

Unbundling Zimbabwe's journey to hyperinflation and official dollarization

by:

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Abstract

The first impetus to Zimbabwe's drive to hyperinflation and official dollarization predates the disruption in production caused by the fast-track land reform programme. The initial push came from the departure from relatively disciplined fiscal policies to a string of measures aimed at pacifying restive groups threatening political power through the transfer of economic and financial resources to those groups to the detriment of the fiscus. This stance caused investors to run away from the Zimbabwean currency thus causing currency depreciation hence inducing cost-push inflation which was worsened by the decline in production that accompanied the land reform programme and the associated disturbances to production in all sectors of the economy. The liquidity expansion by the central bank to prop the ruling party embodied in the quasi-fiscal activities veiled as expansionary Keynesian economics played a major role in firmly setting the stage for hyperinflation in the latter stages of the saga. In the backdrop of hyperinflation, the institution of official dollarization was merely de jure recognition of the unofficial dollarization that had set in. On the basis of Zimbabwe's idiosyncrasies, the article contends that any attempt to dedollarize should be an endogenous outcome of a policy of macroeconomic stabilization.

Keywords: Africa, Zimbabwe, Hyperinflation, Currency problems

JEL classification codes: E31, E42, E58, E61, O55

1. Introduction

Zimbabwe acquired relative prominence in mainstream media in the late 90s, predominantly due to the country's economic and financial dislocation (characterized by hyperinflation at its worst) which culminated in the adoption of official dollarization in 2008. These events came in the backdrop of the fast-track land reform programme, which entailed the expropriation of white-owned commercial farms for redistribution to the landless black majority. Though there is a direct nexus between the two processes, the former cannot be exclusively ascribed to the latter; there are a host of other issues that have contributed to the economic and financial breakdown in Zimbabwe.

The economic and financial breakdown has been explosive as it has been socially harmful. Table 1 below shows the time series evolution of some of the relevant macroeconomic indicators from 1998 to 2007.

Table 1: Macroeconomic trends 1998 - 2007

Year	GDP growth rate (%)	Annual Inflation (%)	M1 change (%)
1998	-0.8	47	26
1999	-2.1	57	39
2000	-7	55	53
2001	-3	112	144
2002	-4	199	171
2003	-10	599	491
2004	-2	133	234
2005	-4	586	547
2006	-3	1281	1315
2007	-6	7982	66659

Source: RBZ (2009)

From table 1 above, inflation increased from 47 percent in 1998 to qualify the Cagan's (1956) hyperinflation definition when it reached of 7,982 percent in 2007, thereon it kept increasing to reach 231,150,889 percent in July 2008 whereupon the country disbanded the national currency and adopted a basket of foreign currencies as legal tender five months later. In some instances inflation was fuelled by huge money expansion that was running at the rate of 66,659 percent annually in 2007. The fall in production and the depreciation of the exchange rate have both been cause as well as consequent to inflation in different instances of the progression of the series.

Though the basic facts surrounding Zimbabwe's hyperinflation have enjoyed widespread exposure in the media, there is a general paucity of academic literature on the fundamental constructs that underlie the phenomenon in Zimbabwe. Coorey *et al* (2007) single out excessive money expansion stemming from the central bank's quasi-fiscal activities as the culprit in Zimbabwe's hyperinflation. These findings are corroborated by Makochekeka (2007) who modeled

Zimbabwe's money demand using an Error Correction Model and concluded Zimbabwe's hyperinflation has been dependent on excessive liquidity. Whilst these studies have been insightful with regards to the actual mechanics of Zimbabwe's hyperinflation, they eschew rigorous analysis of the historical and political factors that gave rise to those mechanics. This study attempts to bridge that gap by answering two specific questions; firstly what factors, political and economic, led to the financial collapse in Zimbabwe? And secondly, given the official dollarization in the aftermath of hyperinflation, what framework could be followed to reintroduce a national currency should the country seek to dedollarize? It is imperative to note that in the second undertaking, this paper does not seek to evaluate the merits or lack thereof, of a dedollarization agenda; rather it seeks an answer to an abstract question pertaining to the optimal dedollarization path for Zimbabwe given its idiosyncrasies. Whilst this approach might *a priori* seem presumptuous, it finds basis in the prevailing climate of opinion, misguided or otherwise, within the country's political establishment that is skewed towards eventual reintroduction of a national currency.

In this endeavor, the paper fuses vignettes of the Zimbabwean experience with analytical narratives based on economic theory. It provides a political-economic analysis of Zimbabwe's history that exposes the ties between financial and political phenomena. In terms of the policy question, the paper seeks to give an evaluative worth of the three options open to the Zimbabwean government for dedollarization and recommends on the basis of a trajectory of what can obtain in the event of the adoption of any of the options. The major findings of the study are that the road to financial collapse has been littered with dirigisme, populist policies and huge money expansion. The study also observed on the basis of the perceived realizations of the possible dedollarization frameworks, that the path for Zimbabwe dedollarization should spurn dirigisme of administrative enforcement or regulatory measures.

The arrangement of the rest of this paper is as follows; section two is broken down into four subsections according to significant political and economic turning points in the country's history, chronicling the route to hyperinflation and official dollarization. Section three explores the several options that are open to the Zimbabwean government in terms of dedollarization and on the basis of the analysis thereof recommends the policy option to be pursued whilst four summarises and ties the arguments.

2. Road to hyperinflation and dollarization

2.1. 1997 to 1999: Political vulnerability and economic breakdown

The last half of 1997 marks a turning point from the relatively disciplined policies that the government had pursued since the attainment of independence in 1980. A string of decisions largely to shore the government's waning political support and appease powerful disgruntled groups through the transfer of economic resources in that period inexorably set in motion a rollercoaster of events that resulted in the economic collapse of the country. These decisions had the effect of damaging confidence in the local currency, concomitantly exerting pressure on the Zimbabwean dollar in the currency markets, which fed to inflation via a pass-through from more expensive imported goods.

Firstly, in August 1997, approximately 60,000 war veterans were granted ZWD50,000 each (approximately USD3,000 at the time) plus a monthly pension of approximately USD125 per month outside the budget (Chitiyo, 2000).¹ The payouts amounted to almost three percent of GDP at the time and this had the immediate effect of inflating the budget deficit at the end of 1997 by 55 percent from the 1996 levels. Concerns were raised pertaining to the financing side of the transaction in view of an already precarious fiscal position, and on that basis in September 1997, the World Bank temporarily withdrew a USD62.5 million standing credit line for the balance of payments support until the government had demonstrated that the payments would not result in a higher than the projected 8.9 percent budget deficit in the 18 months leading to December 1998. As an *ad hoc* decision, the government had intended to accommodate the gratuities payment through tax increases in the 1998 budget but countrywide protests orchestrated by the trade unions forced the government to backpedal and resolve to monetization of the transaction (Amani Trust, 1998).

Even though the World Bank announced that the withdrawal of balance of payments support was only a temporary measure, this act had the significance that it highlighted a growing chasm between the country's leadership and the Bretton Woods financial institutions, as barely two months after the World Bank withdrawal, the IMF sent a delegation to the country to redraft the new lending programme to Zimbabwe which was set to have supported the second set of neo-liberal reforms amid the same concerns as those of the World Bank.

The second populist decision followed in November 1997 when the president, Mugabe, announced plans to compulsorily acquire white-owned commercial farms, again without elaboration

¹ Many grassroots ex-combatants who had not been financially compensated for their role in the liberation struggle were also victims of the twin scourges of poverty to ensuant to the neo-liberal Economic Structural Adjustment Programme and the HIV/AIDS pandemic that was ravaging the country, hence they started agitating for the compensation that was due to them threatening the government hold on to power (Chitiyo, 2000).

on the financing side of the transaction.² This had the immediate effect of giving investors a perception of an ensuing precarious fiscal position and consequently there were spontaneous and concerted runs against the currency and from the money and capital markets. The climax of these events was on 14 November 1997 when the Zimbabwean dollar crashed and lost 75 percent of its value against the USD on a single day, on what is now known as “Black Friday” in Zimbabwean economic history. The stock market also plummeted and the index was down by 46 percent by day end from the peak August levels. The central bank, had to intervene and raise interest rates by six percentage points within that single month (Bond, 1998). Thenceforward the exchange rate continued to depreciate uncontrollably, thus the 1997 financial and currency turbulence set the stage for a long and potentially long slump in the real economy.

The crash of the Zimbabwean dollar in the foreign exchange markets was immediately mirrored by its loss of value on the domestic markets, as in January 1998 there was an upsurge in consumer prices of 25 percent. In response to the attendant fall in real wages, the Zimbabwe Congress of Trade Unions organized protests which paralysed the whole country for two days, dangerously threatening the government’s grip on political power. In an effort to assuage the masses, the government reintroduced price controls and simultaneously attempted to deflect negative public sentiment by shifting its rhetoric against industry, whom it blamed for excessive profiteering by charging exorbitant prices (ibid). The immediate consequence of these price controls was widespread shortages of basic commodities in official markets and the genesis of the informalization of Zimbabwe’s economy, which was to eventually spread to financial markets due to government submarket controls on the forex rates. Paradoxically, the government’s price controls, via the informal economy fuelled prices higher further eroding living standards and further alienating the masses. These events highlight the government’s affinity to dirigisme as the philosophy of economic management, a theme which is recurrent in this doom-laden saga.

The economic crisis the country endured as a consequence of the maladroit expenditure management persisted, and to add harm to injury, in September 1998 the president agreed to send 11,000 troops under the SADC protocol, to the Democratic Republic of Congo (DRC) to back the discredited leader, Kabila, who was under attack by Rwandan and Ugandan backed rebels. Dietrich (2000) contends that this act was simply the utilization of national military by the political elite for private financial gain as it emerged that the Zanu PF bigwigs had been promised mineral concession

²This was parcel of the 1993 Land Designation Act in which the government would compulsorily acquire 1,500 white-owned farms with partial compensation covering buildings and infrastructure for redistribution to the landless black

in the DRC. The precise costs of the ensuing war are open to speculation, as the government was tight-fisted with casualty and financial information pertaining thereto. A letter written by the finance ministry to the IMF seeking funds puts the funds to finance the war at USD1.3 million per month in 1998 or 0.4 percent of GDP and in 1999 when additional troops were deployed at USD3 million per month or at 0.6 percent of GDP (IMF, 1999). Dorman (2001) however, postulates on the basis of a leaked memorandum from the ministry, the costs to have been at least ten times the official figures. The situation, be that as it was, the country could not spare forex outlays of such magnitude and this consequently weakened the currency, again with pernicious effect on price stability. There was intense pressure on the currency and in a bid to increase the flows of foreign currency which were dwindling at precariously low levels, the central bank reintroduced widespread import controls and banned foreign currency accounts. This dirigisme was futile as in the first quarter of 1999 the central bank, had to devalue the currency by 50 percent to trade at USD1: ZWD38 from USD1: ZWD25 (Mumvuma et al, 2003).

In the interim corruption continued to be endemic in both the public and private sector. In one symbolic scandal, an indigenously owned bank, United Merchant Bank of Zimbabwe Ltd, which had been granted an operating license as part of the 1995 financial liberalization reforms, was declared insolvent in the backwash of the 1997-1998 interest rate hikes, after it had fraudulently issued ZWD1,263 million government-guaranteed promissory notes, sold them to other banks and deposited the money into personal offshore accounts of the bank's owner, Boka.³ Due to the high extent of the exposure of other commercial bank to this bank, the whole bank system was in a crisis and the central bank had to intervene to bail out the affected banks with insidious effects on the fight against inflation (Fundira, 2003).

The aforementioned events marked a period in which the inept handling of government expenditure instigated investors to lose confidence in the currency with the consequence that they ran away from it thereby putting a pressure on the exchange rate, which fuelled inflation through the increase in the prices of imports. The pass through from depreciation to prices must have been very high. Due to exchange rate depreciations Zimbabwe's exports became cheaper abroad, however imports also became expensive and caused production costs to rise. Thus a characterization of inflation in this first period is that it was of a cost-push nature. This hypothesis is supported by the

majority.

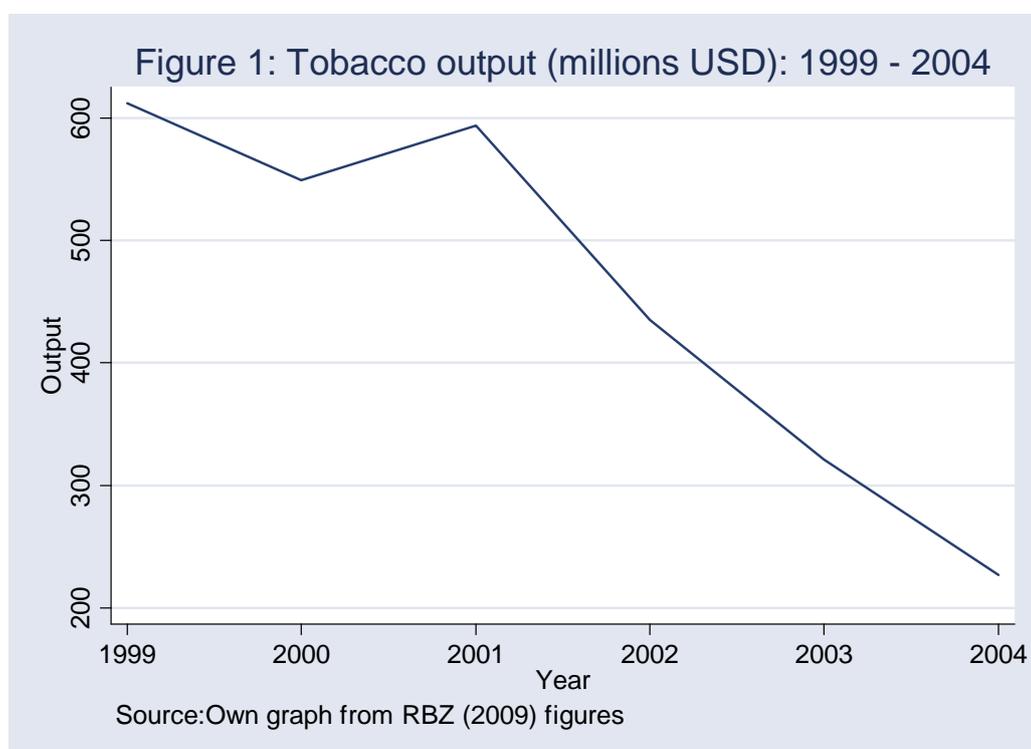
³ The issue of the Boka's bank exposes how political considerations have played a role in Zimbabwe's demise as there was reluctance on the part of the political establishment to have him charged and when he was eventually charged, he blamed government officials for not paying off the loans that he had given them.

findings of Odedokun (1997) who used pooled annual data of several Sub-Saharan African countries, including Zimbabwe, and found that currency depreciation in the official and parallel markets, monetary growth, and foreign inflation have had significant impacts on domestic inflation.

2.2. 2000 to 2003: Land reform and destruction of the production base

The president's rhetoric on confiscation of white-owned farms was elevated to the next level in early 2000, when war veterans, who courtesy of the gratuities, were now the paramilitary wing of the ruling Zanu PF party, started invading white-owned farms as part of an elaborate scheme by Zanu PF to terrorise people to vote for it in the parliamentary election in July 2000 (Shaw, 2003). Terror notwithstanding, the newly formed MDC party went on to secure almost half of the contested parliamentary seats. In the aftermath of the plebiscite, the government delineated the parameters of its land redistribution policy embodied in the fast-track land reform programme under which 300,000 households and 51,000 black commercial farmers would be apportioned the previously white-owned commercial farmers (Sachikonye, 2005).

As a result of the upheavals on the farms, agricultural output was to fall dramatically from the level of 18 percent of GDP in 2000 to 14 percent of GDP in 2002 (World Bank, 2008). Tobacco, the country's major foreign currency earner was not spared as can be seen from figure 1 below.



According to figure 1 above, export proceeds from tobacco declined from USD612 million in 1999 to USD321 million in 2003. The consequences of the falling agricultural output were as immediate as they were harmful. The government could not service its multilateral debts obligations and as a result in October 2000, the World Bank suspended any extra lending to Zimbabwe under the IBRD and IDA facilities due to non-payment of over six months (World Bank, 2000). This marked the closure of the country's relations with the World Bank to date (2009) and paved way for, on a political front, the government's isolationist stance and, on the economic front, free-fall of the unsupported currency. On the other hand the government could not import essential raw materials and fuel as a result of the declining forex inflow, which further fed into falling production with the result that by 2004, total foreign currency earnings from the export of goods and services had declined to less than half the 1996 peak of USD3,169 million (World Bank, 2008).

March 2002 marked presidential elections in Zimbabwe, and taking full cognizance of the parliamentary elections results, the political violence was increased in the period leading to that date, as the Zanu PF militias pounced on supporters of the opposition MDC (Vollan, 2002). In purported retaliation to the perceived deterioration of human rights conditions in the country, the European Union imposed sanctions against the country, after Mugabe had ejected a Swedish election observer before the 2002 elections. Under the terms of the sanctions, The European Union suspended budgetary support to Zimbabwe and terminated '*...financial support for all projects except those in direct support of the population...*' Additionally, a travel ban was imposed on 20 Zimbabwean government officials and their spouses, forbidding them travel within the European Union, and overseas assets held by the targeted officials were frozen (Slaughter, 2002).⁴

There was no reprieve in terms of the isolation when Mugabe was announced re-elected in the aftermath of voting. This isolation has economic relevance insofar as it has implications for bilateral aid that was coming into the country through donor agencies from Western governments. The consequence is that by the end of 2002 aid per capita had almost halved from the 1997 levels of USD28 per capita to USD16 per capita (World Bank, 2008). To add harm to injury, the IMF suspended further technical assistance to the country in June 2002 over Zimbabwe's overdue

⁴ Earlier on The USA had passed the Zimbabwe Democracy Recovery Act 2001 whose 3A '*...allows USA executive director to each international financial institution to oppose the vote against any extension by the respective financial institution of any loan, credit, or guarantee to the government of Zimbabwe; or any cancellation or reduction of indebtedness owed by the government of Zimbabwe to the US or any international financial institution...*' (ZDERA, 2001).

obligations totalling SDR101.9 million (about USD132 million) effectively severing the country's relations with the West (IMF, 2002).

Graham (2006) posits that having exhausted all the means to influence Mugabe's government, the West turned to South Africa to use its considerable influence on Zimbabwe's economy to influence Mugabe's government, on the basis of the worsening humanitarian situation in the country. The Mbeki headed South African government was however, unperturbed by the inauspicious developments in its northern neighbour and would not be hastened to take bold steps towards resolution of the Zimbabwean crisis. A hallmark of what became known as Mbeki's 'quiet diplomacy'.

With the country completely sequestered from the donor community, the crisis caused by forex shortages reached a climax in 2003. An acute shortage of Zimbabwean dollar banknotes developed during the first nine months of 2003 and threatening public order in August as the central bank could not print local currency due to shortage of hard currency to import paper and ink. There was a system-wide bank run like the one that epitomized the Argentinean crisis of 2002 as depositors tried frantically to access their funds. Anti-riot police had to be dispatched to banks to quell rising tempers as clients were denied access to their savings. Retrospectively, one could also conjecture that the crisis was not accidental but rather a simple monetary tightening by the central bank in the light of inflation that was running at over 199 percent. In light of the cash crisis the central bank was immediately under fire and in the midst of mounting political pressure, the central bank chief was dislodged from his post three months prior to the expiration of his term (Mander, 2003).

According to this analysis the major driver of inflation in this period was the shrinkage in aggregate supply sparked by the fall in the agriculture, which then spread to other sectors of the economy. The shrinkage in aggregate supply would *ceteris paribus*, trigger price increases which ignite the price-wage spiral. The exchange rate induced price increases as talked about in the previous period still reinforced inflation and they fed unto each other.

2.3. 2004 to 2007: Pseudo-Keynesian economics

On 1 December 2003 a new governor, Gono, was appointed to head the central bank. The battle against inflation, which now stood at 263 percent on a year on year basis at the end of 2003, became Gono's *pons asinorum* and in his maiden monetary policy statement for 2004, pronounced inflation as the country's number one enemy. He undertook money-targeting framework as the monetary policy strategy and consequently set up a 'Framework for Liquidity Management', which

was to contain money supply growth to levels consistent with inflation targets. The interest rate was the operational target and it was raised acutely in the first quarter of 2004, reaching a peak of 5,242 percent annually in March 2004. Inflation which had soared from about 20 percent in December 1997 to a peak of 623 percent in January 2004, decelerated sharply from March to around 130 percent at the end of 2004 (RBZ, 2007).⁵

Consequent to the high interest rates, financial institutions could not utilize the central bank accommodation window sparking a huge liquidity crisis in January 2004 which resulted in the collapse of Century Discount House on 3 January. Century Discount House was a subsidiary of ENG asset management companies. Its collapse was triggered by the fact that it could not raise depositors' funds totaling ZWD61 billion. The fall of Century Discount House triggered a contagion as too many financial institutions were exposed to ENG, thus triggering a liquidity crisis to mostly indigenously owned banks (Makoni, 2006). In the light of this crisis, which threatened monetary stability, the central bank came to the rescue of the ailing institutions in the form of the Troubled Bank Fund (TBF). The TBF was not a free lunch as onerous conditions were attached thereto, such as change of organizational structure in the affected banks, change in management and directors had to step down. Moving on with the same issue, the high real interest rates and an increasingly overvalued official exchange rate was also putting pressure on domestic producers and exporters, and in a move sold as though it was to bail out the ailing industries, the central bank started engaging in quasi-fiscal activities. The quasi-fiscal activities went beyond the operational realm of a normal central bank and had the effect of undoing the ephemeral achievements in the inflation battle and firmly set course for the drive towards hyperinflation.

The shift to the quasi-fiscal policies disguised as Keynesian economics rhetoric was not only to resuscitate industry but sinisterly it was to nourish the unpopular ruling regime through populist disbursements of money, a classic example of Brantlinger's (1985) 'bread and circuses' in despotic regimes. Table 1 above reveals that at the height of these quasi-fiscal activities, money (M1) was increasing at the rate of 66,659 percent annually in 2007 and this feed to demand pull inflation during this period. The hypothesis that the quasi-fiscal activities is the culprit in the increase in money

⁵Munoz (2007) points a paradox that the fall in inflation preceded the fall in money supply, which is contrary to conventional wisdom. Though inflation was decreasing, broad money growth only started decelerating in July 2004 from over 400 percent at the end of 2003 to 130 percent by the end of December 2004. It implies therefore that prices during this period responded to other factors besides changes in monetary policy. A hypothesis is that the fall in inflation was based on low inflation expectations owing to the aforementioned confidence that people had in the new governor, it was not the anticipation of tight monetary policy that triggered the fall in inflation.

supply, hence the major cause of inflation during the period after 2004, is supported by Munoz (2007) who observes that the major cause of the surge in money during the period 2004 - 2007, has been improvidence in the conduct of quasi-fiscal activities, rather than conventional fiscal laxity as in the period before 2000, as the average central government fiscal deficit for 2003-2005 was been below five percent of GDP.

The notion that the quasi-fiscal activities were without inherent virtues save for political expediency is substantiated by the central bank's selective distribution of food under the central bank BACCOSSI scheme or the farm mechanization programme, which were both largely targeted to areas where the ruling party still enjoyed some support. The central bank crusades to shore the unpopular ruling regime at the expense of the masses went beyond inflation tax but also to diversion of donor funds passing through the central bank to the Zanu PF. A case in point is the revelation that the central bank siphoned funds from the Global fund meant to fight HIV/AIDS, malaria and tuberculosis in 2008 to aid Zanu PF's political campaign (Muchemwa, 2009).

In return to support rendered to Zanu PF, the government turned a blind eye to bureaucratic and personal interests at the central bank that were to the detriment of the country. There was a high rate of organizational consumption at the central bank amounting to four percent of annual GDP for the ten months leading to October 2006 (Munoz, 2007). At the time when general unemployment was running at over 80 percent in the country, the central bank was enlarging its staff at the expense of the whole nation with the result that by 1997 its staff doubled (Hanke, 2008).

The ravaging inflation standing at over 1000 percent meant that the people had to carry large sums of currency to conduct the simplest of transaction and on 1 August 2006, the Zimbabwean dollar was replaced by a new Zimbabwean dollar exchanging at a ratio of 1000:1 and it was subsequently devalued against the USD. A transition period of 21 days during which both currencies co-existed was given and thereafter the old notes ceased to be legal tender. Implicit in this undertaking was an element of state-theft as stringent limits were given for the amounts convertible during that transition day period. Border posts checks and roadblocks were mounted to curb the 'contraband' movement of local currency. According to the central bank governor, the instigator of the currency reforms dubbed '*Project Sunrise*' was the rise of financial disintermediation characterized by 90 percent of the currency circulating outside the banking system. A paragon of the naiveté and erroneous reasoning that pervades the governor's reasoning is unveiled by his suggestion that striking off three zeros from the currency would suffice to cure inflation. According to the central bank governor, the basis of these reforms was that the removal of three zeros would effectively have

‘ positive psychological effect on people's reference points when comparing the relative strength of the local currency against regional and international prices, as well as prices for goods and services...’ (RBZ, 2006). In other words the governor conjectured that by simply removing zeros from the currency people would be confused to think that the Zimbabwean currency was no longer inflationary and hence revise their inflation expectations.

Given the cosmetic nature of the reforms, there was no sign of recess in inflation and Zimbabwe formally entered hyperinflation according to Cagan's (1956) definition in March 2007 when month-on-month inflation reached 50.54 percent and year-on-year 2,200 percent (RBZ, 2007). This period thus, marked the country's accelerated drive towards hyperinflation fuelled by the central bank's quasi-fiscal activities meant to fund the political campaigns of an unpopular ruling regime. In terms of economics, the characterization of inflation in this period is therefore of a demand pull nature consistent with the results of Coorey et al (2007) and Makochekanwa (2007) who found that the major driver of inflation was excess liquidity.

2.4. 2008 to 2009: Dollarization and deflation

2008 was to find hyperinflation gaining momentum, reaching 417,823 percent in March; and it is in that setting that Zimbabweans went to the harmonized presidential, legislature, and local government polls. The elections were relatively peaceful and accordingly in line with the amount of discontent in the country the ruling Zanu PF party lost in all the three elections, for the first time losing its majority in the legislature. The presidential ballot had to go for runoff between Mugabe who had 43.2 percent and Tsvangirai who had 47.9 percent as neither of them had the outright majority.

The presidential poll run-off which was set for June never materialized as Tsvangirai withdrew citing the high level of violence against his supporters which was inimical to a free and fair poll. In the aftermath of that withdrawal Mugabe then declared himself duly elected. The combined effect of the hyperinflation and widespread collapse in social services rendered the country ungovernable without external support. Mugabe had lost legitimacy internally and externally, hence could not access external funds to govern the country thus he was forced to enter into power-sharing negotiations with the opposition.

In September 2008, after 3 months of negotiations overseen by the South African leader under the SADC protocol, Mugabe and Tsvangirai signed a power-sharing deal which would see

Mugabe assume the role of president whilst Tsvangirai that of the prime-minister. However, haggling over the allocation of ministerial posts between the parties delayed the effectuation of the deal.

By December 2008 the use of foreign currency as a medium of exchange was now almost complete albeit unofficially and in a move sold by the central bank as though to help businesses suffering from chronic shortages of foreign currency to import goods and spare parts, it licensed around 1,000 shops to sell goods in foreign currency. This constituted the first conscious recognition of unofficial dollarization in Zimbabwe; however there was nothing altruistic about the central bank's move as it was merely contrived for political expediency. Upon recognition that the country had *de facto* dollarized, and that the government was still collecting taxes in the worthless local currency; the move was to support the ruling regime by increasing the foreign currency flowing into its coffers, through collections of hard currency taxes from the 1,000 shops but simultaneously criminalizing the use of foreign currency from the informal sector where it could not collect taxes. This exposed to all and sundry that the government was self-serving; on one extreme it was still paying civil servants salaries in the worthless Zimbabwean currency, but at the same time somehow expected them access foreign currency to buy necessities in shops.

In January 2009, a month after the licensing 1,000 shops the minister of finance gave legal tender status to the South African Rand and the US dollar, hence completing official dollarization. The role of local currency was relegated for use in small transactions and for change, which is the same role as that is played by local coins in other officially dollarized economies. It is in this background that the opposition leader was sworn in as prime minister as per the power-sharing agreement of September 2008 after reaching a compromise on the allocation of ministerial posts.

The institution of official dollarization underlined by the political accommodation had the obvious immediate effect of stopping hyperinflation and the country actually entered into deflation with consumer price inflation standing at -2.34 percent and -3.26 percent at the end of January and February respectively. Aid from bilateral donors started trickling into the country and for the first time in over ten years the country forecasted positive growth (Ministry of Finance, 2009).

The country's relations with the Bretton Woods financial institutions have yet to normalize though the IMF has approved targeted technical assistance in the areas of; tax policy and administration, payments systems, lender-of-last-resort operations and banking supervision, central banking governance and accounting to Zimbabwe in May 2009. The basis of the resumption of cooperation was the observed substantial improvement in Zimbabwean government's cooperation on economic policies to address its arrears problems (IMF, 2009). On the other hand the World

Bank has not yet re-established any form of cooperation with Zimbabwe noting that conditions conducive to full fledged economic development programme with Zimbabwe have not yet been met (World Bank, 2009).

3. The hypothetical roadmap to dedollarization.

Galindo and Leiderman (2005) postulates that dedollarizing an economy is more often than not, the side effect, or endogenous consequence, of a tenacious process of disinflation and stabilization rather than the principal aim of a policy program. As already noted in the foregoing, this section does not seek to make a case or lack thereof for dedollarization but rather seeks a hypothetical path to dedollarization.

Following Erasmus et al (2009), there are three approaches, or a combination thereof, that Zimbabwe could adopt in the event that it does indeed, decides to dedollarize and reintroduce a national currency. The first approach is market-based, that is the pursuance of macroeconomic policies that give the national currency stability on both the internal and external markets. In other words, according to this approach, dedollarization is just a side effect of these policies of stabilization rather than a conscious objective of policy. The mechanics of this approach is that the stability of the introduced local currency on both the domestic markets will make it attractive to Zimbabwean vis-à-vis foreign currency.

The second alternative is non-market based approach in the form of regulatory reforms. These would aim to change the incentive structure of holding a portfolio of currencies in favor of the envisaged national currency. These reforms could take several forms like setting differential reserve requirements or remuneration rates or adjusting provisioning and liquidity requirements. Other regulatory reforms entail the regulations requiring certain payments to or contracts to be conducted in the local currency.

The third approach would be to employ another non-market means which is administrative enforcement. Basically, this is simply to outlaw totally or limit by law, the use of foreign currency in the country or a variants of that such as prohibition of, or limits on, foreign currency deposits for residents and dollar loans, restrictions on residents holding accounts abroad, taxes on dollar intermediation, and forced conversion to local currency deposits (ibid). One could also use a combination of the approaches in any proportion.

Pursuance of market-based mechanism in Zimbabwe implies the introduction of local currency and the creation of conditions that enhance macroeconomic stability which will restore the

confidence of Zimbabweans in their own currency. It is imperative to realize that dollarization usually persists long after the phenomenon that brought it in the first place has disappeared; hence it will be a slow path to dedollarization (ibid). It will however be the surest way towards dedollarization because it is voluntary and the one that is consistent with freedom as no direct or indirect coercive force will be induced upon Zimbabweans to facilitate dedollarization.

This process therefore hinges critically on the credibility of the reform process. Ndelela (2008) gives several constituent elements of the reform process in Zimbabwe, among which; a political settlement that is consistent with the aspirations of the majority Zimbabweans, a commitment to globally acceptable values of political governance such as the protection of human rights, commitment to rule of law and the final element is institutional reforms among which, ensures independence of the judiciary and the central bank.

Regulatory reforms as an approach to dedollarization in Zimbabwe would shift the currency-holding incentives towards the local currency. These measures make it more profitable for the agent to hold Zimbabwean currency rather than foreign currency. As this approach does not emphasize on macroeconomic stability or qualities of the local currency itself, there is a danger that this factor combined with the differential returns on foreign currency and local currency might encourage a culture of speculation and rent-seeking behavior which will ultimately be to the detriment of genuine investment. Further to this there is need to consider the fiscal implications of these incentives which do not auger well for monetary and fiscal authorities with a history fiscal profligacy. A case in point is say where the government pays above market returns on bonds in local currency which implies an indirect extra cost to the government.

As in the case of a market approach, for this approach to work in Zimbabwe, there should be institutional reforms at the central bank, to make it more independent thus cushion it from being coerced to monetize government deficits, and secondly more transparent hence cease engaging in quasi-fiscal activities, all of which are injurious to the goal of price stability.

The final option is administrative enforcement. It is noteworthy, at a certain level of perception, that this is the system that existed in Zimbabwe prior to official dollarization, as the holding of foreign currency was outlawed. Experience has shown that it would only result in unofficial dollarization (and the attendant black market for currency and corruption as people will always find illegal ways to hold foreign currency) if the local currency is found to be unstable by the people. Attendant to unofficial dollarization, are other ills that are deleterious to the economy, that would arise such as financial disintermediation and capital flight. The combined effect of these things

would be to sharply reduce domestic credit and consequently investment (Priewe and Herr, 2003). All these phenomena as noted before already manifested in Zimbabwe as a result of dirigisme. Another shortcoming is that this will hit hard the poorest in the event that the envisaged currency is of a poor quality as the elite will find ways, illegal or otherwise to take their monies out of the country thus preserving their wealth.

Thus given, on the basis of the perceived realizations in the event of the institutions of either of these three paths, dedollarization in Zimbabwe should be endogenous outcome of a process of macroeconomic stabilization. The recommendation is therefore for a market based approach, the slowness of the process notwithstanding, it is the surest path towards dedollarization and the one that is most consistent with freedom.

4. Conclusion

The issues at the core of Zimbabwe's hyperinflation predate the fast-track land reform programme. The first impetus to the cataclysm lie in the string of policies aimed at pacifying certain disgruntled social groups through the transfer of economic resources in order to retain political power. The combined effects of these measures were to give a perception of fiscal instability to investors which led to currency depreciation hence inflation.

The fast-track land reform programme played a major role in the destruction of the country's production base hence contributing to inflation. In the latter part of the Zimbabwe's case, the quasi-fiscal activities of the central bank were responsible for the growth in money supply which fed to inflation. The quasi-fiscal activities were construed for political expediency to prop the hugely unpopular ruling Zanu PF party.

The whole Zimbabwean saga is littered with dirigisme meant for self preservation of the ruling Zanu PF party. These controls are found in the form of restrictions in the holding of foreign currency and also in the form of price controls.

The decision in the final phase to adopt official dollarization was a mere recognition of the de facto unofficial dollarization. The institution of official dollarization combined with the implementation of the power-sharing deal in Zimbabwe immediately brought down inflation.

Though the pursuance of market reforms to dedollarization will be slow, it is the surest and the one that is most likely to succeed. These will hinge on the credibility of the whole reform process.

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