IOSR Journal of Economics and Finance (IOSR-JEF)
e-ISSN: 2321-5933, p-ISSN: 2321-5925.Volume 6, Issue 1. Ver. I (Jan.-Feb. 2015), PP 30-38
www.iosrjournals.org

Currency Substitution, Dollarisation and Possibility of De-Dollarisation in Zimbabwe

[1]Wellington Garikai Bonga, [2]Netsai Lizzy Dhoro

Abstract:*Dollarisation can be a path to economic stability and growth if managed properly. Governments which end up dollarising only do so as a last resort.This paper used both explanatory and empirical approach to explore the nature of currency substitution and dollarisation in Zimbabwe. The paper also discuss the possibility and the requirements for de-dollarisation to take place. The process of dollarization in Zimbabwe was peculiar in that it was not backed by international reserves as is normally the case with countries that have dollarized. The only foreign currency that the government had was from taxation after full dollarisation. Currency substitution isan important phenomenon in countries with high inflation rates, complicating forecasts of money demand and making monetary policy more difficult to conduct. The most important incentive for currency substitution has been change in the domestic inflation rate, though there have been episodes of currency substitution arising for other reasons. Adequate reforms have been emphasized before de-dollarisation.*

Key Words:*Dollarisation, Currency substitution, Dedollarisation, Currency boards, Bad money, Good money, Gresham's law, Monetary policy, Monetary regime*

I. Introduction

Where is the Zimbabwean dollar? What led to its vanish? Is it normal for a currency to disappear? Will it come back? Many people will perhaps have interest in the last question because it instills differently to those who have seen it all happening. However, all the questions are of crucial importance to be answered. Zimbabwe abandoned its local currency in 2009 after it had been ravaged by hyperinflation which topped 231 million and introduced a basket of foreign currencies dominated by the United States dollar. This paper discusses the journey the Zimbabwean dollar tool until its disappearance from the market, how other currencies dominated the local market, and the possibility of the return of the Zimbabwean dollar in the near future.

All what has happened is commonly known as dollarisation or euroisation, which can occur formally or informally through currency substitution.The kind of dollarisation taken by Zimbabwe will also be discussed to clarify the possibility of such happenings relating to theories and empirics.Besides having been unable to convert domestic money balances of the banking system, the Reserve Bank of Zimbabwe could not provide the lender of last resort function. In fact dollarization in the absence of reserves to re-capitalize the central bank essentially wiped out its capital.

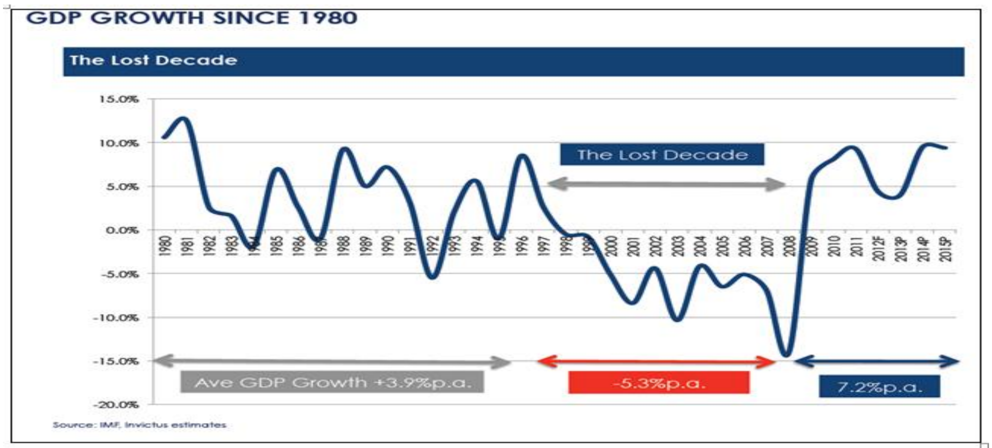
How do people demand local and foreign currencies? In a normal economy the demand for foreign currency is far less than the demand for local currency. This is because majority of residents in the country are not involved in international dealings, they just leave on local production and what business provides. However, it is worth to note that there is both demand for both currencies in the economy and the ratio represents the stability of the economy. The size of the economy and population size really matters on the amount of currency circulating in an economy.

Currency substitution emanates from the functions of money namely the store of value and as a medium of exchange. Several factors are always in place that affects the efficient functions of each currency. The Zimbabwean dollar is not an exception in this case, the currency lost the store of value function and was later unaccepted as a medium of exchange but was still the formal currency for formal markets. The demand for the Zimbabwean dollar decreased by each day as the economy was in crisis. Answering the proposition by Gresham (commonly known as Gresham's law) good money substituted bad money. Bad money refers to the currency that is continuing to lose its functions.

Significant currency substitution does not require even' little old lady on Main Street to hold foreign money. All that is required is a significant subset of individuals and enterprises which on the margin are indifferent between holding another dollar of their money portfolio in domestic versus foreign money. Miles (1984)

According to Dallas and Hafer(1984), "The mere holding of a diversified portfolio of currencies, however, is not sufficient for currency substitution to be meaningful." In their further analysis they say these holdings must also change in response to changes in the relative opportunity costs of holding foreign money balances. That is if individuals actually hold a diversified portfolio of currencies, then they will respond to changes in the cost of holding one currency relative to another by changing the relative amount of each currency held. This readjustment of currency holdings (currency substitution) enables monetary shocks to be transmitted (via money demand) from one economy to another even in a world of flexible exchange rates.

Ho (2003) acknowledge that currency substitution is a common phenomenon in transitional and developing economies. The author adds that among many possible causes, high and persistent inflation should take the lead. The existence of extensive currency substitution will bring about exchange rate instability, alter the demand function of domestic money, and make the implementation of monetary policy futile. It might also become a hindrance to financial and economic developments if improperly managed by the authorities. As discussed in McKinnon (1982) and others, certain undesirable effects such as exchange rate volatility could be created by currency substitution.



The graph above shows the trend of GDP growth of the Zimbabwean economy since 1980. There is a lot of inconsistence in the growth as seen by positive and negative fluctuations. This shows instability in the economy, a stable economy resembles a steady development path with minimum deviations. A serious decline in GDP growth occurred between 1998 and 2008, hence labelled "lost decade." This is the period when the Zimbabwean economy was in crisis, worsening with each year coming. During this period, is when the Zimbabwean dollar was heavily losing value against foreign currency until it was completely substituted.

Zimbabwean inflation has been on the rise since independence. This on its own shows that there was economic policies that failed to harness inflation or there were no seriousness by authorities to control it. Some policies like ESAP, ZIMPREST, MERP among others have inflation decline objective, but they failed to calm it down.

Zimbabwean inflation rates since independence

Date	Rate	Date	Rate	Date	Rate	Date	Rate
1980	7%	1990	17%	2000	55.22%	2008 Sep.	3840000000000000000%
1981	14%	1991	48%	2001	112.10%	2008 Mid-Nov.	89700000000000000000000%
1982	15%	1992	40%	2002	198.93%	2008 Mid-Nov.	89700000000000000000000%
1983	19%	1993	20%	2003	598.75%	2008 Mid-Nov.	89700000000000000000000%
1984	10%	1994	25%	2004	132.75%	2009	-7.7%
1985	10%	1995	28%	2005	585.84%	2010	3.2%
1986	15%	1996	16%	2006	1281.11%	2011	4.9%
1987	10%	1997	20%	2007	66212.30%		
1988	7.30%	1998	48%	2008 Jul.	231150888.87%		
1989	14%	1999	56.90%	2008Aug	471000000000%		

The table above shows the values for inflation since 1980 through to 2011. Till 1990 the figures were below 20% which is a bit showing stability in the economy. Thereafter there is fluctuation in inflation rate showing shacky policies prevailing in the economy, with 1997 registering lowest rate at 20%. After year 2000, the rate started to grow uncontrollably upto 2007, thereafter it shoots like no man's business with 2008 registering its figures each day coming. This is the time when controls were being forced to make the Zimbabwean dollar remain formal currency but it soon failed until the Zimbabwean dollar was completely substituted

A stronger currency is said to appreciate, whereas a weaker currency depreciates. The reasons countries experience or cause a currency depreciation are numerous and in some instances, depreciation is intentional. In other cases, depreciation is an inevitable consequence of economic policy. The Zimbabwean currency have been found depreciating over other competing currencies due to poor economic policies and bad politics.

Timeline Of Currency Denominations And Inflation In Zimbabwe

April 1980
The **(first) Zimbabwean dollar** replaces the Rhodesian dollar at par, which buys US$1.54. A series of bank notes is issued, ranging from Z$2 to Z$20.

From 1994 to 2006
The Reserve Bank issues a new series of notes, from Z$2 to Z$100. As inflation rises and erodes the currency's purchasing power, Z$500 and Z$1,000 banknotes are issued from 2001 to 2005. In the first half of 2006, new Z$50,000 and Z$100,000 denominations debut.

Aug. 1, 2006
The first currency reform is implemented in an effort to contain spiraling inflation. The Zimbabwean dollar is redenominated by lopping off three zeros from the old currency. The **new (second) Zimbabwean dollar** is revalued at one new dollar = 1,000 old dollars.

July 1, 2007
The Z$500,000 note is introduced, valued at about US$16 at the official exchange rate.

Dec. 31, 2007
The Z$750,000 (US$25) note begins circulation.

Jan 1, 2008
The Z$1 million, Z$5 million and Z$10 million denominations debut.

April 2, 2008
Z$25 million and Z$50 million bills are introduced. Prices of basic goods are in millions—a T-shirt costs Z$276.5 million, pants Z$2.75 billion. Tomatoes and other local produce are priced in millions. At a restaurant, two beers and water cost Z$1.24 billion.

May 2, 2008
The Z$100 million, Z$250 million and Z$500 million notes debut. Annual inflation reaches more than 100,000 percent.

May 15, 2008
Z$5 billion, Z$25 billion and Z$50 billion notes are printed.

July 1, 2008
A Z$100 billion note is issued, about the price of three eggs at the time.

Aug. 1, 2008
Another round of currency reforms is implemented. The government slashes 10 zeros from each second Zimbabwean dollar bill and the **third Zimbabwean dollar** is valued at 10 billion old dollars (second Zimbabwean dollars). Inflation continues rising.

Sept. 29, 2008
New Z$10,000 and Z$20,000 notes are introduced.

Oct. 13, 2008
The new Z$50,000 bill is printed.

Nov. 5, 2008
Z$100,000 and Z$500,000 notes are issued.

Dec. 4, 2008
The Z$1 million, Z$10 million, Z$50 million and Z$100 million bills appear. Ten days later, the Z$200 million and Z$500 million banknotes debut, followed by the Z$1 billion, Z$5 billion and Z$10 billion notes issued on Dec. 19, 2008.

Jan. 12, 2009
The government issues two new denominations: Z$20 billion and Z$50 billion bills.

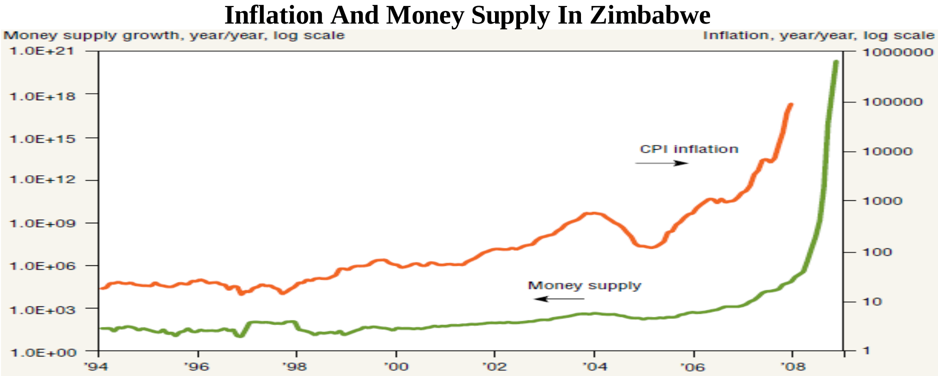
Jan. 16, 2009
Even higher denominations are issued: Z$10 trillion, Z$20 trillion, Z$50 trillion bills and the largest banknote ever—the Z$100 trillion bill.

Feb. 3, 2009
The Reserve Bank of Zimbabwe introduces the **fourth Zimbabwean dollar**, with 12 zeros removed from old bills, making 1 trillion old dollars equal to one new dollar. Denominations of the new currency are the Z$1, 5, 10, 20, 50, 100 and 500 notes. However, loss of confidence quickly leads to abandonment of the Zimbabwean dollar in favor of foreign currencies, primarily the U.S. dollar and the South African rand.

Sources: Data on U.S. dollar equivalence are computed from International Monetary Fund exchange rate data. Adapted from Globalization and Monetary Policy Institute 2011 Annual Report

According to the table above, the Zimbabwean dollar entered a lot of alterations to suit the prevailing environment until it disappeared in the market. Monetary authorities tried a lot to finance inflation through matching money supply to money demand, but it later failed as the currency was substituted by other stable currencies.

Inflation And Money Supply In Zimbabwe



NOTE: Money supply measure plotted is M3, which is the sum of notes and coins in circulation plus demand, savings and time deposits in the banking system. SOURCE: Reserve Bank of Zimbabwe's Monthly Economic Reviews.

As the crisis emanates inflation was no longer controllable and money supply also rise exponentially to levels where accountability was not possible. Policies during that time were merely "management by crisis" based. A lot of currency reforms was done during the period dominated by cancelling zeroes when issuing new denominations.

In Zimbabwe, money supply and prices moved in tandem, as expected from the quantity theory of money (Milton Friedman). In addition, the velocity of money increased as people opted to spend immediately rather than hold on to depreciating cash. This rise in velocity as well as the increase in the stock of money through printing of new currency produced the exponential increase in prices.

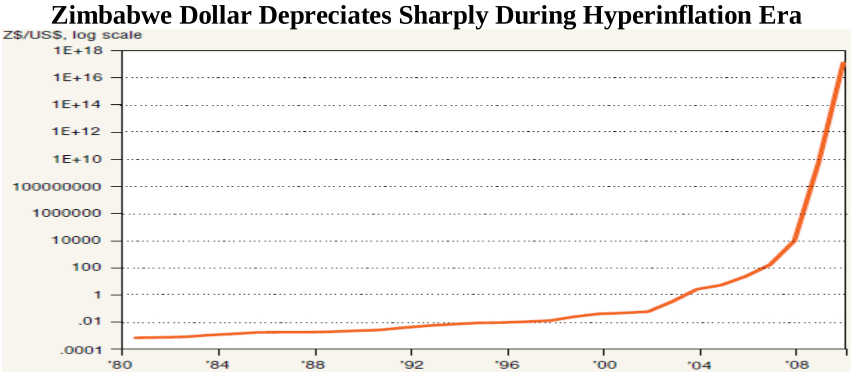
According to Joseph Noko (2011), by 2003, the Zimbabwe dollar had deteriorated to the point where the cost of issuing it in the form of regular notes and coins was greater than the face value, resulting in the government issuing the Zimbabwe dollar by way of time-limited "bearer checks" on lower quality paper, with very high denominations.In 2003, changes to monetary policy and alleged risky practices by certain banks resulted in a liquidity crunch that affected 40 percent of the banking system and cost the system approximately Z$2 trillion (US$350 million) and forced the Reserve Bank to close several locally owned banks (Kwesa 2009).

Monetary Regimes and Inflation

What does the empirics say about monetary regimes and inflation? History has shown that high inflation rates have caused currency substitution. Capie (1986) hypothesizes that wars have beenresponsible for hyperinflations. Many of hyperinflations did occur during wartimes but also under discretionary papermoney standards.Bolivia, Argentina and Brazil hyperinflations inthe 1980s and 1990s occurred during peacetimes. Historically the change from non-inflationary toinflationary long-term development isexplained by changes of the monetary regime.All hyperinflations in history occurred after 1914under discretionary paper money standardsexcept for the French case during theRevolution of 1789-96, when apaper money standard (assignats) wasintroduced.

Zimbabwean currency substitution occurred in hyperinflationary environment. Many problems have been cited as the causes, the greatest being political instability (bad politics). Some causes were the rising debt, hampered international relations, company closures among others. Currency depreciation is an advantage to exporting countries, however Zimbabwe is a primary goods exporter (mainly agricultural and unprocessed minerals) that are lowly valued. Hence, depreciation in Zimbabwe was not intentional but was due to poor policies (blue prints), that lacked business support.

Zimbabwe Dollar Depreciates Sharply During Hyperinflation Era



Source: Alan Heston, Robert Summers and Bettina Aten, Penn World Table Version 7.0, Center for International Comparisons of Production, Income and Prices at the University of Pennsylvania, May 2011.

Hyperinflation, which rapidly destroys a currency's value, is fundamentally a monetary phenomenon. Deprived of conventional means of raising revenue, such as taxation, governments borrow without limit from the central bank. Then, as inflation accelerates, fiscal policy makersbegin administering monetary control.

The Phenomenon Of Currency Substitution

Currency substitution refers to the situation where two or more currencies circulate within a single economy or region to facilitate transactions that are unrelated to international trade and finance, Ho (2003). Most economics literatures define currency substitution as the ultimate consequence of high inflation.Sarajevs (2000) concludes that, ideally, the measure of currency substitution is the value of foreign currency notes circulating in the economy (as a means of payment and a store of value) and all checking accounts and short-term deposits in foreign currency held by residents in domestic banks and abroad.

Theory postulates that the domestic currency of an open economy, in the absence of foreign exchange control, can be readily converted into internationally tradable goods and other currencies. Other than its intrinsic attributes as a store of value, a medium of exchange and a unit of account, the domestic currency with the characteristics of liquidity and convertibility and hence transformable into any assets has a special position in economic agents' portfolios. However, not all currencies are treated equally and the phenomenon of currency substitution basically reflects the demand of residents of an economy for a combination of currencies as a medium of exchange and other monetary functions.

Empirical evidence suggests that in countries with high inflation, foreign currencies are first used as a store of value, then as a unit of account and finally as a medium of exchange. Residents in high-inflation countries are easily aware that their wealth, if denominated in domestic currencies, will erode promptly by negative real domestic interest rates. Hence in a free economy where an agent has a choice of holding assets of any currencies, a rational agent will seek to diversify his portfolio of wealth into foreign currencies, as the latter can provide with a higher degree of purchasing power stability against the background of expectations of high inflation or exchange rate devaluations. As domestic inflation rate rises, people do not swiftly abandon the domestic medium of exchange for foreign substitutes. Rather, the substitution is gradual, with the extent of substitution growing with the domestic inflation rate.

Substitution will then spread to the unit of account function of money when high inflation persists. Some prices, especially big-ticket items, start to be quoted in foreign currency. The process completes itself as transactions begin to be conducted in foreign currencies, as a medium of exchange. In fact, as evidenced by the experience of transitional economies in the early 1990s, the degree of currency substitution will not subside immediately after inflation has been stabilized to a moderate or low level. This requires a long adjustment process before the economic agents change their attitude towards their preference of different kinds of money holdings.

Consequently, the existence of currency substitution exposes the domestic economy to monetary shocks from both home and abroad, thus hobbling monetary authorities' attempt to determine policy independent of foreign influences. As a result, the impact of any particular monetary stance on the domestic economy may not turn out as the authorities originally expect.

Another argument against currency substitution is its hindrance to financial and economic developments. Empirical evidence shows that countries with a high degree of currency substitution tend to have low financial depth and effectiveness of monetary policy. Notably it affects the stability of the velocity of circulation of and the demand for the domestic money, making it difficult for the central bank or monetary authorities in formulating and conducting monetary policy.

The Central Bank of Zimbabwe (RBZ) tried to print discretionary paper money to match the rising demand to pay for government expenses, but it failed to match the speed at which the currency was eroding. High denominations were issued, a lot of zeroes emerged, new bearer cheques were issued cancelling the zeroes, soon the zeroes developed again as the inflation continue to rise, high denominated bearers were issued, until it was no use to continue printing. Electronic transactions were smoother but importing companies later could not survive for new imports as they were paid in formal currency which was hard to convert.

Dollarization – Complete Currency Substitution

Dollarisation may be formal or informal. There are no strict rules of holding United States dollars. Actually the United States benefits from seigniorage. Every year the United States makes billions of profit from printing new notes. It costs 6 cents to print any note. Dollarisation can be completely or just the ratio remains strong of domestic versus foreign currency circulating in the economy. Authorities may just authorize the formal use of foreign currency on business transactions whilst the local currency is also circulating. For Zimbabwe the local currency completely failed until authorities, authorized the use of forex in all formal dealings and the Central Bank ceased to issue new notes and coins. Dollarisation in Zimbabwe suffers from lack of coins to support full functions of money, making trading a bit expensive and inconvenient.The foreign currency in the hands of the government was obtained from taxes subsequent to full dollarization.

According to ReemHeakal (2010), many emerging economies already use dollarization to some extent or another, however, many have shied away from it because economies that would consider full dollarization are those that are still developing. For many countries, having an autonomous economic policy and the sense of individual statehood that comes with it is too much to give up for full dollarization, an extreme option that is for the most part irreversible. Berg and Borensztein (2000), referred dollarisation as when a country officially abandons its own currency and adopts a more stable currency of another country (most commonly the U.S. dollar) as its legal tender.

Monthly inflation turned negative between January and May 2009: -2.3 percent for January, -3.1 percent for February, -3.0 percent for March, -1.1 percent for April, and -1.0 percent for May (Kwesu 2009).During this time, bank failures, which had plagued the country, most perceptibly in 2003 when several banks failed, resulting in losses of about US$350 million, did not trouble the country. Having eliminated the Zimbabwe dollar, banks were forced to adopt more competitive and transparent practices and this, among other benefits, caused the banking system to stabilize.

Dollarization, though it benefited the general public, did have an adverse effect on most businesses. Low confidence in the financial institutions of the country caused the public to keep their foreign currency transactions outside the financial system. Slowly however, the discipline brought about by dollarization caused a change in the practice of financial institutions, and confidence in them increased. Total bank deposits, which had fallen to US$200 million in December 2007, rose from their December 2008 level of US$290 million by 141 percent to US$700 million as June 30, 2009. By the end of 2009, total bank deposits stood at US$1.5

billion(Kwesa 2009).Full dollarization is the most direct, irreversible, and credible way of bringing about tighter trade and financial integration (Bogetic 2000).

Countries Officially DollarisedOr Having A Dual Currency

Countries	Population 2002	GDP* 2002	Legal Currency	Local coins	Since
Andorra	73 000	1,2	Spanish peseta and French franc replaced by the Euro		2002 (euro) 1278 (franc and peseta)
East Timor	857 000	0,2	U.S. dollar		2000
Ecuador	13 100 000	24,3	U.S. dollar	x	2000
El Salvador	6 500 000	13,0	U.S. dollar Progressive disappearance of the colon		2001
Guatemala	12 000 000	23,2	Dual currency : American dollar and the quetzal		2001
Kiribati (Gilbert Islands)	82 000	0,1	Sterling pound replaced by the Australian dollar		1979 (Australian dollar) 1943 (Sterling pound)
Liberia	3 300 000	0,5	Dual currency : American dollar and Liberian dollar		1945
Liechtenstein	31 000	0,7	Suisse Franc		1921
Marshall Islands	61 000	0,1	U.S. dollar		1944
Micronesia	120 000	0,2	U.S. dollar		1944
Monaco	32 000	0,8	French franc replaced by the Euro	x	2002 (euro) 1865 (franc)
Nauru	11 000	0,1	Australian dollar		1914
Palau	19 000	0,2	U.S. dollar		1944
Panama	2 900 000	9,5	U.S. dollar	x	1904
San Marino	26 000	0,1	Italian lira replaced by the Euro	x	2002 (euro) 1897 (lira)
Tuvalu (Ellice Islands)	11 000	0,0	Australian dollar		1892
Vatican City	1000	0,0	Italian lira replaced by the Euro	x	2002 (euro) 1929 (lira)

Source: Minda (2005)

The above table clearly shows countries that underwent dollarisation, some with full dollarisation and others partially dollarized. For countries that have officially adopted other currencies they do have access to coins of the adopted currency, whilst informal dollarisation has no access to coins. The table shows that the concept of dollarisation is not new, some countries have used it as a way to stabilize their economies and the most adopted currency is the United States dollar.

Pros and Cons Of Dollarisation

Why is dollarisation an important reform for staggering economies? Many of the economies opting for dollarization already informally use foreign tender in private and public transactions, contracts, and bank accounts; however, this use is not yet official policy, and the local currency is still considered the primary legal tender, ReemHeakal (2010). By deciding to use the foreign tender, individuals and institutions are protecting against possible devaluation of the local exchange rate. Full dollarization, however, is an almost permanent resolution: the country's economic climate becomes more credible as the possibility of speculative attacks on the local currency and capital market virtually disappears.

Besides reducing risk and protecting against inflation and devaluation, there are some compelling reasons for a country to decide to give up so much control over its economy. Full dollarization creates positive investor sentiment, almost extinguishing speculative attacks on the local currency and the exchange rate. A more stable capital market is attainable, thus the end of sudden capital outflows, and a balance of payments that is less prone to crises. Full dollarization can improve the global economy by allowing for easier integration of economies into the world's market.

Important differences exist between informal and full dollarization, presenting transitional problems for governments considering it. All government and private debt under full dollarization is denominated in dollars, and both public and private accounts must be converted to dollars. To make the conversion, countries must set the rate at which old debts, contracts, and financial assets will be converted to dollars.

There are some substantial drawbacks to adopting a foreign currency. When a country gives up the option to print its own money, it loses its ability to directly influence its economy, including its right to administer monetary policy and any form of exchange rate regime. The central bank loses its ability to collect 'seigniorage', the profit gained from issuing coinage. Instead, the U.S. Federal Reserve collects the seigniorage, and the local government and gross domestic product (GDP) as a whole thus suffer a loss of income.

In a fully dollarized economy, the central bank also loses its role as the lender of last resort for its banking system. While it may still be able to provide short-term emergency funds from held reserves to banks in distress, it would not necessarily be able to provide enough funds to cover the withdrawals in the case of a run on deposits.

Another disadvantage for a country that opts for full dollarization is that its securities must be bought back in U.S. dollars. If the country does not have a sufficient amount of reserves, it will either have to borrow the money by running a current account deficit or find a means to accumulate a current account surplus. Finally, because a local currency is a symbol of a sovereign state, the use of foreign currency instead of the local one may damage a nation's sense of pride.

Weighing the pros and cons of full dollarization is complicated by the virtual absence of historical experiences. Panama is the only sizable country with a history of using a foreign currency—the U. S. dollar—as legal tender, and it is fairly small, and has very close historical, political, and economic links to the United States. Even if there were more country experiences to assess, they would have to be over longer periods than is usual for evaluating monetary and exchange rate options. That is because dollarization is nearly permanent, and some of its benefits can be gained only in the long run.

Currently, the government revenue has collapsed and could not be matched to the wage bill and other government obligations. The government has been borrowing to pay the wage bill and in the process committing the cardinal sin that you do not borrow for consumption.

De-Dollarisation

Will the Zimbabwean dollar return? How soonest? What are the necessary conditions? What the proper time to avoid re-vanishing? How is it going to be received by economic players? At what rate in relation to other currencies? All these questions have to be answered and wherever possible there is need for clarification. It's very possible for the Zimbabwean dollar to return in the market. However, a lot of conditions need to be met. Proper time is when sufficient and necessary conditions are met. The important them all is that Central Bank should retain its credibility as an autonomous entity to the country politics. There is need for stability in the economy and money supply should be linked to reserves. International relations need to be restored, there is need for political stability. Investor confidence should be boosted particularly by offering long term licences in the market. Issues of corruption in the public sectors to be addressed. Parastatal reforms and business capacity utilisation raised.

One of the more significant downsides is if a dollarized country suddenly reintroduced their domestic currency, it might flood the market with millions of now-unneeded U.S. dollars, reducing the value of all of them. It doesn't even have to be a whole country. If the dollar was used widely enough, huge purchases of dollars by foreigners could significantly affect its value.

The only country Cohen knows of that has de-dollarized is Israel, which introduced the U.S. dollar in the late 1970s as a parallel currency, and only managed to get rid of it after a series of economic reforms reinstated confidence in the shekel. Lots of informally dollarized countries, like Argentina, go through waves of increasing, then decreasing dollarization in line with citizens' confidence in the local currency.

An important issue in business is expectations of economic players. Expectations play a major role in perpetuating higher prices during bouts of hyperinflation, and the effect of those expectations on money and inflation is amplified relative to other influences, such as the business cycle. To blunt exponential price increases, government finance must change in a credible way so the public believes there is real commitment to eliminating abuses that caused rapid inflation and currency devaluation. According to Globalization and Monetary Policy Institute 2011 Annual Report, past chronic inflation episodes have been stabilized through the adoption of an independent central bank, an alteration in the fiscal regime and by instituting a credible exchange rate stabilization mechanism. In most cases, price stability was achieved virtually overnight following exchange rate stabilization.

García-Escribano and Sosa (2011) in their study explored the short-term drivers of both credit and deposit de-dollarization in Bolivia, Paraguay, Peru and Uruguay.They found that the drivers of deposit de-dollarization are different from those of credit de-dollarization.The introduction of prudential measures to create incentives to internalize the risks of dollarization has fostered credit de-dollarization.The development of the capital market in local currency (for example, through the issuance of long-term treasuries in local currency) has been one of the drivers of credit de-dollarization as it has facilitated bank funding and pricing of long-term loans in domestic currency.

Gresham's Law Discussed

All what has happened to Zimbabwean dollar is not new, and has been proposed long back by Gresham's law. Policy makers should have done better to address the Zimbabwean situation but surprisingly they put forward measures that have failed from other nations. Authorities linked price rises to politicsand put forward price controls in the market (the commonly known was reverting to June 30 prices). Companies were forced to use the local currency when it was no longer profitable. The consequences were that, many workers resigned from work for greener pastures (hence human flight), many companies closed (raising unemployment levels and capital flight), state universities and government schools closed, food shortages occurred, backdoor trading (survival of the fittest) and civil wars and increased crime rates.

Gresham's Law suggests that a high quality currency is driven out of circulation by a cheaper currency. The literature on Gresham's Law application is relatively narrow. Alejandra Irigoin (2009) studies the political economic consequences of the disappearance of the Spanish silver peso standard in Spanish America. Since in Latin America different currencies co-existed within a formerly highly integrated economic space, a widespread Gresham's Law effect exacerbated the conflict among local and regional elites issuing the diverse currencies. There are doubts on the correct specification of the Gresham's Law theory. Rolnick and Weber (1986) studying a part of U.S. and English coinage history argue that the popular version of the Gresham's Law does not deserve its status as a law because it has too many unexplained exceptions. Velde*et al.* (1999) study the conditions under which Gresham's Law holds and develop a model of commodity money with light and heavy coins under imperfect information. Li (2002) develops a model to study how legal restrictions may account for the fact that Gresham's Law sometimes holds but other times fails. In his words, a government policy sufficiently favorable to light coins can induce the existence of an equilibrium where both coins circulate and light coins are even accepted at a premium. Mundell (1998) even argues that the phrase, "bad money drives out good," is not a correct statement of Gresham's Law nor is it a correct empirical assertion. In his words, the opposite has been the case throughout the history because the laws of competition and efficiency ensure that "good money drives out bad".

II. Conclusion

To conclude the study, it is worth noting that dollarisation is a positive stance for stabilisation in the short run and several countries have adopted such regime to attain stability. Panama adopted the dollar as its official currency in 1904, Ecuador dollarized in September 2000 and El Salvador followed suit in January 2001.Dollarization may promote economic stability in the short term, but structural and institutional problems must also be addressed if a dollarizing country is to achieve long-term economic growth and development.Even after adopting U.S. monetary policy by dollarizing, post-hyperinflation Zimbabwe still faces challenges: rebuilding public finances, instituting and maintaining credible policies to control government spending, reducing poverty and promoting economic growth.A high degree of partial dollarization not only has an impact on the effectiveness and performance of economic policies, but also requires adjustments in prudential regulations.

The author recommends that serious reforms need to be undertaken before the national currency is to be returned. The current multi-currency system should be maintained until confidence has been built and credibility of the central bank restored. The importance and impact of expectations should be well respected to avoid another dark transition if the currency is returned before adequate reforms are undertaken. Business cycles do conform to expectations of economic players and should not be tampered with, rather be respected in policy formulation.Once macroeconomic stability and strong fundamentals, which are pre-conditions for de-dollarization, are achieved, marginal changes in macroeconomic variables (such as inflation rates) do not appear to have any impact on financial de-dollarization.Re-engagement with the World Bank, the IMF, and other potential sources of outside assistance is of crucial importance. Finally, the government should take serious steps to establish a partnership with the private sector to address the most serious economic and social issues facing the country.

References

[1]. Andrew Berg and Eduardo Borensztein (2000), "Full Dollarization: The Pros and Cons," International Monetary Fund, Economic Issues No. 24.

[2]. Berg, Andrew and Eduardo Borensztein. 2000. "The Pros and Cons of Full Dollarization." IMF Working Papers WP/00/50. Washington, D.C.: International Monetary Fund.

[3]. Bernholz P (1989), "currency Competition, Inflation, Gresham's Law and Exchange Rate," Journal of Institutional and Theoretical Economics 145(3), pp 465-88.

[4]. Bogetic, Z. (2000) "The Calculus of Full Dollarization." Central Banking 11 (2): 45–57.

[5]. Bogetic, Zelijko. 2000. "Full Dollarization: Fad or Future?" Challenge, 43, no. 2: 17-48.

[6]. Bordo Michael and Choudhri (1980), "Currency Substitution and the demand for money; Evidence for Canada," Discussion paper 190.

[7]. Cagan, P. (1956) "The Monetary Dynamics of Hyperinflation." In M. Friedman (ed.) Studies in the Quantity Theory of Money. Chicago: University of Chicago Press.

[8]. Chrystal, K. Alec. "Demand for International Media of Exchange," American Economic Review (December 1977). pp. 840—50.

[9]. Cohen, B.J. (2000). Dollarization: Pros and Cons, Department of Political Science,
[10]. Coltart, D. (2008). A Decade of Suffering in Zimbabwe. Centre for Global Liberty and Prosperity Development Policy Analysis (5), 1-21.
[11]. Cuddington J (1983), “Currency Substitutability, Capital Mobility and Money Demand,” Journal of International Money and Finance 2, pp 111-133.
[12]. Dallas S. Batten and R. W. Hafer (1984), “Currency Substitution: A Test of Its Importance”
[13]. Gabriele Camera, Ben Craig and Christopher J. Waller (2001), “Dollarization via Currency Substitution,” Preliminary Version.
[14]. García-Escribano and Sosa (2011), “What is Driving Financial De-dollarization in Latin America?,” IMF Working Paper No. 11/10.
[15]. Goldfjan, Ilan and Gino Olivares. 2000. “Full Dollarization: The Case of Panama.” Working Paper Series. Rio de Janeiro, Brazil: PontificiaUniversidadeCatólica.
[16]. Hanke, S. (2008). On Dollarization and Currency Boards: Error and Deception. Policy Reform Journal, 5(4), 203-222.
[17]. Hanke, Steve, 2008. Zimbabwe: From hyperinflation to growth. Cato Journal, pp. 1-33
[18]. Hayek, F. A. (1976) Choice in Currency: A Way to Stop Inflation. London: Institute of Economic Affairs.
[19]. Ho N.W (2003), “Currency Substitution and the Case of Macao” Monetary Authority of Macau.
[20]. Ize, Alain and Eduardo Levy-Yeyati. 1998. "Dollarization of Financial Intermediation: Causes and Policy Implications." IMF Working Paper. International Monetary Fund.
[21]. Ize, Alain and Eduardo Levy-Yeyati. 2006. "Financial De-Dollarization: Is It For Real?," in Financial Dollarization: The Policy Agenda. AdriánArmas, Alain Ize, and Eduardo Levy Yeyatied: Palgrave MacMillan.
[22]. Jayson Coomer, “Zimbabwe’s Economic Crisis & Hyperinflation 1997 – 2009,” Masters in Financial Management, University of Cape Town.
[23]. Joseph Noko (2011), “Dollarization: The Case of Zimbabwe,” Cato Journal, Vol. 31, No. 2 (Spring/Summer 2011). Cato Institute.
[24]. Kwesa, I. (2009) “Banking in a Dollarized Environment.” In L. Gwata (ed.) Banks and Banking Survey 2009. Harare: Zimbabwe Independent and FBC Ltd.
[25]. Kwesu, I. (2009) “By the Way Zimbabwe Still in Hyperinflation.” In L. Gwata (ed.) Banks and Banking Survey 2009. Harare: Zimbabwe Independent and FBC Ltd.
[26]. LubosKomarek and Martin Melecky (2002), “Currency Substitution in a Transitional Economy with an Application to the Czech Republic,” Technical University of Ostrava, the Faculty of Economics.
[27]. Lucas, R. (1987): Models of business cycles. Basil Blackwell.
[28]. Makochekanwa Albert, 2007. Zimbabwe’s Hyperinflation Money Demand Model. University of Pretoria Working Paper: 2007-12
[29]. McKinnon , R. I. (1985): Two Concepts of International Currency Substitution. In.: The Economics of the Caribbean Basin , (eds.) Connolly, M.D. and J. McDermott, pp. 101-113.
[30]. McKinnon, Ronald I. “Currency Substitution and Instability in the World Dollar Standard,” American Economic Review (June1982), pp. 320—33.
[31]. Mercedes Garcia-Escribano and Sebastian Sosa (2011), ““Good-Bye” to the U.S. Dollar? Financial De-Dollarization in Latin America,” EconoMonitor.
[32]. Meyer, S. (2000). Dollarization: An Introduction, Paper presented at the Philadelphia Council of Business Economics.
[33]. Miles M.A (1978), “Currency Substitution, Flexible Exchange Rates, and Monetary Independence,” American Economic Review 68, pp 428-36.
[34]. Miles, Marc A. “Currency Substitution, Flexible Exchange Rates, and Monetary Independence,” American Economic Review (June 1978a), pp. 428—36,
[35]. MumvumaTakawira, Mujajati Charles &Mufute Bernard (2003): Understanding reform: The case of Zimbabwe, University of Zimbabwe, Harare
[36]. Muñoz, S. (2006). Suppressed Inflation and Money Demand in Zimbabwe. IMF Working Paper WP/06/15. International Monetary Fund - African Department.
[37]. Mutengezanwa Margaret (2012), “The Possibility of Reintroducing The Zimbabwean Dollar,” Australian Journal of Business and Management Research Vol.2 No.06 [01-08] | September.
[38]. MyriamQuispe-Agnoli (2002), “Costs and Benefits of Dollarization,” Latin America Research Group Research Department Federal Reserve Bank of Atlanta.
[39]. Patricia Álvarez-Plata and Alicia García-Herrero (2008), “To Dollarize or De-dollarize: Consequences for Monetary Policy,” German Institute for Economic Research (DIW) and BBVA
[40]. ReemHeakal (2010), “Dollarization Explained,” Investopedia
[41]. Rocio Gondo and FabrizioOrrego (2011), “Dedollarization and financial robustness,” Banco Central De Reserva Del Perú, Working Paper series.
[42]. Sarajevs, V. (2000): Econometric Analysis of Currency Substitution: A Case of Latvia. Bank of Finland Discussion Papers, Institute for Economies in Transition, no. 4, 2000.
[43]. Savastano, M.A. (1996), “Dollarization in Latin America: Recent Evidence and Some Policy Issues,” IMF Working Paper, No. 96/4, January.
[44]. Soller Curtis E. and C. Waller, (2000), “ A Search Theoretic Model of Legal and Illegal Currency, Journal of Monetary Economics, 45, 155-184.
[45]. Stiglitz, J.E. and A. Weiss (1981), “Credit Rationing in Markets with Imperfect Information,” American Economic Review, Vo. 71, No. 2, pp. 393-410.
[46]. Terrence Kairiza (2012), “Unbundling Zimbabwe’s journey to hyperinflation and official dollarization,” National Graduate Institute for Policy Studies (GRIPS), Tokyo.