

CASH SHORTAGES IN ZIMBABWE: ANY PROSPECT FOR SOLUTIONS?

By

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Abstract

The paper gives special attention to the hyperinflation and cash shortages as well as the possible implications of the measures announced by the Minister of Finance and Economic Development on Tuesday the 29th of July 2003. An attempt will be made to forecast how well the monetary policy measures are likely to perform given the nature and magnitude of the problems it is meant to address. Whereas the problems bedevilling the economy may have several dimensions, we will not be drawn into argument as to the significance of each of the components since the pre-occupation of this paper is a solution package for the current cash shortages. It is the deliberate intention of this paper to discuss the short-term, implications of the solutions in place by relying on the observation method and a historical comparative approach.

Background

The financial (currency) crisis in Zimbabwe is one of the most significant events of the new millennium. It began modestly at the end of 1999 as a speculative attack on the Zimbabwe dollar. The Zimbabwean dollar has as a result ‘depreciated’¹ sharply despite the controls. The crisis has also been reflected in the principal asset markets namely stock markets and the real estate markets. The health of the banks and the non-bank financial institutions (financial sector) is seriously under threat. The situation has been worsened by and is worsening the economic slowdown and the foreign investors have lost confidence in the economy. Zimbabwe’s once vibrant economy, used to decades of growth, has been plunged into deep recession and the economic hardships are fast approaching the levels reached during the great depression of the 1930’s, if lasting solutions are not hatched immediately.

The currency crisis has forced a reappraisal of the policies ranging from corporate governance to exchange rate management. It has spawned wide-ranging discussions on solutions to the problems bedeviling the financial sector. The paper attempts to give a socio-economic perspective on the implications of the shortage of cash, and the introduction of new notes, traveler’s cheques, and the bearer cheques.

The poor performance of most economic sectors over the past four years amid high inflation rates (399.5%) and negative growth rates have culminated in the near collapse of the banking system, which has until recently, been defying the odds and making huge profits when other sectors were under-performing. Without overlooking the resilience of the financial sector in

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¹ Due to the controls on the exchange rate for the greater part of the period, it was more of devaluation than depreciation.

comparison to the real sector, we should closely analyse why in the last four months cash shortages have become the order of the day in the country. The people are reeling from the impact of the country's acute shortage of bank notes- the latest shortage to hit Zimbabwe, where basic consumer goods, fuel, electricity and foreign currency are all in short supply. The shortage of bank notes became apparent in November 2002 when the circulation of the \$500² note, dropped sharply as the Christmas festive season approached. The bill has now almost completely disappeared, with small notes (\$10 and \$20) resurfacing to form the basis of transactions.

We perhaps should learn a lesson or two from the resilience of the colonial regime of Ian Smith during the period when the country was reeling under sanctions. Unilateral Declaration of Independence (UDI) could not have lasted for as long as it did had the government not realised that its political power rested mainly on the white electorate. The regime managed to instil confidence in the small but crucially important enclave of whites, who constituted the majority of the electorate under the racist electoral laws. The economic policies then were devised such that they specifically targeted certain racial groups. Walker (1971) says,

‘It is possible to make a case for two economic policies, one for the white people and one for the black people on the basis that the economic requirements and reactions of the two communities are sufficiently different to justify two different economic approaches’.

Such can only be expected of the academics of that time that effectively acted as think-tanks for the regime. The colonial regime should be credited for effectively making use of the advice it regularly got from the intellectuals. In a democracy, the people lead whilst the government follows obediently. Such should be the most extreme (ideal) case if the electorate is to own the policies and have confidence in them.

Clearly the UDI sanctions were not as crippling as the current EU/Commonwealth sanctions. Could it mean that the Zimbabweans have now run out of resilience strategies? Or they have lost trust in the ability of the policy-maker to bring emancipation from the current crisis? If the later is true, as we believe it could be, then there is an urgent need to restore policy credibility.

Causes of the cash shortage

Hyperinflation: - Empirical economic evidence suggests that in a hyperinflationary environment real monetary balances contract. High inflation usually results in a flight of domestic financial assets into foreign financial assets or real assets. Inflation erodes the real value of money that makes it difficult to use the same amount of money to

- buy goods and services due to fast increase in prices. Hardy et.al (1998) argues that boom-bust cycles of inflation cause bank crises.

² \$ refers to Zimbabwean dollars in this article.

- **Speculation:** - The distortion in the markets due to controls lead to shortages in the commodity and foreign currency markets and the resultant overpricing in the parallel markets. People disinvest from the money market into the real and stock markets, leading to serious speculation.
- **Lower interest rates:** - Under financial repression negative real interest rates result, while expansionary monetary policy would result in an increase in inflation. Saving the source of investment funds is being discouraged. This leads to stagflation and low deposits.
- **Loss of confidence in the financial sector:** - People hoard money in anticipation of a unexpected/ unforeseen circumstances. Cash shortages lead to cash shortages because of lack of confidence in the financial system.
McCall M et.al (1998) attributes financial crisis to weak financial oversight and 'crony capitalism' (in this case corrupt dealing in cash). The central bank in Zimbabwe was virtually caught unawares by the shortages despite the high inflationary situation, which should have acted as an indicator of impending high demand.
- **Externalization of the domestic currency:** - Cross-border traders keep a lot of cash outside the country for speculative purposes in the foreign exchange market because of the possibility of arbitrage.
- **Parallel commodity market:** - People hoard money in anticipation of finding goods for resale, is there exists simultaneously a cash and commodities (especially food) shortage.
- **Shortage of special ink and printing paper:** - To avoid production of fake notes the paper for producing notes is imported. Lack of foreign currency can reduce the central bank's ability to produce notes and coins. The Reserve Bank of Zimbabwe (RBZ) has been facing foreign currency shortages to import such material.
In Zimbabwe the surge in the demand for cash, leading to shortages in summary can be attributed to underlying macro-economic imbalances as well as socio-economic and political factors.

Government's Solution to the Cash Crisis

Amid the worsening crisis involving the shortage of bank notes and the failure of financial institutions to meet the depositors' cash needs various solutions have been proffered. The RBZ has of late been asking banks to come up with their own strategies and measures to encourage deposits and use of alternative means/modes of payments (non-cash financial transactions) for goods and services (e.g. credit cards, cheques, point of sale facilities and direct debits). It has asked banks to reduce or scrap off the numerous service charges on cash deposits and ensure that depositing of money is done in the easiest and most convenient manner.

The RBZ itself had promised to inject \$24 billion in \$500 notes into the market by mid-June 2003 as part of its efforts to alleviate the situation.

The Finance Minister's July Proposals

The Finance Minister on 29th of July 2003 announced the following among other measures to curb the cash shortage:

- Introduction of CD3 forms for transport operators plying the cross-boarder routes.
- Introduction of new \$500 note to replace the current \$500 note by the 26th of September.
- Introduction of the new \$1000 denomination by the first of October.
- Printing of notes in and outside the country to try and match cash demand by both individual and corporate bodies.
- Injection of \$2.5billion every month till the situation normalises.

Analysis of the proposal

The \$1000 note is meant to avoid the handling of bulk notes, which has become associated with the smaller denominations. It is probably interesting to note that the magnitude of the inflation problem will make it very difficult for such a move to sufficiently address the issue. An introduction of even higher denominations of \$5 000, \$10 000, and \$20 000 is most likely to match the hyperinflationary situation. It is important to note that the ability of a currency to perform its functions is crucially dependent on the confidence and acceptability, which the generality of the people have in it as a legal tender. In the absence of that component it might be a waste of time and a plunder of limited national resources if anyone were to call for a change of the appearance of the notes without any promise at all on how the intrinsic value of the money would change. The replacement of the current \$500 note with a new one might not even achieve the long-term objective of bringing the notes back to the formal financial system unless the government is able to monitor all the financial transactions in the country, which capacity it lacks beyond any reasonable doubt.

Lotz (2002) argues that if the old currency fails to achieve a smooth circulation, then introducing a new note of the same value will not solve the problem as the new one would still not circulate since the government is only able to effectively monitor a fraction of the total transactions in the economy. It is one thing to bring the money back into the formal financial system and yet another to achieve a sustainable circulation of that money. Do we really need the means or the end result? This is the question we should pose if we are to analyse the prowess or lack of it in the proposed measures.

Over the last half of the month of August 2003, the monetary authorities continued to announce more "strong measures" of dealing with the cash shortages and promised to consolidate on the previously announced measures. Key among the measures was the introduction of "Local Travellers' cheques", previously unheard of in this country. The authorities were optimistic that such cheques would be a good substitute for cash. The cheques have been issued in denominations up to as large as \$100 000. The experience over the few weeks in which, they have been in use (up to 10th of September 2003) has shown that they are only acceptable in limited circles and therefore have failed to effectively circulate. The cheques have the following key weaknesses:

- They have not been well publicised and most of the security features which they contain cannot be easily identified except with specialised equipment which is not always available on most points of sale.
- Most of the goods are currently sold on the informal sector, and in some cases in the black market. Given that the informal sector dealers rarely accept the cheques a consumer who intends to purchase basic commodities on such markets will find himself in a dilemma. How many liquor outlets for instance are ready to accept the cheques?
- The large denominations have increased the incentive to produce and circulate fraudulent cheques (counterfeits) of the same nature. A fraudster who manages to get hold of only ten cheques of \$100 000 value would have a million dollars extra worth.
- The cheques are more expensive for the authorities to manage compared to the bank notes. This is because the cheques are usually used for single transactions.

Alternative Prescriptions to the Crisis

Restore Policy Confidence and Credibility

The general attitude of the Zimbabweans towards their economic circumstances in the last few years clearly put them way ahead of several other people the world over in terms of how they underplay serious problems. It is apparent that we treat dangerous issues too lightly to our own detriment. Ours is a tragedy of inaction, where salvation is held outside self, but within the realms of some “benevolent leadership” whose wisdom and abilities we rarely question and whose legitimacy we cannot publicly scrutinise. This has developed into a scenario where not many policies go through the normal process of citizen input and broad-based consultation.

There is clear evidence that in the last few years we have had a good number of policy inconsistencies and policy reversals whose overall effect has been to weaken the credibility of policy and the regime generating those policies. The expenditures directed towards the non-productive activities have had a significant influence on the fiscus, creating a situation we now call “economic crisis”³. Its existence, which used to be subject of heated debate in the late 1990s is no longer in question, rather the debate has taken a new twist with the theme now being the causes of the crisis and the way forward. In most cases the objectivity on the various issues has been lost, with political inclination deciding the virtues of what should otherwise be the domain of intellect (technocrats). Some strange arguments that violate all economic logic and rationale have been advanced to justify certain perspectives. Some self-acclaimed ‘economic analysts’, whose academic record cannot be traced to any recognised institution, have also hijacked the economic debate in Zimbabwe.

There is need to restore confidence in our financial sector policies through consistency and predictability. Policies must have the input of all interest groups to promote ownership and

³ Dr. Leonard Tumba (RBZ governor) gives the same arguments as quoted in the Herald, 30-05-2003.

easy implementation. The RBZ governor noted the need to restore confidence in the country's economy collectively as stakeholders in order to bring down inflation as a very important factor in solving the crisis (Herald, 30 May 2003).

The Currency Value

At independence in 1980, we replaced the Rhodesian currency with a new currency. The ratio of the new currency to the old was one-to-one. The implications, if you may ask, are very clear. It was a 'change of colours' whose effect was at best symbolic. In real terms the exchange rate of the new currency remained at Z\$1:US\$1.4. A non-event! Of course it sounds like it. The purchasing power of the currency maintained the previous trends. The interest here could be on how the transition was managed. Since the Zimbabwean currency was very strong against the major currencies, the issue of introducing a stronger currency to replace an old currency did not arise. It was rather easy to eliminate the old currency from circulation.

To digress a little bit, the feudal lords in Japan were in 1869 prohibited by the imperial power to issue notes, such that only the government could establish a standard currency. The replacement was not complete until 1879. Why then did it take them a decade to convince people to abandon the notes issued by local clans? A closer look at the events would reveal that the people had immense confidence in the old localised currencies and they did not realise the merits of the new. We however, cannot overlook the lack of coordination and the difficulties of enforcement that characterised the society of the day.

Given the rate at which the Zimbabwean currency has been losing its purchasing power, which we will generalise as value, it is unlikely that the citizens will present the resentment to a new currency. At a time when the people no longer have confidence in the local currency, the pre-conditions for a change of currency build up. The following key points are indicators to the effect that the Zimbabwean currency has lost credibility:

- The disappearance of the local currency from the formal financial system
- The general dislike by citizens (both corporate and individuals) to keep their assets in the form of local currency. This has been more apparent from the low savings the people are keeping at financial institutions.
- The rush to withdraw cash by individuals and the failure of the business community to deposit most of their cash collections.
- High inflation rates, which now exceed 399.5% according to Central Statistical Office for year, ended September 2003.

Under the circumstances above, there is a real danger that the whole formal financial system might collapse due to pending bank-runs. We therefore need to examine the factors, which influence the government's ability to establish a new currency or eliminate an old one. It is also important to consider how we are going to manage the co-circulation of the currencies during the transition period.

Is there an opportunity to introduce a stronger currency?

Under the fixed exchange rate system, notwithstanding the possible adverse effects, the government has the capacity to influence the value of a currency. However, such a policy if adopted would need a number of ancillary re-alignments to the equilibrium price level of goods in terms of those of major trading partners. In the first instance it would be naïve to expect the value of the new currency to be endogenously determined in a laissez-faire fashion. Legal tender laws would need to be revised so that the agents are allowed to convert the old for the new without any prejudice. Lotz (2002) argues that if the co-circulation is allowed and private agents are left to determine the value of the new *vis a vis* the old, then the old currency may or may not be more valuable than the new one (remember Gresham's law). Is it prudent? We doubt so. From the informal discussion we have had so far it looks like we all want a strong currency and a low inflation rate. If that is the case then we should give the monetary authorities the independent mandate to replace the old denominations with the new in the hope that the new would have greater purchasing power. But what happens if we replace the current \$500 note with another \$500 note of different design but exactly the same value? The answer is clear, nothing happens. Perhaps the only thing that we might experience is a drain on the fiscus since it is not costless to print money. This becomes even more worrisome when the announcement to introduce a new \$500 and a \$1 000 comes barely three weeks after the Reserve Bank has injected the remaining batch of the \$24 billion into the market in the form of \$500 notes (old). For the authorities to call back the money and destroy it is puzzling to say the least. Such a move would only be tolerated when we are assured that the new notes will make a significant difference to our lives.

The Case for a New Stronger Currency

We need once again to pause and ask what the implications would be if we were to replace the old currency with a new currency whose value is 100 times higher than the value of the present notes. What would happen to the amount on our bank balances for instance? What would happen to the prices of goods marked on the shelves? How many digits would our annual inflation rate have? How are we going to manage our mortgages and other fixed payments or commitments? Who is going to win and who is going to be the loser in the game? Will it be a zero sum game or a win-win game? Will there be any real change? What happens to our exchange rate against other currencies? Are we not going to return to the previous situation of bulk money in the end?

Feasibility of the transition to a stronger currency

There is no doubt that the major instrument, which the government can use to effect a currency change, are the legal tender laws. Lotz (2002) argues that it would be important to establish the equilibrium price levels of the new and old currencies. The need for government monitoring would increase the higher the deviation between the government-set rate and the laissez-faire rate. Setting a specific future, but realistic date when the old currency becomes illegal, can facilitate the implementation of the policy. Where enforcement is stronger enough, the old currency will gradually go out of circulation and is replaced by the new.

There is extensive evidence that administrative authorities have the capacity to establish or eliminate a currency from circulation. For instance during the 17th century paper money issued by Japanese merchants was replaced by the spread of notes issued by local feudal lords. In 1869, the local lords were themselves prohibited by the imperial power from issuing notes, though the notes did not disappear from circulation until 1879. The confidence of the public in the new currency is crucial to the effectiveness with which it will replace the existing currency.

When the Soviet Union disintegrated, Ukraine left the ruble and launched its new national currency (karbovanets) in November 1992. The citizens however continued to prefer the rubbles and the new currency could only circulate at a discount.

Abrams and Cortes-Douglas (1993) believe the creation of new independent states is an opportunity to institute new currencies. This probably explains why at the dissolution of the Soviet Union many republics such as Estonia, Latvia, Lithuania, Kazakhstan and Kyrgyzstan managed to launch their own currencies.

Lotz claims that the new currency can only replace the old currency at the same value if the latter was circulating in the economy. It is therefore futile to replace the existing \$500 note with another \$500 with the same purchasing power since the current \$500 note is itself not circulating properly. We would advocate for a policy where the new currency has a significantly higher value than the existing currency. Such a currency would have the following broad advantages:

- It would gain the confidence of the public who now assign high priority to strong currency
- The confidence achieved would allow the currency to circulate without any discontinuities or hoarding.
- The cost of printing stronger notes is significantly lower than it would otherwise cost to produce notes of low value. For instance it would cost 100 times less to print notes which are 100 times more valued, assuming that the quantity of money required in circulation is constant only in real and not nominal terms
- The queues which have become common-place in most retail outlets would be significantly reduced since the bulky money would be replaced by money which is say 100 times less bulky. The time which shopkeepers and till-operators spend counting the notes in every transaction would likewise be reduced.
- Speculation is likely to be curbed considering the fact that some of the price increases in the economy have been a result of expectations by the economic agents, not necessarily based on the current levels of economic variable. A stronger new currency will break the spiral and set the ground for a new era. Sometimes it is better to start on a new page! But only provided you don't go on to spoil even the new page itself.

Conclusion

The cash shortages in Zimbabwe have been attributed to a number of factors that include, the emergence of a shadow economy, speculation on the parallel market, the shortage of goods in the country, externalisation of local currency to neighbouring countries and socio-political factors.

Summary of Implications

Cash Shortages

Persistent cash shortages are likely to have far-reaching consequences to the economy.

Some of the problems the crisis could trigger are: -

- Low demand for goods and services. This has negative repercussions on production and investment leading to deeper stagflation.
- Loss of confidence in banks. This may lead to collapse of the banks seriously affected by the crisis, due to bank runs.
- Hoarding of more cash. Hyperinflation leads to transactions on a cash basis.
- Collapse of already distressed companies due to low business activity. Workers spend many working hours in queues.
- Bank invasions by angry mobs will be the order of the day.
- Increase in government expenditure in printing huge sums of money (notes) to catch-up with runaway inflation.
- Zimbabwe ceases to be a viable destination for foreign investors given high levels of uncertainty and disintermediation. Shortages of bank notes cripple operations in business and industry.

New 500 and 1000 dollar notes

The introduction of these notes might lead to: -

- A negligible improvement in the situation given the current macroeconomic fundamentals that promotes speculation both in the commodity and currency markets.
- A further increase in inflation due to an increase money supply.

There might be need for even greater denominations to catch up with the inflation spiral that will be triggered by substantial cost of living adjustments being awarded to workers. There is likelihood that even these new notes could be expatriated to neighbouring countries as well by cross border traders.

Traveller's Cheques

Most people don't seem to understand how they operate, thus they are not acceptable as a legal tender. This means that their ability to save the situation is scuttled. In rural areas their use is very limited by the size of most rural transactions. They are also likely to increase the Reserve Bank of Zimbabwe's costs of production since they have a limited circulation period.

Businesses in the informal sector will collapse since it is cash driven sector. Flea market operators, whose premises are almost empty nowadays, are already experiencing this. Business has suddenly died a natural death. This is because traveller's cheques are being treated as ordinary cheques not as cash by banks.

The research paper is however, not exhaustive but just a stimulant to more technical economic researches on the current economic and financial crises in Zimbabwe. However, Zimbabwe's currency shortages require immediate attention. The research mainly relied on the observation method, which may not give conclusive policy prescriptions. More detailed

primary research methods may be used to investigate the underlying causes of the cash shortages. Statistical inference and models of financial crisis can be applied to make more precise forecasts of the impact of the new policy measures and the cash shortages.

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