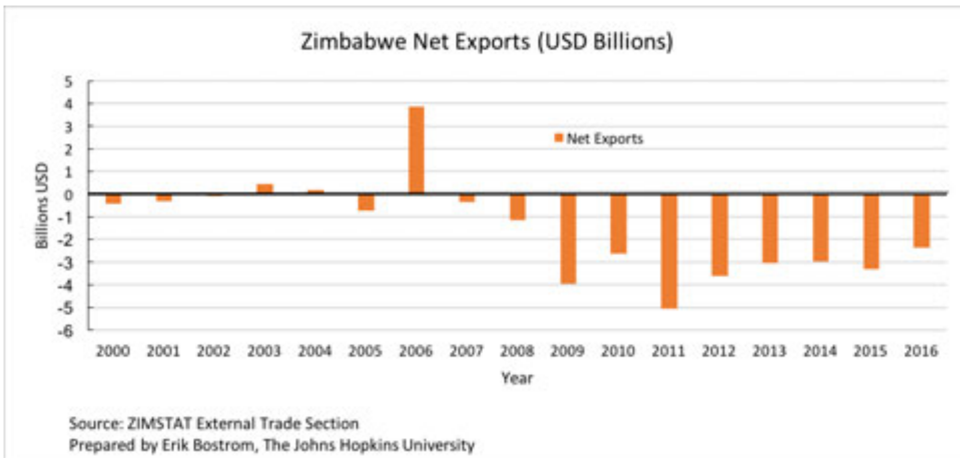


The most important aspect of the Indigenization and Economic Empowerment Act is its effect on foreign investment. A key principle of dollarization is to allow inflows of foreign capital to ensure that there is liquidity to fuel consumption and investment. However, Zimbabwe has problems in securing steady inflows of U.S. dollars. Most capital inflows have been through loans, which have seen a two-thirds decline between 2014 and 2016.

Furthermore, looking at net imports and exports indicate that Zimbabwe has begun to feel the shortage of U.S. dollars. Exports to the United States have remained constant, while there has been a huge decline in imports from the United States over the past five-year period. Although this would suggest an increase in net exports, Zimbabwe's trade deficit has remained large, indicating that Zimbabwe's exports are struggling, a potential downside to restrictions on foreign capital (see Figure 3).

These two issues have proved to be limiting factors in securing a steady stream of U.S. dollars, as they hinder foreign investment and full financial integration with the international economy.

Figure 3 – Net Exports of Zimbabwe



Government Wage Spending and the Public Debt

The second area of reform necessary for full orthodox dollarization is the reform of government institutions and practices, most notably fiscal spending. Despite multiple attempts to decrease government spending since 2009, spending has significantly increased, with domestic debt in October 2016 equaling nearly 30 percent of total GDP (Figure 4, pg. 9).

Even as Zimbabwe has faced a liquidity crunch due to an annual trade deficit of over 2 billion USD since 2009, it has managed to increase government spending. This spending, however, has not managed to keep up GDP growth, which has stalled over the last two years (See Figure 2, pg. 6). Government spending itself presents an interesting trend concerning the allocation of funds. Between 2012 and 2015, the Administrative, Finance and Management sector rose from 21 percent to 26 percent of total government expenditure. Conversely, the Roads and Works sector dropped from 24 percent to 16 percent and Health and Education fell from 13 percent to 11 percent (see Table 2).

The fact that most government spending is being directed to bureaucratic and financial ends is troubling for successful dollarization. A government needs an administrative and management staff, but large increases in those roles' share of the budget on top of growing government spending set a dangerous precedent, considering the quickly rising domestic debt. As of 2016, government wages accounted for 91 percent of total government revenue, up from 65 percent in 2015 (Government of Zimbabwe Annual Budget Review 2017, 40). Although the government has made plans in the Public Service Wage Bill to reduce government wage spending to 65 percent by 2019, proper implementation of the bill remains questionable given the record of the ruling ZANU-PF political party.

The more worrying aspect for successful dollarization is how the government goes about financing spending increases. When the local currency was abolished in 2009, the role of the central bank, the Reserve Bank of Zimbabwe, should have become much smaller, becoming limited to data collection with no role in monetary policy. However, the RBZ still remains a key player in economic policy, working at the behest of the government to support large debts and spending.

Table 2: Expenditures by Category, Selected Local Authorities, 2012-14 (%)

	Actual				
	2012	2013	2014	2015	Ave
Administrative, Finance, and Management	21%	18%	29%	26%	23%
Health and Education	13%	10%	12%	11%	11%
Water Supply	12%	15%	19%	16%	15%
Water Sanitation	4%	7%	3%	5%	5%
Solid Waste and Environ. Management	5%	6%	4%	4%	5%
Roads and Works	24%	18%	11%	16%	17%
Welfare, Community Infra., and Parks	5%	3%	4%	3%	4%
Housing and Public Buildings	4%	13%	6%	6%	8%
Income Generating Activities	3%	2%	2%	3%	3%
Police and Emergency Services	9%	7%	10%	9%	8%
TOTAL	**100%**	**100%**	**100%**	**100%**	**100%**

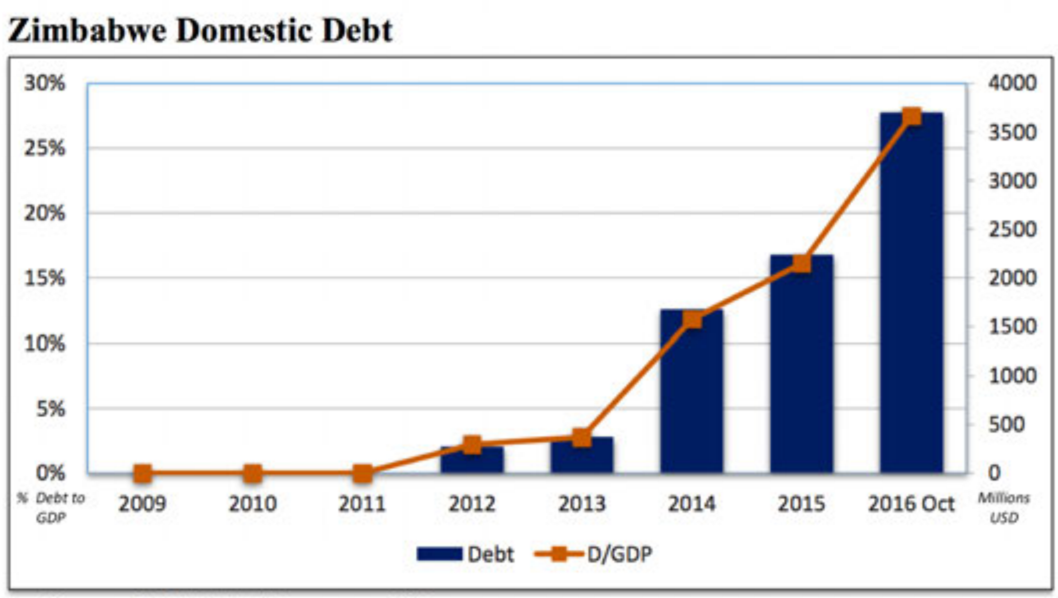
Source: Ministry of Local Government

From 2011 to October 2016, Zimbabwe's domestic debt has risen from zero to 30 percent of GDP and equaled 3.6 billion USD by October 2016. In a report by the Ministry of Government in March 2017, this number had risen to 4 billion USD, with the pace of accumulation showing no signs of slowing. Without more reform to government spending, the country will begin to face further liquidity problems as loans dry up and domestic debt rises. As a result, to fund the debt, the government has turn to the issuance of Treasury Bills (T-bills), creating a slew of liquidity problems.

As of March 2017, the number of Treasury bills issued by the Zimbabwean Government amounted to over $2 billion. The government has issued four different categories of T-bills. The first category is long-dated bills of 549 million USD issued to banks for the acquisition of nonperforming loans by the Zimbabwe Asset Management Corporation (ZAMCO). The second category is long-dated bills amounting to 300 million USD issued for the capitalization of institutions that include the Reserve Bank, the Agricultural Development Bank of Zimbabwe, the Infrastructure Development Bank of Zimbabwe, ZB Bank, the Cotton Company of Zimbabwe, and CAPS Pharmaceuticals. The third category is medium- to long-dated bills amounting to 780 million USD issued under the Reserve Bank Debt Assumption Act for the central bank debt taken over by government. The fourth category is short-to-medium-dated bills in an amount of 450 million USD issued to finance the gap between expenditure and revenue collection by government. Only the last two categories of T-bills can be traded on the market; the first two types must be held to maturity.

In September 2016, tradable T-bills maturing in 2017 were being discounted 11-14 percent, those maturing in 2018 were being discounted 29-30 percent, and T-bills maturing from 2019 to 2020 were being discounted at rates of 39-40 percent. Some financial analysts have even discussed trading T-bills at discounts of up to 65 percent. In addition, according to the latest IMF Article IV report on Zimbabwe, the banking industry "could lose up to 15 percent of its capital base (about 1 percent of GDP) for every 10 percent discounting of T-bills, with domestically-owned banks at higher risk" (IMF July 2017, 41).

Figure 4 – Zimbabwe's Domestic Debt



Source: Public Debt Management Office
Prepared by the Ministry of Finance and Economic Development, The 2017 National Budget Statement

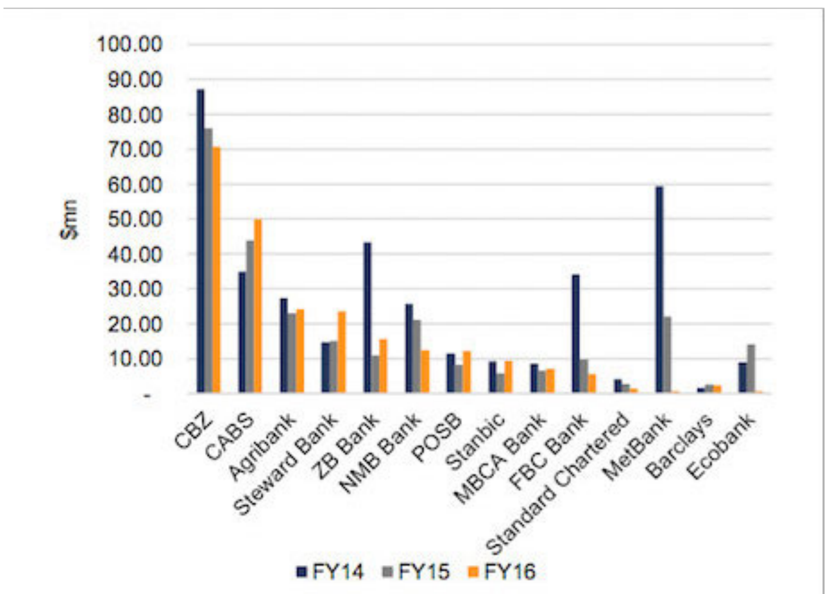
Although highly discounted now, these T-bills are likely to face even further discounts as accounting procedures are updated. On January 1, 2018, Zimbabwe will adopt a new accounting policy, International Financial Reporting Standards 9, which replaces the old method, International Accounting Standards 39.9. The new policy will require financial institutions to recognized T-bills as Fair Value Other Comprehensive Income (FVOCI) on the balance sheet rather than on the income statement. The implication is that if there is an accounting mismatch, the entity's own credit risk must be recognized on the consolidated income statement. Furthermore, the impairment rules in the new standards will require credit losses in FVOCI to be anticipated in a forward-looking, "expected-credit loss" model, whereas currently they are not recognized until after the fact when a "trigger" event occur (FinX, 2017).

The change is expected to create a more conservative banking sector, as long-term risk emerging on balance sheets will increase FVOCI and catalyze a subsequent increase in loan loss provisions (Old Mutual Zimbabwe Limited, 2016). The increase will have to be large, considering that the RBZ has "issued" large sums of T-bills onto institutions and that T-bills now comprise a significant portion of bank assets. However, to raise provisions for losses in a cash-strapped economy, banks are likely to recall or no longer issue loans and limit withdraws, effectively taking more money out of circulation.

Reserve Bank of Zimbabwe

The government policies that predominately prevent Zimbabwe from enjoying the full benefits of a dollarized economy are those regarding the RBZ and the financial sector in general. As mentioned previously, the RBZ should have been effectively sidelined after the disastrous hyperinflation in 2009. However, as of 2017 the institution still remains largely unreformed, and has even grown in influence.

Figure 5 - Distribution of Nonperforming Loans by Bank



Source: RBZ

In 2015, the government enacted the Reserve Bank Debt Assumption Act. It took onto the government's books a total of 1.4 billion USD of pre-2008 debt from the RBZ, with a general set annual interest rate of 5 percent. The act significantly contributed to enlarging domestic debt, from 2.3 billion USD as of November 2010 to 3.9 billion USD by the end of 2016. The debt included arrears dedicated to the government-run Zimbabwe Asset Management Corporation (ZAMCO), which was supposed to "acquire, manage, restructure, and dispose" of nonperforming loans (NPLs) from Zimbabwean banks. ZAMCO was helpful to the private nonfinancial sector and to commercial banks: nonperforming private sector loans by banks fell from 20 percent of the total in 2014 to only 8 percent by 2017. However, in doing so, ZAMCO has endangered government accounts through the assumption of over 800 million USD as of 2016 (Government of Zimbabwe Annual Budget Review 2016; see also Figure 5).

ZAMCO also assumed pre-2008 arrears as a result of the Reserve Bank of Zimbabwe Debt Assumption Act in 2015. Its large portfolio of risky loans poses a threat to the Zimbabwean government. The Public Debt Management Act, which authorizes the RBZ to act as an agent of the state and issue securities in repayment of the public debt, is an exercise in trying to postpone the problem rather than addressing it.

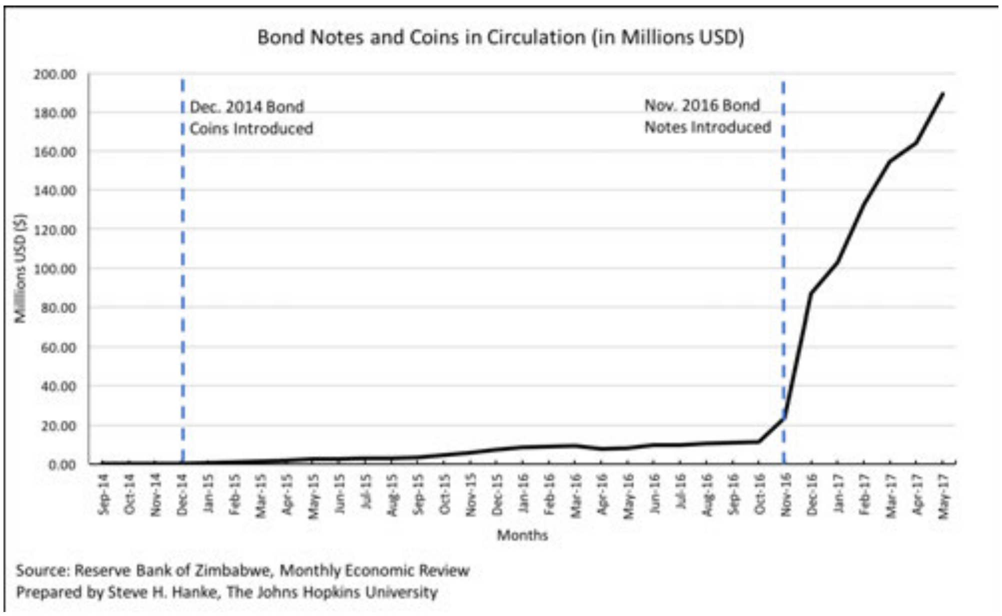
None of these actions would be particularly alarming under orthodox dollarization, as the government would be forced to reduce the deficit due to liquidity shortages. However, the adoption of Statutory Instrument 70 (S.I. 70) in 2015, which demonetized Zimbabwe dollar coins and notes, and S.I. 133 in October 2016, hint at future monetary troubles. S.I. 133 of 2016 allows for the issue of "a tender of payment of bond notes and coins issued by the Bank [RBZ] that are exchangeable at par value with any specified currency other than Zimbabwean currency" (S.I. 133, 44B). The act goes on to declare that all bond notes are legal tender for "all transactions as if each unit of a bond note is exchangeable for one United States dollar." In March 2017, S.I. 133 became an official act, giving it more entrenched legal status, as the Reserve Bank of Zimbabwe Amendment Act (Phiri, 2017).

On November 28, 2016, the country began circulating 10 million USD worth of so-called bond notes of $2 and $5, as well as a $1 bond coin.[2] On February 3, 2017, the RBZ began circulating 15 million USD worth of $5 bond notes. Later in February the government started issuing $10 and $20 bond notes. The bond notes are backed by 200 million USD of support from the Africa Export-Import Bank (Afreximbank), a Cairo-based international financial institution. It has been questioned though by financial analysts how legitimate the $200 million backing is, as Afreximbank has had credibility issues in the past and is seen to have an unusually close relation with the Zimbabwean government. Some South African news sources have disputed the backing and Afreximbank has not published anything related to the $200 million on their website as of August 2017. As of May 2017, there were $186 million worth of bond notes and coins in circulation, according to the RBZ, up from the $87 million in circulation in December 2016, and the $11 million in October 2016 before notes were released (see Figure 6). As of June 2017, roughly $175 million is solely in notes. (See Reserve Bank of Zimbabwe, Monthly Economic Review; June 2017)

[2] Note that in 2014, bond coins were in circulation as 1, 5, 10, and 25-cent coins and in 2015 a 50-cent coin was introduced. These bonds were also reportedly backed by 50 million USD of support from Afreximbank.

Bond notes are facing particular scrutiny on the black market (Makochekanwa; see also Mabeza). Officially, they are to be traded on par with the U.S. dollar. On the black market, premiums for converting bonds into U.S. dollars range widely, and as of early 2017, bond notes traded at a 5-15 percent discount for USD, while corporations and large-sum conversions by bank officials faced higher discounts of around 20 percent (Zwinoira). Black markets for bond notes are also reported to exist in Mozambique, Botswana, Zambia, and South Africa, highlighting the uncertainty of the fair value of bond notes (Saigal).

Figure 6 – Bond Notes and Coins in Circulation



The bond notes are rightfully being treated as a surrogate currency on the black market, but the RBZ and the Zimbabwean government have imposed an official exchange rate, limiting the freedom of large corporations and financial institutions operating in Zimbabwe, which are legally not allowed to discriminate against accepting bond notes. The Bank Use and Promotion Act, which was updated in 2004, makes it illegal to trade the bond notes at less than par. Smaller businesses are officially not allowed to discriminate against bond notes either, but their violations are harder to detect, so many small business owners have been reported to offer discounts of up to 50 percent to people paying USD. Furthermore, other countries do not view the Zimbabwean bond notes as legal tender, making trade harder for the import-heavy country. As of August 2017, an additional $300 million-dollar facility from Afeximbank in currently in progress to back the issuance of more bond notes.

Alternatively, Zimbabweans have turned to the real time gross settlement (RTGS) payments system set up by the government of Zimbabwe in the early 2000s. The system accounted for approximately 78 percent of the total value of electronic and plastic transfers in 2016. The RBZ is supposed to facilitate transfers by backstopping them with its foreign reserves held in offshore accounts. These accounts are increasingly viewed to no longer possess enough foreign assets to support the RTGS system. This is indicated by the long transfer times of many payments, with some transfers, which are supposed to be instantaneous, taking up to two weeks, alongside premiums for USD in transactions involving RTGS.

T-bills are also currently being redeemed through the RTGS system. This is the most worrying aspect of the entire monetary system. If the RBZ lacks sufficient foreign assets in offshore accounts to support the RTGS system (as some sources claim) the whole repayment system would become a Ponzi scheme. In this increasingly-likely scenario, T-bills are issued to banks to fund government debt, while the government receives hard USD in return. Banks, in turn, receive principal and interest, but in RTGS form, that contains some USD. Since the RTGS system would not contain enough USD to back the transfers entirely, the government must issue more T-bills in order to not default on its previous loans. The cycle continues until the government either is able to control its finances or, more likely, defaults when it runs out of foreign assets in its offshore accounts.

The continuing issuance of what is, in effect, a new local currency, allows the government of Zimbabwe to undertake further discretionary monetary measures that should have been eliminated under dollarization.

Conclusion

Dollarization in Zimbabwe ended hyperinflation and prompted a modest real return to economic growth by drastic, but necessary measures. However, the methods implemented by ZANU-PF, the ruling political party, show a reluctance to accept a nondiscretionary monetary system. By not adhering to orthodox dollarization, Zimbabwe has left open, and used, a back door to monetary policy. The dollarized system will falter under a noncompliant government with large debt and increasing discounts for bond checks and Treasury bills. In the worst-case scenario of Zimbabwe defaulting — which is increasingly likely — bonds are only expected to fetch between 5-18 cents on the dollar, further reducing investment and credibility for the financial system (Hanke, 2017, see also Muronzi, 2017).

With a back door to monetary policy open, Zimbabwe is likely to and has even announced plans to reintroduce a local currency (backed by gold and diamond reserves) and break free from the remaining monetary constraints of dollarization. This undertaking will result in further inflation, perhaps even another hyperinflationary deathblow, as the government has not developed an internationally integrated financial system, fiscal responsibility, and independent government institutions. (Moreover, diamond and gold production over the past years has reportedly slowed, calling into question the potential liquidity of the proposed system). Zimbabwe's current liquidity problems are made worse through government programs, leading to more people unwilling to spend the USD they have currently, fearing that they will have difficulty reacquiring USD. The government policies described above have choked the flow of foreign investment, and have also limited local investment, as people worry that assets issued by the government will soon be worthless once again.

Government reform will be a requirement for successful dollarization, especially since the government still faces credibility problems stemming back from the early 2000s. Since then, it has time and again proven untrustworthy to international investors, making strong economic growth extremely difficult. Under President Mugabe’s ruling ZANU-PF party, confidence is unlikely to improve anytime soon. Recent power struggles to see who will succeed Mugabe, who is 93 years old and in ill health, exacerbate problems with national stability. Unless the government unconditionally accepts the constraints that orthodox dollarization imposes, Zimbabwe will follow in the footsteps of its past, producing economic crises and hardship for a nation that possesses huge potential for economic growth.

Appendix: Laws and Regulations on Dollarization in Zimbabwe

Bank Use Promotion and Suppression of Money Laundering Act – Prevents bond notes from being legally traded at less than par in Zimbabwe.

Indigenisation & Economic Empowerment Act – Requires at least 51 percent business ownership by Zimbabweans who are “native” to Africa.

Public Debt Management Act - Reserve Bank of Zimbabwe is required to act as an agent of the central government.

Reserve Bank of Zimbabwe Amendment Act 2017 – Formalized SI 2016-133 introducing bond notes as legal tender to be valued at par with USD.

Reserve Bank of Zimbabwe (Debt Assumption) Act – Assumes Zimbabwe’s debt in terms of USD from before the scrapping of the Zimbabwe dollar in 2009.

SI 2015-70 - Reserve Bank of Zimbabwe (Demonetisation of Notes and Coins) – Removes all value from notes and coins from the Zimbabwe dollar which hyper-inflated and was scrapped.

SI 2016-064 - Control of Goods (Open General Import Licence) – Restricted the importation of certain goods to boost local production.

SI = Statutory Instrument

References[3]

FinX. “The Accounting Conundrum: How To Report Currency Issues And How To Account For TBs.” FinX. 01 March 2017. Web. 19 July 2017. http://fxzim.co.zw/2017/03/01/the-accounting-conundrum-how-to-report-currency-issues-and-how-to-account-for-tbs/

Government of Zimbabwe. "ANNUAL BUDGET REVIEW FOR 2016 AND THE 2017 OUTLOOK." 20 July 2017. *Veritaszim*. Web. 23 July 2017. http://www.veritaszim.net/node/2141.

Government of Zimbabwe. "Bank Use Promotion and Suppression of Money Laundering Act [Chapter 24:24]."*Veritaszim*. Web. 16 June 2017. http://www.veritaszim.net/node/161.

Government of Zimbabwe. “Government Gazette.” Zimbabwean Government Gazette. 31 October 2016. Web. 28 June 2017. https://www.zimlii.org/zw/zw/subleg-consol/SI 133 of 2016 - Bond Notes 31 OCT 2016.pdf

Government of Zimbabwe. "Indigenisation & Economic Empowerment Act (Updated May 2015)." *Veritaszim*. Web. 16 June 2017. http://www.veritaszim.net/node/1271

Government of Zimbabwe. "Public Debt Management Act, 2015." *Veritaszim*. Web. 16 June 2017. http://www.veritaszim.net/node/1347.

Government of Zimbabwe ."Reserve Bank of Zimbabwe (Debt Assumption) Act, 2015." *Veritaszim*. Web. 16 June 2017. http://www.veritaszim.net/node/1385.

Government of Zimbabwe. "Reserve Bank of Zimbabwe Amendment Act [Act 1/2017]." *Veritaszim*. Web. 16 June 2017. http://www.veritaszim.net/node/2013.

Government of Zimbabwe. "SI 2015-70 - Reserve Bank of Zimbabwe (Demonetisation of Notes and Coins) 2015." *Veritaszim*. Web. 16 June 2017. http://veritaszim.net/node/1291.

Government of Zimbabwe. "SI 2016-064 - Control of Goods (Open General Import Licence) (No 2) (Amendment) Notice 2016 (No 8)." *Veritaszim*. Web. 16 June 2017. http://veritaszim.net/node/1715

Hanke, Steve H, and Alex K. F. Kwok. “On the Measurement of Zimbabwe’s Hyperinflation. ”*Cato Journal*, vol. 29, no. 2, Spring/Summer 2009. https://object.cato.org/sites/cato.org/files/serials/files/cato-journal/2009/5/cj29n2-8.pdf

Hanke, Steve H. "Zimbabwe: From Hyperinflation to Growth." *Cato Institute*. 25 June 2008. Web. 28 June 2017. https://www.cato.org/publications/development-policy-analysis/zimbabwe- hyperinflation-growth

[3] There are some people who were consulted but have been not listed so as to preserve the confidentiality of their communications.

Hanke, Steve H. “Zimbabwe, From Disaster to Disaster.” *Forbes*, 31 July 2017. Web. http://www.forbes.com/sites/stevehanke/2017/07/31/zimbabwe-from-disaster-to-disaster/ -4878dc0f221a

International Monetary Fund (IMF). "Zimbabwe: 2017 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for Zimbabwe." *Country Report* 17/196 (2017). Web. 11 July 2017. https://www.imf.org/en/Publications/CR/Issues/2017/07/07/Zimbabwe-2017-Article-IV-Consultation-Press-Release-Staff-Report-and-Statement-by-the-45052

Mabeza, Farai. “Bond notes fuel black market.” *Financial Gazette* (Harare). 02 February 2017. Web. 29 June 2017. http://www.financialgazette.co.zw/bond-notes-fuel-black-market/

Makochekanwa, Albert. "Zimbabwe to introduce Zimbabwe Bond Notes: reactions and perceptions of economic agents within the first seven days after the announcement." *Munich Personal RePEc Archive* (2016) *Munich Personal RePEc Archive*. 08 June 2016. Web. 16 July 2017. <https://mpra.ub.uni-muenchen.de/71695/>.

Moreno-Villalaz, Juan Luis. “The Monetary Experience of Panama: A Dollar Economy with Financial Integration.” *Cato Journal* 18, no. 3 (Winter 1999): 421–39

Moreno-Villalaz, Juan Luis. “Financial Integration and Dollarization: The Case of Panama,” *Cato Journal* 25, no. 1 (Winter 2005): 127–40.

Muronzi, Chris. “CBZ Bank soaks up US$760 m Treasury Bills.” *Zimbabwe Independent.* 17 March 2017. Web. 19 July 2017. https://www.theindependent.co.zw/2017/03/17/cbz-bank-soaks-us760m-treasury-bills-2/

Noko, Joseph. "Dollarization: The Case of Zimbabwe." Cato Institute, 2011. Web. 17 June 2017. https://object.cato.org/sites/cato.org/files/serials/files/cato-journal/2011/5/cj31n2-9.pdf

Old Mutual Zimbabwe Limited. “Abridged Financial Statements.” 31 December 2016. Web. 19 July 2017. http://www.oldmutual.co.zw/docs/librariesprovider5/About-Us/omzil-financial-statements---31-december-2016.pdf?sfvrsn=0

Phiri, Gift. “Jail term for devaluing bond notes.” Daily News. March 28, 2017. Web. 29 June 2017. https://www.dailynews.co.zw/articles/2017/03/28/jail-term-for-devaluing-bond-notes

Reserve Bank of Zimbabwe. “Monetary Policy Statement.” January 2017. Web. 13 June 2017. http://www.rbz.co.zw/assets/2017-monetary-policy-statement-.pdf

Reserve Bank of Zimbabwe. *Monthly Economic Review.* June 2017. Web. 27 July 2017. http://www.rbz.co.zw/assets/monthly-economic-review-may-2017.pdf

Reserve Bank of Zimbabwe. “RBZ Monetary Statement January 2017.” http://www.techzim.co.zw/wp-content/uploads/2017/02/Reserve-Bank-of-Zimbabwe-Monetary-Policy-Statement-2017.pdf

Saigal, Kanika. "Zimbabwe: Uncertainty surrounds Afreximbank bond notes loan." *African Business.* 07 December 2016. Web. 29 June 2017. http://africanbusinessmagazine.com/region/southern-africa/zimbabwe-uncertainty-surrounds-afreximbank-bond-notes-loan/

Schuler, Kurt. "Basics of Dollarization." U.S. Congress, Joint Economic Committee Staff Report, July 1999, updated January 2000. Web. https://web.archive.org/web/20110826134330/http://users.erols.com:80/kurrency/basicsup.ht m

World Bank. "The state in the economy." *Zimbabwe Economic Update* no. 2, 2017. Washington, D.C.: World Bank Group. http://documents.worldbank.org/curated/en/333081497536246610/The-state-in-the-economy

Zwinoira, Tatira. "Zimbabwe: Cash Dealers Swell on Harare's Streets." AllAfrica.com. 09 July 2017. Web. 11 July 2017. http://allafrica.com/stories/201707090004.html