



ZIMBABWE ECONOMIC  
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# Currency Reform in Zimbabwe: An Analysis of Possible Options<sup>1</sup>

by

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## 1. Introduction

Prior to the official adoption of the multi-currency system in January 2009, the economy was characterized by hyperinflation, high & unsustainable budget deficit; a growing balance of payments deficit; dwindling foreign currency reserves, acute foreign exchange shortages, low capacity utilisation; financial disintermediation and shortages of the local currency (Zimbabwe dollars Z\$ cash). Skills flight, low staff moral, foreign exchange shortages; low effective demand also led to low production & productivity in all productive sectors. Declining incomes due to increasing unemployment was accompanied by increasing levels of poverty. The economy witnessed an upsurge in the informal sector activities that became the mainstay of the economy. Informalisation of business activities also created a conducive environment for tax evasion and thus undermining efforts by Government to broaden the tax base and minimize leakages.

The hyperinflationary environment, led to loss of value and confidence in the local currency; reduction in planning horizons (short-termism); increased cost of doing business; loss of competitiveness (as domestic inflation was higher than that of trading partners); uncertainty leading to postponement of investment decisions; forced company closures or scaling down of business; inflation hedging (locking productive resources in illiquid physical assets, equities, foreign currencies). Consequently the economy declined by 40% over the period 2000-2008.

The hyperinflationary environment was so endemic to the extent that normal economic transactions and systems broke down. Economic agents sought ways to preserve value of their hard earned incomes; companies pursued capital preservation strategies that excluded the use of domestic currency whose value was eroding extremely fast. Prices were quoted in foreign currency indexed to parallel market rates. Multiple parallel market rates were used depending on the medium used in the transaction (i.e. transfer rate for electronic transfers, cash rate and cheque rate).

Foreign currency (in particular the US\$ and South African Rand) was initially used as a store of value (asset substitution) and later as a medium of exchange (currency substitution). The business of changing money became a thriving business especially among the unemployed youths. However, the market distortions especially the arbitrary changes in the rates, the demand for huge amounts of Z\$ cash, endless queues in banking halls and shortage of Z\$ cash generated debate on policy alternatives to stabilize the economy and provide a viable medium of exchange and store of value.

Several policy analysts and commentators recommended adoption of dollarization given the common use of foreign currency already prevailing in the economy. In particular, Hanke (2008) observed that "To stop hyperinflation, Zimbabwe needs to immediately adopt a different monetary system. First is "dollarization." This option would replace the discredited Zimbabwe dollar with a foreign currency, such as the U.S. dollar or the South African rand."

Hanke's recommendation on dollarization which, was supported by several business leaders<sup>1</sup> and policy analysts was stating a fact that was already prevalent on the ground. This fact was

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<sup>1</sup>The Harare Chamber of Commerce, Tax Management Services (TMS) and Coalition for Market and Liberal Solutions (CO-MALISO) held a Breakfast Forum on Dollarization on 6 December 2008 where, Reserve Bank proposals on foreign currency licensed wholesalers and retail shops (FOLIWARs) and Prof Hanke's proposal were debated.

acknowledged by Acting Minister of Finance, Hon. Patrick Chinamasa when he said, “honourable members will be aware that in the hyperinflationary environment characterizing the economy at present, our people are now using multiple currencies for day to day business transactions, alongside the Zimbabwe dollar” (2009 National Budget Statement, p41).

The 2009 National Budget and Monetary Policy statements that were announced on 29 January and 2 February, respectively gave legal effect to the use of foreign currency for transaction purposes, thus legalizing currency substitution. Prior to this announcement foreign currency was predominantly used as a store of value. The foreign currency would be converted to the Z\$ which, was still exclusively the legal tender.

The Reserve Bank selectively legitimized the use of foreign currency when it introduced Foreign Currency Licensed Wholesalers and Retail Shops (FOLIWARS) in October 2008. Prior to this the use of foreign currency was legalized for the purchase of fuel coupons under the Direct Fuel Imports Scheme. The FOLIWARS and the fuel coupons system<sup>3</sup> had shortcomings which, the official adoption of the multiple currency system sought to address. The Short-Term Emergency Recovery Program (STERP) adopted the Rand as the reference currency. The Zimbabwe dollar balances held by the financial sector as well as notes and coins in circulation were demonetized in the 2009 Mid-Term Fiscal Policy review.

Thus, the adoption of the multi-currency system has fundamentally changed the country's macroeconomic landscape, with far-reaching economic and political implications some of which were hazely understood at the time when the policy was advocated for. There is a growing body of literature that has attempted to at evaluate the costs and benefits of “dollarisation in its different formats”. This paper will provide an overview of this literature and provide a context to the factors that led to the adoption of multicurrency regime in Zimbabwe, its implications and draw lessons from country experiences with dollarization. The paper will conclude by identifying some emerging policy issues regarding the proposed currency reform options and pro-offer suggestions on the way-forward. The following section will provide a summary of the different definitions of dollarization with a view of putting into context the multicurrency system adopted in Zimbabwe.

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<sup>3</sup>Coupons were now circulating as a form of money as people were being paid in coupons, bus fares paid in coupons. Traders of foreign currency shifted to buying and selling fuel coupons following the dwindling of business in foreign currency trading (which is now confined mainly on cross rates between the US\$ and Rand).

## 2. Definition of Dollarization

The term dollarization has been used loosely to mean different things by different commentators on this subject. Generally dollarization refers to the substitution of a foreign currency for a domestic currency to fulfill the essential functions of money as medium of exchange (currency substitution), store of value (asset substitution) and unit of account (future payments are indexed to an exchange rate).

A distinction is also made between official/(de jure)/full dollarization and partial/unofficial/defacto dollarization. Full/official dollarization refers to the adoption of a foreign currency as the predominant or exclusive legal tender. Partial/Unofficial/de facto dollarization refers to a situation where the local currency remains the exclusive legal tender but financial transactions are allowed to be denominated in foreign currency-allowing a dual/multiple currency system. De facto dollarization is a rational response to loss of confidence in the local currency arising from hyperinflation and currency devaluations.

Other uses of the term dollarization include payments dollarization (use of foreign currency for transaction purposes); financial dollarization (residents holding financial assets or liabilities in foreign currency) and real dollarization (indexing, formally or de facto of local prices and wages to foreign currency). The United States dollar (US\$) is by far the dominant currency used in bi-currency systems given its international reserve currency status. However, the Euro, the Australian dollar and the Rand are other examples of anchor currencies. Thus, the term dollarization is used in the literature in its generic sense and not referring specifically to the adoption of the US\$.

A situation whereby a government grants authority to its citizens to use foreign currency (as happened through the 2009 National budget and Monetary Policy Statements) without formal agreements with the issuing countries is called unilateral dollarization. Initially Government allowed the local unit to continue as legal tender and while it co-circulated with other foreign currencies. Dollarization in Zimbabwe has a basket of currencies as anchor currencies with the Rand as the reference currency, hence the term multicurrency system. However, the practice is the same as in any dollarized economy. Thus, in this paper the term dollarization and multicurrency will be used interchangeably.

### 3. Reasons for Adopting Dollarization

The following reasons among others have driven countries to adopt dollarization (partial/full):

- Move towards a single currency union,
- Attraction of foreign direct investments;
- Reducing risk of domestic hyperinflation and exchange rate devaluation;
- Borrowing policy credibility as policies in the domestic economy mimic those of the issuing/ anchor country;
- Desire for monetary stability anchored by low & stable inflation,
- Deepening financial & economic integration with the anchor country.

The decision to officially adopt a multi-currency system in Zimbabwe was spurred by macroeconomic problems in particular severe shortages of foreign currency & hyperinflation, leading to loss of value and confidence in local currency to perform the essential functions of money (store of value, medium of exchange and unit of account).

#### 3.1. Partial Dollarization

As we noted earlier partial (de-facto) dollarization occurs when local currency remains the predominant or exclusive legal tender but financial and payment transactions are allowed to be denominated in foreign currency. Domestic currency dominates small transactions while foreign currency is important for large transaction. Where people do not trust the local banking system large foreign currency deposits are held in foreign banks or money is kept outside the banking system in safes and mattresses. Some of this money may be held in violation of national laws against holding of foreign currency.

Partial dollarization creates arbitrage opportunities where the local currency is exchanged for a stronger foreign currency. In Zimbabwe while there was acute shortage foreign currency in the banking system, the "illegal" parallel market was awash with foreign currency. Thus, businesses and individuals requiring foreign currency relied on the parallel market. Police played a cat and mouse game with foreign currency dealers on a daily basis but given the high returns it became the only game in town. Some business people were arrested for externalising foreign currency. All this demonstrated the loss of confidence not only with the local currency, the prevailing official exchange rate regime and the banking system.

The phenomenon of partial dollarization has been experienced by a number of countries in recent years. The set of partially dollarized economies includes a large number of developing, emerging and transition countries. The extent of dollarization is measured by the ratio of onshore foreign currency deposits to total onshore deposits. The table below shows the ratio of average foreign currency deposits to total deposits for the period 1996-2001.

**Table 1: Average Foreign Currency Deposits to Total Deposits**

Regions	Number of						
	Countries	1996	1997	1998	1999	2000	2001
South America	8	45.8	46.1	49.4	53.2	54	55.9
Transition Economies	26	37.3	38.9	43.5	44.3	46.9	47.7
Middle East	7	36.5	37.2	37.7	37.5	38.2	41.9
Africa	14	27.9	27.3	27.8	28.9	32.7	33.2
Asia	13	24.9	28	26.8	28.8	28.7	28.2
Central America and Mexico	7	20.6	20.8	22	22.1	22.5	24.7
Caribbean	10	6.3	7.6	6.8	6.7	6.1	6.2
Industrial Countries	14	7.4	7.5	7.5	6.7	7	6.6

Source: Guide, A; Hoelscher, D; Ize, A; Marston, D and De Nicolo, G (2004), 'Financial Stability in Dollarised Economies', Occasional Paper 230, International Monetary Fund, Washington DC

Table 1 shows that the level of foreign currency deposits, which is an indicator of the extent of dollarization in these countries, has been increasing overtime. Schuler (1999) cites a study of the United States Federal Reserve System that estimates that foreigners hold 55 to 70 per cent of dollar notes in circulation. The highest concentrations occur in Latin America and the former Soviet Union. One key concern most frequently cited in relation to financial dollarization, is its deleterious impact on the vulnerability to default in the financial sector (financial fragility). A dollarized banking sector can be characterized by higher insolvency risk and higher deposit volatility. Liquidity & solvency risk are likely to be high where a small fraction of foreign currency deposits are held by local banks in the form of liquid assets abroad rather than loaned locally.

### 3.2. Official Dollarization

Official dollarization entails that, the domestic monetary base (all local currency coins and notes in circulation plus the vault cash reserves of banks) would be redeemed for the anchor currency (i.e. US\$ or Rand) at some predetermined conversion rate and then be destroyed. All contracts denominated in Z\$ would be transformed into US\$ or Rand contracts (i.e. local currency bank deposits). However, if dollarization is unilateral no permission is required from anchor country (i.e. United States or South Africa). Consequently the country gives up any power to conduct independent monetary policy and would implicitly accept monetary policy decisions of the anchor country. Alternatively the country can negotiate a Treaty of Monetary Association with the anchor country. Such a treaty would establish a compensation formula (i.e. seigniorage sharing formula) for loss of monetary policy independence and facilitate the import of the anchor currency in sufficient quantities).

The expected benefits of dollarization include among others the elimination of exchange rate volatility (against the anchor currency); increased level of integration of the dollarizing economy with the anchor economy and enhancement of a sovereign borrower's credibility in international financial markets, and thereby increasing international financial integration. However, the currency stability promised by dollarization is itself relative, given that the anchor currency (i.e. US\$ or Rand) will fluctuate against major currencies.

The major reasons why the official dollarization is not more widespread include the political symbolism of a national currency, issues of sovereignty and monetary autonomy, historical patterns and the perceived economic and social costs of dollarization.

Official/full dollarization entails 100 percent substitution of the local currency for the foreign anchor currency. In a fully dollarized economy:

- the anchor currency (i.e. US\$ or Rand) replaces the discredited local currency as the legal tender with the exception of small coins (in some cases);
- capital flows are free to enter and leave without any restrictions;
- central bank restructures its traditional function and acquires new functions;
- the possibilities of devaluation is eliminated and consequently reduce currency risk or exchange rate risk (exchange rate risk remains on the cross rates);
- transaction costs in the purchase and sales of foreign currency are reduced;
- the inflation rate will tend to converge to the inflation rate of the anchor country;
- enforces fiscal discipline where government has surrendered the monetary policy autonomy and the capacity to print money to finance fiscal deficits;
- interest rate differential between the domestic interest rate and the international interest rate is reduced as the risk of devaluation that is normally factored in interest rate calculations is eliminated. However, the interest rates will not decrease easily to international levels if the expected inflation rate and the country risk remain high;
- autonomous monetary and exchange rate policy is relinquished, including the use of central bank credit to provide liquidity support to the banking system in emergencies.

Potential credibility gains from official dollarization are achieved through lower interest rates, surrendering monetary policy by domestic central bank to the central bank of the anchor economy and forced fiscal discipline. The macroeconomic situation is expected to improve in a country after the dollarization. However, dollarization may also increase risks that will undermine the potential credibility gains and thus generate pressure to de-dollarize. For example the loss of seigniorage revenue (if not compensated by increase in revenue generated from increased business activities) may undermine critical government expenditure. Full dollarization diverts this flow of seigniorage revenue from the domestic monetary authority to anchor country monetary authority.

Seigniorage is the revenue earned by issuing notes and coins that the public holds willingly without receiving interest. The Central Bank, which typically has the monopoly of issuing the national currency, can exchange currency for interest bearing securities. Retaining the ability to print one's own currency gives governments a flexible way to raise revenue. Emerging markets economies are typically subject to big shocks, and large fractions of government revenue are linked to volatile commodity prices. Moreover, increasing traditional tax rates is difficult and does not guarantee sufficient revenue when evasion is widespread and the informal sector is large. In this context seigniorage is a valuable fiscal instrument, for raising non-tax revenue. However seigniorage revenue should not be extracted beyond the optimal levels. Fry (1996) provides a detailed discussion and estimates seigniorage revenue for a number of countries.

Because, dollarization entails a loss of both seigniorage revenue and independent monetary policy, it is likely to have important consequences for the conduct of fiscal policy especially where the fiscal space is limited. Chang and Velasco (2000) argue that an optimal taxation plan would always entail surprise inflation (or devaluation) because this acts as a lump-sum tax and therefore is non-distortionary. Dollarization removes the ability of the government to use this tax.

It should however be noted that the level of seigniorage prior to dollarization is not the true opportunity cost of dollarization. There is need to focus on the seigniorage revenue that would have been earned at the new and lower level of inflation. An officially dollarized country can regain seigniorage through the establishment of revenue sharing formula with the anchor country. The costs of official dollarization are divided into two forms (stock and flow costs). Stock costs are the once off costs associated with the initial amount of the new currency that has to be acquired. The flow costs are associated with seigniorage revenues forgone.

For a country like Zimbabwe that does not already have enough foreign currency reserves to buy up their domestic currency and thereby dollarize, the acquisition of the initial stock could add indirect costs. Furthermore, if the country lacks the credit-worthiness to borrow reserves, it would be forced to accumulate them through the current account surplus. The cost of this could be substantial in forgone investment. This may entail running some unsustainable current account deficits.

Loss of monetary and exchange rate policy means that government cannot finance budget deficits by creating inflation/devaluation because it no longer issues its own currency. In the presence of asymmetric shocks this could imply problems for the economy. It may result in a growing debt and/or more social conflicts. However, this point needs to be looked at within the context of the effectiveness of these policy instruments prior to dollarization. If these policies have not been used correctly in the past, the effects of the loss may be negligible. Prior to the adoption of the multi-currency system the prevailing exchange rate regime was out of tune with the prevailing economic fundamentals. In particular the official exchange rate did not reflect the true opportunity cost of foreign currency.

Dollarization severely limits the ability of the central bank to act as a lender of last resort/guarantor when the banking sector is in distress. One of the crucial roles that banks perform is maturity transformation: taking in short-term deposits and making long-term loans. This naturally puts a bank at risk if, for whatever reason, depositors have a sudden increase in their demand for liquidity and want to withdraw their money. However, with dollarization the central bank cannot print money to give loans to prop up the banking system in time of distress as happened in the recent financial crisis. The central bank's intervention will depend on the amount of foreign currency reserves in the economy or the availability of contingent lines of credit with international banks. The dollarized economy does not have access to central bank of the anchor country to act as lender of last resort. For, example the Federal Reserve System of the United States of America, accommodates USA banks and not banks from other countries that use its currency.

Low levels of international reserves will undermine the capacity of the economy to respond to negative shocks that require liquid funds in foreign currency. For example, if the banking sector has a bank run on foreign currency denominated deposits, the central bank which cannot print foreign currency will be incapacitated to respond to such a crisis without resorting to assistance from the anchor country. Giving up the local currency is more likely to make liquidity crises more frequent and/or more severe. In this regard the policy challenge in a unilaterally dollarized economy is devising other mechanisms for dealing with liquidity crises.

The other risk arises where the financial sector, has a maturity mismatch that is related to the fact that it has short term liabilities in foreign currency, while its assets in the same currency have a larger average maturity. Although this type of liquidity risk is common to the banking systems, the risk in a financially dollarized economy is higher because the central bank would have lost the lender of last resort function. The liquidity challenge can be more severe where the capacity of the central bank to borrow from international capital markets to boost its foreign currency reserves is constrained.



### 3.3. Examples of Official Dollarized Economies

Only a few countries have officially adopted a foreign currency as legal tender. Table 2 below shows

**Table 2: Independent Countries Officially Dollarized or 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	US dollar		2000
Ecuador	13 100 000	24,3	US dollar	X	2000
El Salvador	6 500 000	13,0	US 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	US dollar		1944
Micronesia	120 000	0,2	US 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	US dollar		1944
Panama	2 900 000	9,5	US 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	1 000	0,0	Italian lira replaced by the Euro	X	2002 (euro) 1929 (lira)

Source: Minda, A (LEREPS-GRES), 2005, 'Official dollarisation : a last resort solution to financial instability in Latin America ?', Cahiers du GRES 2005-02, Groupement de Recherches Economiques et Sociale [http://pagesperso-orange.fr/jb.desquilbet/docs/B\\_Dollarization2.pdf](http://pagesperso-orange.fr/jb.desquilbet/docs/B_Dollarization2.pdf)

Many of these countries are city states that are fully integrated to their neighbours' economies (e.g. Andorra, Monaco and Lichtenstein). Some of the countries in which full dollarization has occurred have extremely small populations and only rudimentary financial system. The most cited case of an officially dollarized economy is Panama, which has been dollarized since 1904. Panama has close historical, political and economic links with the USA. Other recent cases of countries that officially dollarized are Ecuador (2002), El Salvador and Guatemala in 2001. Ecuador adopted official dollarization to cope with wide spread political and financial crisis rooted in massive loss of credibility in its political and monetary institutions. El Salvador on the other hand adopted official

dollarization after years of unofficial dollarization, as a result of internal debate and in the context of stable macroeconomic fundamentals, to deepen regional integration. Evidence shows that dollarization has been more popular in Latin America. Hira et.al (2004) observed that dollarization is embedded in the politics of the region.

Thus, the debate on full dollarization suffers from lack of relevant case studies. Chang and Velasco (2003) noted that there are very few observed cases of dollarization and history provides little guidance of the consequences. Schuler (2005) observed that most countries that were dollarized but now have their own currencies and truly independent monetary policies have performed worse in terms of monetary stability than they would have by remaining dollarized. Cuba is cited as an example. Notable exceptions cited in the paper, occurred in the oil-rich countries in the Middle East, where their currencies have preserved their purchasing power better than the Indian rupee, which the countries formerly used.

Berg et.al (2000) noted that the main attraction of full/official dollarization is the elimination of the risk of a sudden, sharp devaluation of the country's exchange rate. This allows the country to reduce the risk premium attached to its international borrowing. They further observed that, dollarized economies could enjoy a higher level of confidence among international investors, lower interest rate spreads on international borrowing, reduced fiscal costs and more investment and growth.

### **3.4. Dollarization and monetary policy**

In a partially dollarized economy the switching from the local currency to the foreign currency to avoid the effects of inflation, may increase the volatility of money demand and thus undermining the capacity of the central bank to conduct monetary policy. This was evident in Zimbabwe in the period preceding the official adoption of the multi-currency system as people substituted the local currency for foreign currency. The situation was worsened by the shortage of Zimbabwean dollars as the Reserve bank failed to cope with the demand for the local currency. As the flight to readily available foreign-currency in the parallel market became less costly, the demand for reserve money became more sensitive leading to the rapid expansion of the monetary base and changes in the parallel market exchange rate. .

Furthermore, in a fully dollarized economy the central bank will have no capacity to influence economic activity using the interest rate or exchange rate channel. Monetary policy will thus be surrendered to the anchor economy.

### **3.5. Dollarization and growth**

The implications of dollarization on growth and output volatility are not well understood. There are few empirical studies that have systematically addressed this issue. Dollarization may detract from the capacity to use the real exchange as a buffer against real shocks and dollarized countries are likely to exhibit greater cyclical volatility. In addition, financially dollarized economies, due their sensitivity to currency fluctuations, are likely to be more prone to suffering banking crises and episodes of capital flight, the sharp economic contractions typically induced by the latter would also contribute to output variability. By contrast, while there are reasons to believe that output volatility per se may inhibit growth and that the adverse real effects of financial crises (more likely in dollarized economies) may be highly persistent, the link between FD and long-run growth is a priori less transparent.

### **3.6. Dollarization of Existing Liabilities and its Implications**

Liability dollarization refers to domestic borrowing denominated in or indexed to a foreign currency. Both sovereign debt and private debt in emerging market economies are often dollarized. Private sector dollar-denominated debt, which both direct borrowing by individual firms and borrowing

by the domestic banking sector is set to increase in the multicurrency environment. This creates a balance-sheet mismatch that greatly increases their vulnerability in the event where the government abruptly reintroduces the local currency.

### **3.7. International Experience with Dollarization**

Recurrent currency crises in emerging economies have generated intense debate on exchange rate policies-leading to some countries completely giving up their national currencies i.e. Ecuador-abolished its currency and adopted the US\$ in 2000, El Salvador and Guatemala adopted US\$ as legal tender in 2001.

Edwards et.al (2001) observed that historically the macroeconomic record of dollarized economies shows that, inflation and economic growth are lower in dollarized economies (DE) than in non-dollarized economies (NDE). He also noted that macroeconomic stability is not significantly different between DEs & NDEs in Latin America. Lower growth in DEs is due to countries' difficulties in accommodating external disturbances, in terms of trade and capital flow shocks.

Turkey experienced reduced yield of inflation tax; higher and more volatile inflation for a given level of budget deficit. There is also evidence of reduced monetary authorities' control over domestic liquidity by increasing the component over which little direct influence can be exerted, thus making money demand less stable. Unofficial dollarization has also been accompanied by increased exposure of the banking system to additional risks on account of uncovered foreign liabilities.

According to IMF (2007) Brazil avoided financial dollarization and developed a large and sophisticated financial market based entirely on its domestic currency. Brazil has the lowest dollarization ratio in the Latin American region.

### **3.8. Firm-level Impact of Dollarization**

Although there is not much literature on the impact of dollarization at firm level, however, a study on a sample of firms in five Latin American countries sampled by Bleakley and Cowan (2002), found out that firms that produce tradable goods had a tendency to hold more dollar debt than firms that produced non-tradable goods, hence they did not find the evidence to support negative balance sheet effects. However, Escheverry et al (2003) did find out that, on the contrary, debt dollarization at the firm level did have negative balance sheet effects and the significance of the impact depended on the level of dollarization of different countries. For example, they found out that despite low dollarization in Colombia, firms that borrowed in dollars were not fully hedged and suffered from economic fluctuations. This result was also echoed in Brazil, a country with low dollarization and Peru, a country with high levels of dollarization (Arturo Galindo and Leornado Leiderman 2003).

Arturo Galindo and Leornado Leiderman (2003) conclude that in terms of financial dollarization, countries that have relatively underdeveloped derivative markets suffer negative effects of dollarization since they leave the export of goods as the only hedge against dollar denominated obligations. Furthermore, they also concluded that balance sheet effects at the firm level can result in adverse effects on the country's investment, growth and financial fragility (susceptible to solvency and liquidity risks). In a case of domestic currency deposits, the Central Bank can remedy the liquidity risk by stepping in as a lender of last resort, while with foreign currency deposits it can not.

Dollarization has also unintended effects on the country's public debt. Calvo et al (2002) show that dollarized public debt in Argentina was cited as one factor that played a significant role in explaining its crash. They found out that Argentina's public debt composition was highly dollar

denominated, a case where public sectors which are in themselves non-tradable were highly indebted in foreign currency.

When an earthquake hit El Salvador in 2001 and shattered its infrastructure, the country could not print its own money to fund the resuscitation of the infrastructure hence relied on its US Dollar little revenue and tariffs. This scenario had negative impact on the livelihoods of the poor, who were heavily affected by the cuts in social services expenditure that was re-directed to fund infrastructure (Towers and Borzutzky 2004).

Growth of local industries is also affected by the Central Bank's loss of monetary policy independence in that its use of the interest rates to lessen the impact of business cycles is lost as a result of dollarization. Keynesian economists believe that economic authorities need such instruments to initiate positive cycles of consumption demand and investment in slacking economies.

Another unintended consequence of dollarization is labour loss or cuts in minimum wages. For heavily export oriented industries such as tobacco, gold, platinum and other metals, a fall in prices can only lead to either a cut in minimum wages or loss of employment, since authorities cannot manipulate the currency to increase product competitiveness.

While it is generally believed that dollarization reduces inflation and exchange rate risks, it does not consequently lead to increased capital inflows and low borrowing costs for government and private sector. There is rather the probability of more tax options to raise more revenue and also probability of capital controls.

### **3.9. Dollarization versus Currency Board**

The difference between a currency board and dollarization are few but important. Dollarization's key distinguishing feature is that it is permanent or nearly so. Reversing dollarization is much more difficult than modifying a currency board. In a currency board system, the central bank acquires foreign reserves equal to the domestic currency issue. As a result of issuing non-interest bearing debt (currency) and holding interest earning assets (foreign reserves) the central bank earns gross profit, which is also called seigniorage (Berg et.al. 2000).

## 4. De-Dollarization

As noted above reversing dollarization in dollarized economies can be a very taxing adventure. In any case, the failure rate has been massive over the years. Of the 85 countries that are known to have dollarized, specifically their financial dollarization, only four are known to have financially de-dollarized successfully (Reinhart et al 2003). These countries are Israel, Mexico, Poland and Pakistan.

### 4.1. Rationale for De-Dollarization

The dollarization literature has frequently suggested the need to de-dollarize given the entrenched risk of macroeconomic instability. In particular, one of the main risks associated with a high and persistent financial dollarization is the balance sheet effect. This happens when the increase in the local currency value of dollar liabilities outpaces the increase in the value of the borrower's assets or income flow. To the extent that dollar debtors may no longer be able to service their loans, this can trigger corporate and banking crises (even if banks' currency positions are balanced by regulation), cause output volatility, and ultimately result in costly self-fulfilling macroeconomic crises. An example of this was the combined impact of the Asian and Russian crisis. As a consequence of the crisis, seven banks (out of 25) were closed (Moron et. al., 2003).

It can be noted that dollarization is associated with higher exchange rate pass-through, which may limit, at least in principle, the flexibility of monetary policy and its countercyclical capacity. Indeed, such concerns seem to be an important enduring determinant of the fear of floating in highly dollarized environments. An adverse external shock on real variables can cause exchange rate risk which can transform itself into default risk increasing the stress of the financial system. The need to pursue a de-dollarisation strategy is based on the above premise and the current literature provides us with a broad menu of policy options to counter this phenomenon.

### 4.2. Country Experiences with de-dollarization

This section reviews a number of experiences with de-dollarization. For countries that have pursued policies to promote de-dollarization, the results have been mixed. In fact, generally speaking, countries that have chosen a gradual market-driven approach have had more success at achieving sustained de-dollarization than countries that have implemented a forced de-dollarization (see also Fischer. S. 2006).

The literature on de-dollarization identifies four countries (Poland, Israel, Chile, and Egypt) that are considered to have de-dollarized successfully, i.e. where (i) the deposit dollarization ratio declined by at least 20% points; (ii) settled at a level below 20%; and (iii) remained below that level with no substantial macroeconomic costs. These countries implemented policies to promote a gradual, market-driven de-dollarization as part of a broad economic stabilization program. Israel and Chile also used indexation successfully to promote the use of the local currency to hedge against inflation and exchange rate uncertainty. Indexation to the CPI provides an excellent alternative to dollarization because it directly provides protection against inflation volatility. If one abstracts from indexation lags and other measurement issues, it dominates dollarization as a hedge, as it insulates lenders and borrowers from real exchange rate risk, and not only the nominal risk. In particular, with indexed rather than dollarized debt, the average borrower is better prepared to deal with a substantial depreciation of the currency.

However, de-dollarization has been stronger on the deposits side than on the liabilities side. Once the use of foreign currency for transactions becomes acceptable, it may be difficult to reverse the process even after achieving stabilisation. Reversing high levels of dollarization in the financial system is a long-term process and not many countries have been successful in doing so. Dollarization can also be costly and very difficult to reverse because its permanent attributes emanate from the fact that it happens when people have completely lost confidence in the local currency and have suffered a lot due to hyperinflation.

The key to the success of the Chilean experience has been the credibility that Consumer Price Index (CPI) (referred to as UF - unidad de fomento - introduced in 1967). Another key policy component was the creation of a significant supply and demand for indexed debt. This included large issues by the Central Bank, initially to finance the resolution of the banking crisis of the early eighties, and the creation of a sizable institutional investor base for those instruments, comprised of private pension funds and insurance companies. Once the financial crisis was resolved in the early 1980s, domestic financial intermediation grew consistently in a stable macroeconomic environment. There is little doubt that public policies contributed significantly to Chile's financial indexation. Only recently, peso denominated financial contracts have started to prevail above indexed contracts, among short and medium term instruments.

A conscious effort was made to deepen the market for local currency denominated government bonds. This has obviously come at a cost, in terms of higher interest payments paid by the public sector particularly in a period of high real interest rates. However, the costs have been reduced year after year as the disinflation program started bearing fruit and inflation finally reached single digits. Apart from nominalising the debt, first through CPI-indexation and later without any indexation, Israel has also lengthened the maturity of its public debt.

The central bank played a very active role in promoting markets in financial derivatives and other instruments to insure against exchange rate risk. On the monetary front, the key pillar of Israel's strategy was the introduction of inflation targeting which anchored expectations and, thereby, reduced investors' uncertainty about local currency assets. This seems to have contributed to monetary credibility and eventually, to price stability. De-dollarization is evidenced by the rise in the share of local-currency denominated bank deposits in total deposits, from 3% in 1984, the year of highest inflation, to 38% currently.

Poland and Egypt offered very high interest rates on local currency deposits after the financial sector was liberalized. By 2007, the ratio of foreign currency deposits to broad money in Chile, Egypt and Poland was 5.7%, 0.2% and 2.8% respectively, compared with 26% in Israel.

The successful experience of Chile, however, has not been replicated in other countries. Colombia, for example, was another country where CPI indexed financial instruments gained great importance. Fluctuations in the real exchange rate led to liquidity effects at the financial intermediary level that forced the Central Bank to provide liquidity frequently in a way altering the conduct of monetary policy. Lack of long-term demand for CPI-indexed financial instruments, as well as low credibility associated with frequent changes in the indexation rule severely limited the behaviour of financial indexation in Colombia. In the set of countries that implemented measures to force rapid de-dollarization, only Mexico and Pakistan succeeded in keeping dollarization low (2.5% and 5.2% respectively at end-2007), although in both cases there were adverse macroeconomic consequences.

Mexico forced a conversion of all United States dollar denominated assets to pesos, and Pakistan forced deposits to be converted to domestic currency in 1998. These policies, implemented in reaction to economic shocks, were coupled with the implementation of policies to stabilize the

economy. Even though Mexico and Pakistan managed to reduce dollarization, they did so at some cost in the form of capital flight, lower remittance inflows, and less financial intermediation.

In other countries, forced de-dollarization proved to be a failure and had significant macroeconomic costs. The cases of Bolivia and Peru are clear examples of unsuccessful currency conversions of deposits. They implemented measures to rapidly de-dollarize the banking system in the first half of the 1980s, by forcing conversions of foreign currency deposits to local currency. These efforts, undertaken while inflation was high, were followed by an abrupt depreciation of the local currency, resulting in capital flight and financial disintermediation and a sharp reduction in private sector credit. In order to regain some financial depth, re-dollarization was allowed.

Although de-dollarisation led to an initial drop in the measured level of dollarisation, the substantial macroeconomic costs associated with it forced authorities to accept increased dollarisation a few years later. More specifically, continued macroeconomic instability over the next few years led to a reversal of policies, which lifted the restriction on foreign currency deposits and led to rapid re-dollarisation. Bolivia is again one of the most highly dollarised economies with a ratio of foreign currency deposits to broad money at 45.1% at end-2007. In Peru, despite its track record of solid economic management over the past several years and the adoption of inflation targeting, dollarisation remains high (46.1 % at end-2007).

As in the case of Mexico and Pakistan, de-dollarisation in Argentina occurred in the face of a severe financial crisis when its currency board became unsustainable, and foreign exchange reserves declined significantly as people moved assets into United States dollars. In response, and as part of a comprehensive policy response to stabilize the economy, the government forcibly converted foreign currency deposits into the domestic currency.

Most other countries remained highly dollarised at end-2007 with the ratio of foreign currency deposits to broad money in excess of 30%, although in a few of these countries, i.e. Bolivia, Croatia, Paraguay, Peru, Turkey and Uruguay, the ratio declined by around 20% during 2000-07. It can be noted that in all of these countries, de-dollarisation occurred following successful implementation of macroeconomic stabilization policies (sometimes in the context of inflation targeting) that succeeded in reducing inflation, supporting real growth, and nominal appreciation of the domestic currency, as well as policies aimed at strengthening the domestic financial sector. These governments also implemented some measures to support the demand for the local currency, including requiring higher reserves of foreign exchange deposits, requiring that all consumer credit be extended in the local currency, and prohibiting pricing and cash payments in foreign exchange in the retail sector.

One can note that dollarisation is not easily reversed, even after the underlying causes have been removed. This is due to the expected volatility of the local currency exchange rate and a perceived lack of policy credibility. Empirical evidence suggests that successful de-dollarisation is usually the outcome of a persistent process of disinflation and stabilization, rather than a main policy objective. Institutional changes that bolster the credibility of sustainable macroeconomic policies, such as an independent central bank with a clear mandate to stabilize prices, can also promote confidence in the domestic currency and thus reduce dollarisation.

## 5. Lessons for Zimbabwe from the De-dollarization Experiences

When a country gives up the option to print its own currency, it loses its ability to directly influence its economy, including among other factors, its right to administer monetary policy and form the exchange rate regime. Most countries have chosen to pursue de-dollarisation as a means to make monetary policy more effective, increase seigniorage, and reduce the financial sector's vulnerability to shocks. Forced de-dollarization has had limited success. Countries that tried to force de-dollarisation experienced financial disintermediation and capital flight. Some chose to reverse their policies some years later to counter the adverse economic consequences.

Successful attempts to de-dollarise have been market-based and combined a track record of economic stability with micro-based policies to promote use of local currency both for transactions and as a store of value. Countries where de-dollarisation was sustained without adverse economic consequences had some characteristics in common:

- Track record of macroeconomic stability: This is a necessary, but not sufficient, condition. Dollarisation tends to be persistent; many highly dollarised countries with an extended track record of economic stability did not experience significant reduction in dollarisation. Successful de-dollarisation cases show that, only after an extended period of macroeconomic stability can micro measures help reduce both transaction and financial dollarisation without macroeconomic cost.
- Financial sector development: To increase the use of the local currency as a store of value, there is need for a reasonably well-developed financial sector. Introduction of local currency instruments indexed to inflation or the exchange rate and efficient pricing of risk have helped encourage economic agents in other countries to hold local currency assets even in a highly dollarised environment.

### 5.1. Preconditions and Policy Options for Zimbabwe

Before taking an option of reviving the local currency, there are some preconditions that should be met to maintain stability of the adopted currency. The government has a role to play in setting up credible policies to maintain macroeconomic stability. Sound macroeconomic management needs to be strengthened. To enable financial sector stability, there is need to adopt appropriate banking and supervisory practices and to liberalise the exchange rate among other factors.

The government of Zimbabwe needs to build confidence to use own currency and address, first the issues that led to the fall of the local currency before its re-introduction. Given that the government is struggling to meet its expenditure requirements due to fiscal constraints, economic agents do not have confidence that it will manage to finance the deficit without recourse to money printing. Hence a successful resurrection of the Zimbabwe dollar is dependent on:

- improved revenue mobilisation,
- increased productivity and production levels, and
- broadening tax base as more jobs are created.

Domestic resource mobilisation needs to be complemented by resources from international financial institutions and bilateral donors.



## 5.2. Strategies for De-dollarisation

- Monetary and fiscal policy should be credible - sound monetary and fiscal policy is a necessary condition for successful de-dollarisation. Policy makers should refrain from policy reversals so as to enhance policy credibility. The implications of policy pronouncements should be thoroughly investigated prior to announcement.
- A credible disinflation framework – Inflation targeting framework is an option that can be explored.
- Restore confidence in the banking sector – confidence is regained when banks are perceived to be well capitalised and when customers can withdraw their money without restrictions. The recapitalisation of banks requires the support of foreign investors since government's revenue base and domestic sources of private capital are currently limited. Entry of foreign banks brings expertise and help to strengthen domestic banks through transfer of technology and best practices. Negative perception regarding the Indigenisation and Economic Empowerment Act with regard to limiting participation of foreign investors in the country need to be addressed.
- To get the incentives for de-dollarisation right, most important is to strengthen institutions that promote monetary credibility and stability of the financial sector.
- In the de-dollarisation route, developing capital markets in domestic currency or in indexed units associated with sound monetary and fiscal policy seems crucial. In that respect, CPI Indexed debt or financial instruments are one of the alternative assets. But using CPI index instruments requires stability in inflation and real exchange rate depreciation, developed and well functioning secondary markets. It can also be noted that the most important disadvantage of using CPI indexed instruments is increasing inflationary inertia in the dollarised economy. Therefore it should be designed in a forward-looking manner.

## 5.3. Policy options

- De-dollarization would reduce the Zimbabwean economy's vulnerability to external shocks.
- A longer track record of good economic policies and reinforcement of the financial market is needed to increase confidence in the Zimbabwean dollar.
- Given the comprehensive nature of dollarisation, forced de-dollarisation with premature removal of legal tender status of multiple currencies would be risky and unwarranted. Countries that have attempted forced de-dollarisation were either reacting to an adverse shock or implemented policies in a stable economic environment where the local currency was already important to the economy. Thus forced de-dollarization can prove to be very risky, with potential adverse macroeconomic outcomes.
- As noted by Kokenyne et al. (2007), the first step towards de-dollarisation is to re-establish the credibility of macroeconomic policies, particularly monetary policy, before other measures to reverse dollarisation are introduced. In this context, the Reserve Bank of Zimbabwe should therefore focus on credibly reducing and stabilizing inflation. While continuing to reinforce macroeconomic policies and develop financial markets, Zimbabwe could consider policies to promote a gradual market-driven de-dollarisation. Some options to achieve this are as follows:
  - o Developing the domestic financial market. A deep and liquid domestic financial market provides flexible alternative investment opportunities to foreign currency denominated deposits. In this regard, introducing domestic currency-denominated securities could contribute to a decrease in foreign currency denominated assets. In the absence of confidence in local currency-denominated assets, a credible indexation system (either to the exchange rate or inflation rate, for example, as in Nicaragua, Chile and Columbia) can enhance investment in such assets.
  - o Once the legal tender status of the Zimbabwean dollar is re-introduced there will also be need to encourage agents to hold local-currency-denominated assets. Prudential regulations that encourage banks to hold local currency deposits could be considered if they are consistent with promoting financial sector stability. Foreign currency denominated accounts should offer lower interest rates as compared to the local currency denominated

- ones. Local currency denominated indexed instruments can be introduced to hedge against the nominal depreciation of the local currency.
- o Encourage the use of local currency for payments. Ways to do this include offering more convenient and lower-cost services for domestic currency payments than for payments in foreign currency, imposing limits on foreign currency lending, or requiring additional provisioning or capital for foreign currency denominated loans to the non-tradable sector. Peru, for example, introduced a 2% tax on cheques denominated in foreign currency to discourage the use of foreign currency in payments.
  - o Refocusing public debt management toward Zimbabwean dollar denominated instruments. Once the environment for a resumption of borrowing has been established, borrowing in the local currency could help to deepen the local currency market.
  - o Administrative measures such as placing limits on foreign currency deposits or loans, and imposing a tax on foreign currency denominated intermediation.
  - o Remove the legal tender status of multiple currencies. While a comprehensive plan to promote a significant and sustained de-dollarisation will likely require a change in the multiple currencies regime, the timing of the change would need to be studied to reduce potential macroeconomic costs. Given the potential downside risks, this policy change should be carefully communicated to the public as part of a broader agenda to promote economic stabilization and growth. A key issue that would need to be considered at the outset is whether the authorities would continue to allow a de facto role for multiple currencies in the economy since forcing agents to use a currency in which they do not yet have confidence could lead to a risk of disintermediation, or capital flight.
- Policy makers should focus on alternative measures to promote the local currency and encourage the use of Zimbabwe dollar-denominated instruments. These may include: (i) improvements in monetary management (such as changes in operational procedures that stabilize Zimbabwe dollar interest rates and enhance the transparency of monetary policy); and (ii) a refocusing of public debt management towards Zimbabwe dollar-denominated instruments (to help deepen the local currency markets).
  - Price indexation is often proposed as a better alternative to dollarisation, particularly for the longer maturities. As long as monetary credibility remains low, switching from multiple currencies to price-indexed instruments will be easier than from multiple currencies to Zimbabwe dollars. Converting a nominal (Zimbabwe dollar) rate into a real rate eliminates the component of the Zimbabwe dollar premium that reflects inflationary expectations (a component that is expected to dominate at longer maturities). Once the economy is real Zimbabwe dollar based, the greater exchange rate flexibility (that reduces output risk and interest rate volatility in Zimbabwe dollars) may in turn facilitate a second-stage switch to nominal instruments.

However, it has to be noted that the value of indexed Zimbabwe dollar will fall (reflecting the backward-looking indexation) in the event of a currency adjustment, whereas the foreign currency denominated rises. Moreover, the liquidity of price-indexed instruments at times of crises (and agents' capacity to move in and out of them) is likely to be limited, particularly in incipient markets. In addition, broad acceptance in the market place of price-indexed instruments takes time and substantial supporting efforts, including as regards public debt management policy (Herrera, 2004).

Thus, while indexed Zimbabwe dollars might help (particularly in terms of providing an alternative to the US dollar for long-dated instruments such as mortgages), they are unlikely by themselves to induce a spontaneous switch out of the use of foreign currency, unless their introduction is accompanied by an active regulatory policy that makes them more appealing, including the development of bond markets that facilitate the pricing and trading of Zimbabwe dollar

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instruments. But if these conditions are in place, the introduction and promotion of price indexation could be viewed as an unnecessary and costly detour.

## 6. Adoption of the Rand as the Anchor Currency

This section of the paper looks at the advantages and dis-advantages to Zimbabwe for joining the Common Monetary Area (CMA). We start by providing an overview of the history of the CMA since its formation, outlining in broader terms the successes and failures of the union. Secondly, we focus on the advantages and disadvantages to Zimbabwe for joining this monetary union. The section concludes by pro-offering advice on whether the country should join or not join the CMA.

Southern African Customs Union (SACU) dates back to 1889, however a formal agreement was only reached in 1910. It developed as a product of the member countries' shared colonial past, just similar to the growth of Federation of Rhodesia and Nyasaland which was made up of the Northern Rhodesia, Southern Rhodesia and Nyasaland (now known as Zambia, Zimbabwe and Malawi) from 1953 -1963. However, only countries of the SACU have successfully implemented a monetary union, since the federation collapsed after only ten years. SACU is made up of South Africa, Botswana, Lesotho, and Swaziland. Political drive has always been the driving force towards such unions. According to a World Bank (1996) the common features of the SACU agreement are:

- Free flow of goods among member countries
- Common external tariff
- Free movement of labour
- A customs duty structure for member countries that was similar to that of South Africa

Although SACU has been amended several times, these important features remain definitive. Subsequently, SACU also gave birth to the Rand Monetary Agreement (RMA)

Formalized in 1974, the Rand Monetary Agreement (RMA) was an offshoot of the South African Customs Union, although it could be defined as a parallel structure to SACU. RMA provided for Botswana, Lesotho and Swaziland to issue their own currencies, a legal tender within their own territories and also circulating alongside the South African rand. Namibia joined the union upon gaining independence in 1990.

The agreement also allowed the countries to have their own central Banks. This was followed by Swaziland and Lesotho establishing their own central banks in 1979 and 1982 respectively. The Swaziland Lilangeni and the Lesotho Loti were initially pegged at par with the rand. Botswana, however, exited the RMA in 1976 and began to issue its own currency, the pula which was initially pegged against the United States dollar, but maintained parity with the South African rand. After a decade or so, it was pegged to a basket of regional currencies that formed Botswana's trading partners after which it was then eventually floated.

In 1986, the RMA was replaced by the Common Monetary Area (CMA). This agreement was characterized by tri-lateral agreements and bilateral agreements between South Africa and individual countries (SA-Swaziland and SA-Lesotho agreements) (Aziakpono 2003). This tri-lateral relationship was changed in 1992, when Namibia joined the CMA and became known as the Multi-Lateral Monetary Agreement (MMA), although Namibia was a de-facto member before. The MMA remained focused on the main objectives of the CMA, although it added on more emphasis on the advancement of less developed countries and need to promote equity in the allocation of benefits to members. Some of the important features of the CMA and MMA included the following:

- Individual countries issue national currency, but at the same time allowing the South African rand to remain as legal tender.
- Have a single exchange rate, with currencies of other countries pegged at par to the rand.
- Each country manages its gold and foreign reserves.
- Countries allow free flow of capital funds and that capital funds would flow wherever they would earn the highest returns.
- Individual central banks with own monetary policy, but effectively the South African Reserve Bank formulates policy for the CMA.
- The MMA which superseded the CMA advocates for consultation before the formulation of monetary policy.

The table below gives a summary of CMA/MMA features juxtaposed with those of the other monetary unions obtaining in Africa and Europe.

**Table 3: Features of Different Monetary Unions**

	WAEM	CAEMC	EURO Area	CMA/MMA
Number of entities	8	6	12	4
Single currency	Yes	Yes	Yes	No, but de-facto common currency
Common central bank	Yes	Yes	Yes (but, national central banks execute monetary policy)	No (but SARB has considerable influence)
Common pool of Reserves	Yes	Yes	Yes	No
Regional surveillance of fiscal policy	Yes	Yes	Yes	No
Free trade area	No	No	Yes	Yes
External current account convertibility	Yes	Yes	Yes	Yes
Degree of capital mobility within region	Low (in principle free)	Low (in principle free)	High	High
External exchange rate anchor	Yes (peg to euro)	Yes (peg to euro)	No	No
Ratio of per capita GDP of richest to poorest in area (2004)	4.8	16.9	4.2	7.7

Source: *Jian et al (2007)*: CAEMC refers to Central Africa Economic Area. WAEMU refers to West Africa Economic and Monetary Union. CMA refers to Common Monetary Area.

### 6.1. Advantages and Disadvantages of joining the CMA

According to Guillaume et al (1999) South Africa pays the other union members for the loss of fiscal space, the implicit protection for South Africa industry, the price increasing effect of the customs and the industrial protection of the tariff. In 1969 this agreement allowed for a compensation of 42% of the respective share of customs revenue. A revision of the agreement that was done in 1977 allowed for the inclusion of a stabilization factor to counteract variations in payment. Other attendant benefits include;

- Elimination of transaction costs;
- Improved allocation of common market capital;
- Intensified cross-border competitive pressures;
- Higher efficiency of corporate ownership; and
- Increased output as a result of reduced and converged inflation rates.

According to Jian-Ye Wang et al (2007) countries in the CMA have benefited through the facilitation of cross border trade, common monetary policy, capital mobility and the general price stability and the positive spill over of the South African Reserve Bank's monetary policy credibility.

South Africa, apart from the fact that it is the largest economy in the region, has managed to dominate SACU and CMA given its high levels of financial intermediation. The country has one of the most sophisticated financial systems in the third world that is only comparable to a number of developed countries. Its industrial structure also gives it comparative advantage over its neighbours, who at most have nascent industries that are predominantly primary in nature. Although the other countries have benefited in terms of having stable currencies, inflation rates and interest rates, this does not however, guarantee immunity from any external shocks that may affect the South African economy. The rand has been volatile for the past decade, however, its negative effects have been cushioned by the fact that South Africa is the major trading partner for these countries.

South Africa has also enjoyed comparatively high levels of efficiency in almost all its economic sectors giving it the much needed leverage in attracting foreign capital as well as foreign labour. For example almost all the banks in Lesotho are branches of South African banks. Swaziland had meaningful gains in private investment during the times when South Africa was highly unstable due to apartheid, since then South Africa has recovered its lost investment leverage. According to Lambertus Van Zyl (2003), it would be difficult for a country that does not share the same history with the union members to join it.

The CMA also remains susceptible to volatility in world demand for commodities, especially the labour intensive manufacturing and agricultural products. However, within their union, the nature or composition of their exports has often led to asymmetric shocks.

Within this context, it would also be proper to look at the SADC initiatives on regional integration and the issue of common currency. SADC is probably the broadest regional grouping in Africa south of the Sahara, but not the deepest in Africa in terms of economic integration. SADC has set upon itself a time-table towards the achievement of full regional integration. The SADC regional Indicative Strategic Development Plan adopted in 2003 envisages an;

- o Operational free trade area by 2008
- o Customs union in 2010
- o Common market 2015
- o Monetary union 2016
- o Single currency 2018

These steps can only happen if countries' macroeconomic environments move towards regional macroeconomic convergence, more importantly the currency convergence. Regional currency convergence may mean convergence with the South African Rand, a basket of currencies or a neutral currency that is determined by the members, as happened in the Euro zone. Reform towards a single currency will naturally gravitate towards the use of the rand or any other currency as the common single currency. However, over the past decade the rand has been volatile against the United States Dollar and other major currencies. The volatility of the Rand and the implied macroeconomic instability may not augur well with the expectations of a regional block of 14 countries of a strong regional currency.

## **6.2. Implications for Zimbabwe joining the Common Monetary Area (CMA)**

Given the trade volumes between Zimbabwe and South Africa and the similarity in their industrial structures it would seem at face value, a wise idea for Zimbabwe to join the CMA. However, there are still a lot of issues that need to be investigated. Pre-conditions for entering such a union are normally, the need for the candidate country to have a well developed financial system, strong institutions and less structural problems. If Zimbabwe has to join the CMA, it has to align its 'currency', interest rates, inflation, gold and exchange control to the union's, particularly to that of South Africa which is the dominant partner. The country's entry would allow it to access the much needed capital from South African institutions. Also, the entry into this union will allow the country to have some payment and share of seignorage from the union and remain with its right to make monetary policy, although it has to be considered within the framework of the union.

In joining the CMA Zimbabwe seeks to borrow policy credibility from the anchor country South Africa. However, there is a danger for Zimbabwe to tie its policies and future development on the developments in South Africa especially where the two countries' developments needs are not synchronised. Zimbabwe and South Africa are both members of SADC, which seeks to establish a single currency in 2018. In this regard it may pay more dividends for Zimbabwe to continue with the multi-currency system, stabilise and grow the economy in preparation to negotiate for the single currency within SADC as a strong economy.

The debate of whether Zimbabwe should join the CMA should also be considered within the context the country's membership in COMESA and the proposed harmonisation of SADC, COMESA and the EAC. The current membership of Zimbabwe in the COMESA Custom Union and the proposed SADC Customs Union in 2010 will certainly affect the balance of trade between Zimbabwe and members of SACU and consequently the revenue distribution should it decide to join the SACU. Revenue distribution is calculated on the basis of the country's share in the inter-regional trade in imports, which means the entry of Zimbabwe in SACU will definitely alter these ratios. The other important consideration is that Zimbabwe has a different position with regard to Economic Partnership Agreements (EPA) and that of the SACU members plus Angola and Mozambique. This will definitely have an effect on trade between Zimbabwe and specifically South Africa, which enjoys bilateral trade arrangements with Europe.

The issue of macroeconomic stability is also another very pertinent issue. Macroeconomic convergence is a very fundamental pre-condition for joining a monetary union be it within the context of SACU, COMESA and SADC. For example, SADC has set the following convergence criteria, single digit inflation, budget deficits of less than 5% of GDP, government debt of less than 60% of GDP, foreign reserves covering 3 months imports, central bank credit to government of less than 10% of tax revenue/income. Achievement of these set targets requires deeper institutional and economic reforms beyond just currency reforms.

## 7. Common Regional Currency

A common regional currency entails a single set of economic, monetary, financial and fiscal policies to influence the balance of payments of the region. Such a single set of policies can be justified only when there is a high degree of synchronization of business cycles for all prospective member countries of a currency union. According to Mundell's seminal contribution (1961), known as optimum currency area (OCA) conditions, countries experiencing common external shocks would be better suited to form a currency union because it permits the use of union-wide policies to correct any imbalances, including the adjustment of the common currency. The OCA conditions have since been elaborated, refined and updated by growing literature on the subject [Bayoumi and Mauro (1999), Eichengreen and Bayoumi (1999), International Monetary Fund (1997)]

The gains from a currency union, which are in terms of increase in efficiency, arise primarily from two sources. The first is that a common currency eliminates transaction costs usually incurred when trade and investment transactions need currency conversion. Secondly, a common currency eliminates risk from uncertainty in the movements of exchange rate between trading partners (De Grauwe 1997). One more gain is that a currency union provides a potential for reinforcing fiscal discipline and credibility of monetary policy (McKinnon 1993).

The disadvantages are obvious. They relate to the loss of two important macroeconomic adjustment tools, namely independent monetary and exchange rate policies. The member country has to abide by common monetary policy for the union as a whole and it has to relinquish its exchange rate, an instrument for protecting itself from economic shocks. The OCA literature identifies the following as key deciding factors for a currency union: openness, intra-regional trade volume, degree of product diversification, similarity in industrial structures, high correlation in economic activities, similar inflation rates, flexibility in wages and prices and factor mobility.



## 8. Conclusion

Dollarization that results from a loss of confidence in the local currency after a period of poor macroeconomic management and economic instability is usually very persistent. While most highly dollarized economies have chosen not to pursue policies to promote de-dollarization and others have fully dollarized, some countries have attempted to de-link from the dollar in an effort to firm up monetary policy and reduce balance sheet vulnerabilities. Countries that have tried to force de-dollarization have experienced adverse macroeconomic effects; in some cases they have had to reverse policies several years later when there was no sustained fall in dollarization. Those countries that have experienced sustained de-dollarization with no significant economic costs have pursued a market-based approach that combines an extended period of economic stability with micro measures to encourage economic agents to hold the local currency both for transaction purposes and as a store of value.

Cross-country experience with de-dollarization offers some lessons for Zimbabwe should the authorities consider policies to de-dollarize. Zimbabwe could consider micro measures to encourage lending in local currency and the purchase of local currency assets. The legal tender status of the multiple currencies could be withdrawn if that would not weaken financial sector stability or cause capital flight. Effective communication of a policy strategy that recognizes that de-dollarization is a gradual market-driven process will increase the probability of achieving sustained de-dollarization without adverse macroeconomic consequences.

To revive the discredited local currency without the revival of the financial sector will be a non-starter since people no longer have confidence in the financial system. In addition, the revival of the Zimbabwe dollar will ignite the temptation of printing money, which is inflationary. Lessons from other country experiences show that successful revival of local currency requires central bank's total independency and free from political interference. Germany, after experiencing a hyperinflation environment, went on to establish an independent central bank, the Bundesbank, which gained international reputation through its fight against inflation. Policy should also be developed towards developing capital markets in domestic currency or in indexed units in such a way that dollarization can be reduced at a time when sound monetary and fiscal policies gain credibility.

Israel's experience (which is similar to the Chilean case) suggests, even if there is no direct policy initiative aimed at de-dollarizing the financial system, when sound fundamentals are in place the authorities can play an active role in developing a market in domestic nominal assets such as government bonds, and in lengthening the maturity of these assets over time. Israel's experience is also useful in illustrating how banking supervision enacted various measures aimed at ensuring proper coverage of banks' foreign-currency positions and at developing various domestic financial derivative instruments.

The financial sector is a key component of the economy in terms of mobilizing savings for investment. The critical factors that will enhance financial intermediation and create normalcy in the banking sector need to be explored in tandem with the currency reform debate. Any economic turn around is premised among other factors on the ability of financial institutions to mobilize resources that will be channeled to productive activities. The Zimbabwe Stock Exchange for example, plays

an integral part in mobilizing equity finance that is critical for the development of the economy. The ZSE resumed trading on 19 February 2009 following the adoption of multiple-currency regime having stopped trading in 2008 due to the extremely high volatility in Zimbabwe dollar share prices.

Last but not least, currency reforms should not be viewed as a substitute for deeper institutional reforms that are needed to improve economic performance in Zimbabwe. Without credible and holistic economic and institutional reforms backed by strong political will at both the design and implementation levels, it is unlikely that the economic recovery, transformation and growth agenda will be achieved in the near future.

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	Date of adoption	Reason for dollarization	Reasons for the success/failure of de-dollarisation
Argentina	1991 – 2002	<ul style="list-style-type: none"> <li>Type of dollarisation – de facto (exchange rate fixed to \$).</li> <li>Dollarisation was adopted amid a full-scale macroeconomic crisis.</li> </ul>	<ul style="list-style-type: none"> <li>An initial boom across the board was followed by serious deterioration in certain areas in 1999 – 2000.</li> <li>Agricultural exports, particularly wheat and meat clearly declined over the period.</li> <li>Manufacturing growth actually turned negative in 1999</li> <li>Mining, including petroleum, by contrast performed better until 1998.</li> <li>The stagnation of the Argentine economy took place in 1998</li> <li>Areas of the economy that are raw materials exporters (i.e agriculture and metals) seem to be hurt by dollarisation while sectors that depend on imported inputs, Argentine's growing mineral exports (natural gas and petroleum) and the intermediate goods sectors, experience neutral or beneficial effects.</li> <li>Dollarisation became unsustainable economically and politically – unemployment crept steadily upwards from 7.4% in 1990 to 12.9% between 1992 and 1998 and 15.6% in 1999-2001 periods.</li> <li>Although basic services seem to have improved after the privatisations, income distribution steadily worsened, and poverty and incidence worsened.</li> </ul>
Cambodia		<ul style="list-style-type: none"> <li>Lack of confidence in the local currency (riel) due to an underdeveloped monetary system, political and economic uncertainty, and weak legal and institutional structures resulted in dollarisation of the economy.</li> </ul>	<ul style="list-style-type: none"> <li>In Cambodia the economic and social achievements after a decade of trying de-dollarisation was impressive.</li> <li>GDP growth averaged close to 10% and poverty incidence fell by about 1% per year (from 47% to 35%, for the decade up to 2004), even though inequality worsened (World Bank 2007).</li> <li>Inflation fell sharply from an average of 56% over 1990–1998 to an average 3.5% over 1998–2007.</li> <li>stock of FDI increased from \$38 million in 1990 to \$1.6 billion in 2000, to about \$3.5 billion in 2007. The annual inflow in 2007 of \$820 million is more than five times the average annual inflow for 1990–2000.</li> <li>Trade has flourished, with the export share in GDP rising from around 30% in 1998 to about 70% in 2008. Its trade openness index is currently around 120%.</li> <li>Even on the financial side, there has been rapid growth in monetization and increased financial intermediation, but both have contributed to the increase in dollarisation.</li> </ul>

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Chile		<ul style="list-style-type: none"> <li>Hyperinflationary environment.</li> </ul>	<ul style="list-style-type: none"> <li>Chile has a well developed and stable financial system supported by a stable monetary policy which date back to the 1970s.</li> <li>The success of the Chilean economy can be attributed to the credibility of its macroeconomic policy which allows a much more stable floating exchange rate regime.</li> <li>Chile also implemented policies to promote a gradual, market-driven de-dollarisation as part of a broad economic stabilization program. Rather, de-dollarisation was a consequence of policies aimed at lowering inflation and deepening financial markets.</li> <li>Markets for local-currency-denominated bonds were created, and differential remuneration rates on reserve requirements on foreign currency deposits introduced a wedge in bank intermediation spreads.</li> <li>These measures were coupled with active bank supervision to ensure that banks had fully covered their foreign currency positions.</li> <li>At the same time, to hedge against exchange rate risk foreign currency loans were largely directed to sectors that earned foreign exchange.</li> <li>Chile also used indexation successfully to promote the use of the local currency to hedge against inflation and exchange rate uncertainty.</li> <li>By 2007, the ratio of foreign currency deposits to broad money in Chile, was 5.7%.</li> </ul>
Colombia		<ul style="list-style-type: none"> <li>Increases in dollarisation are attributed to episodes of macroeconomic or political instability.</li> </ul>	<ul style="list-style-type: none"> <li>Colombia was another country where CPI indexed financial instruments gained great importance.</li> <li>Fluctuations in the real exchange rate led to liquidity effects at the financial intermediary level forced the Central Bank to provide liquidity frequently in a way altering the conduct of monetary policy.</li> <li>Lack of long-term demand for CPI-indexed financial instruments, as well as low credibility associated with frequent changes in the indexation rule severely limited the behaviour of financial indexation in Colombia.</li> </ul>
Ecuador	September 2000	<ul style="list-style-type: none"> <li>Type of dollarisation – de jure</li> <li>Dollarisation was adopted amid a full-scale macroeconomic crisis. From the 1980s growth rates of the economy declined reflecting a series of shocks, such as fluctuations in world oil prices, natural disasters and a weak macroeconomic management and political instability.</li> </ul>	<ul style="list-style-type: none"> <li>Dollarisation of bank liabilities was followed by dollarisation of bank assets. At the end of 2009, US dollar denominated loans accounted for almost two-thirds of total lending. Thus, when the sucre came under pressure in 1998/99, banks' balance sheets weakened substantially.</li> <li>After adopting the US dollar, annual inflation began to converge to US levels, declining from 52.2% in 1999 to 12.5% in 2002. However, this decline was not immediate. Rather, initially inflation increased further in the course of 2000, partly reflecting the pass-through of the steep depreciation in 1999 and some price liberalisation. As a result, Ecuador experienced a strong real exchange rate appreciation</li> </ul>

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		<ul style="list-style-type: none"> <li>• From 1982 to 1999 inflation rate was over 20% and the local currency (sucres) lost value against the US dollar.</li> <li>• While budget deficits were modest, the current account showed persistent negative balances and the external debt rose to about 95% of GDP</li> <li>• At the end of 1999 the sucre again came under heavy pressure in the exchange rate market, depreciating from about 1 1000 sucres per US dollar to 24825 sucres per US dollar and political instability ensued.</li> <li>• Ecuadorian authorities ultimately decided to adopt the US dollar as the domestic currency at the fixed conversion rate of 25000 sucres per US dollar.</li> <li>• The percentage of US dollar-denominated deposits in total deposits rose rapidly from 13.3% in 1990 to 53.7% in 1999 (Berkerman, 2001).</li> </ul>	<p>accompanied by a severe deterioration in the current account. The 2000 surplus of 6.6% of GDP was turned into a deficit of 6.6% of GDP in 2002.</p> <ul style="list-style-type: none"> <li>• Fiscal developments were positive, mainly owing to the effect of higher oil prices as well as to stronger non-oil revenues associated with higher growth and fiscal reforms.</li> <li>• With the move to dollarisation, liquidity pressure on the banking sector abated. Domestic interest rates declined, but did not converge to US levels. In particular, lending rates remained higher than those prevailing in the US.</li> <li>• On the international capital market, Ecuadorian bond spreads dropped substantially in the aftermath of dollarisation. In mid-2002, spreads were affected by the Brazilian induced turmoil.</li> <li>• For Ecuador, factor mobility increased significantly a few years after the adoption of the US dollar as legal tender. Close to 500 000 Ecuadorians are said to have left the country since 1998, mainly for Spain and the US (Solimano, 2003). In total, around 1 200 000 Ecuadorians are living abroad, i.e. 10% of the total resident population.</li> <li>• In line with these developments, remittances rose from about USD 200 million in 1995 to an estimated USD 1.36 billion in 2000 (approximately 10% of GDP).</li> <li>• Dollarisation initially restored economic confidence, as it led to \$200 billion in IMF loans and new agreements with creditors.</li> <li>• It was also accompanied by the rise in oil prices.</li> <li>• However, the economy has since returned to its previous problematic state.</li> </ul>

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<b>El Salvador</b>	<b>December 2000</b>	<ul style="list-style-type: none"> <li>Type of dollarisation – de jure, colonies still acceptable @ 8.7/US\$</li> <li>The introduction of official dollarisation was mainly motivated by the authorities' aim to reduce domestic interest rates, exchange rate risk and transaction costs (IMF, 2003).</li> </ul>	<ul style="list-style-type: none"> <li>Post-dollarisation stability gains have been modest.</li> <li>Interest rates not only declined but also started to follow rather closely the trend set by the US federal funds rate.</li> <li>Remittances rose to close to USD 2 billion (about 15% of GDP).</li> </ul>
<b>Israel</b>		<ul style="list-style-type: none"> <li>Dollarisation was a consequence of policies aimed at lowering inflation and deepening financial markets.</li> </ul>	<ul style="list-style-type: none"> <li>Stabilization efforts were complemented by relatively active policy of changing the composition of public sector deficit finance toward nominal, local currency assets, lengthening the maturity of domestic nominal assets, and the introduction of foreign exchange rate risk hedging instruments such as futures, options and swaps.</li> <li>Israel used indexation successfully to promote the use of the local currency to hedge against inflation and exchange rate uncertainty.</li> <li>De-dollarisation is evidenced by the rise in the share of local-currency denominated bank deposits in total deposits, from 3% in 1984, the year of highest inflation, to 38% currently.</li> </ul>
<b>Kosovo</b>	<b>1999 2002</b>	<ul style="list-style-type: none"> <li>The economies of Kosovo and Montenegro were an integrated part of first the former Yugoslavia (until 1992) and then the Federal Republic of Yugoslavia (until 1999).</li> <li>In the 1960s and 1970s, the country saw growth and comparatively high living standards.</li> <li>At the end of the 1980s, however, economic and political strains increased, culminating in the first episode of hyperinflation. This was followed by a decade of steep economic decline with GDP falling by more than 50%.</li> </ul>	<ul style="list-style-type: none"> <li>In 1999 when Kosovo and Montenegro opted for euroisation, annual inflation stood at 42% (IMF, 2001).</li> <li>Remittances contribute about 25-30% of GDP (World Bank, 2003).</li> <li>Euroisation in Kosovo and Montenegro followed two decades of extreme monetary instability accompanied by a high degree of unofficial euroism, as the Deutsche Mark was widely used as a store of value and as a medium of exchange.</li> <li>Indeed, inflation rates declined rapidly to 10% and 3.6% in 2000 and 2002 respectively.</li> <li>In 2001/2002 the economy experienced strong growth, based on foreign aid, private remittances and a vibrant private service sector largely operating in the informal economy.</li> <li>Kosovo has an open economy, with openness ratio of about 75%.</li> <li>Trade balance had been recording a deficit of 50% of GDP.</li> </ul>

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Liberia	<p>1944 -2000 - US dollar, Liberian dollar notes and coins</p> <p>2001 -present - US dollar, Liberian dollar notes and coins</p>	<ul style="list-style-type: none"> <li>Moreover, in December 1993 and January 1994 the newly established Federal Republic of Yugoslavia faced on of the most extreme phases of hyperinflation in economic history. Once again subsequent reforms proved to be short-lived.</li> </ul>	<ul style="list-style-type: none"> <li>In the 1960s and early 1970s, the country saw a continued increase in living standards, with GDP growth rates averaging 6% and 4% respectively. However, the income distribution remained highly skewed owing to the existence of a huge subsistence agricultural sector, accounting for most of the employment (80% of the labour force).</li> <li>Available evidence for Liberia supports the proposition that dollarisation favours a low inflation environment. From 1966 – 1989 inflation remained subdued and followed similar patterns as in United States (i.e. single digit inflation for the majority of the years). Whereas Liberia managed to keep inflation low, neighbouring Sierra Leone and Ghana experienced periods with inflation reaching more than 100% per year.</li> <li>The post-1974 period was characterised by rising budget deficits as the government tried to stimulate the economy by launching large public investment programmes. Moreover, the newly created National Bank of Liberia was heavily involved in financing government expenditure. The balance of the consolidated central government budget turned from a surplus of USD6.8 million in 1974 to a deficit of about USD140 million in 1979, approximately 13% of GDP. Fiscal discipline eroded before dollarisation finally came to an end.</li> <li>In 1988 Liberia's fiscal deficit had increased to almost 19% of GDP. The balance of payments had worsened as well, while the level of outstanding debt had reached 170% of GDP. Local and foreign depositors transferred convertible deposits abroad, contributing to a dramatic fall in US dollar liquidity.</li> <li>In the 1960s Liberia's trade-to-GDP ratio rose from about 70% to more than 100%, making Liberia one of the most open economies of the world.</li> <li>In 1989 the Liberian dollar was introduced at a 1:1 parity. The official parity of the Liberian dollar to the US dollar was formally abandoned.</li> </ul>



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<b>Montenegro</b>	November 1999 2001 2002	<ul style="list-style-type: none"> <li>Refer to Kosovo</li> </ul>	<ul style="list-style-type: none"> <li>Montenegro's growth performance followed closely that of the former Yugoslavia.</li> <li>Inflation rates declined to 36.1% in 2000 and further declined to 16.8% in 2002. During the same period, the Euro area experienced single digit inflation of around 2%.</li> <li>While Montenegro had been facing substantial inflation differentials, in Kosovo they had come close to euro area levels.</li> <li>In 2001/2002 Montenegro's growth had been modest as the transition to a market economy has been more gradual.</li> <li>Foreign aid, though still significant, has not been as sizeable as in the case of Kosovo.</li> <li>Factor mobility is high with quite a sizeable number of Montenegrins working abroad, mainly in the European Union and Switzerland.</li> <li>Foreign aid represented about 7.5% of GDP in 2002, down for 14% in 2001.</li> <li>The economy is highly open, with openness ratio of about 100%.</li> <li>Trade balance had been recording a deficit of 35% of GDP.</li> </ul>
<b>Uruguay</b>		<ul style="list-style-type: none"> <li>Dollarisation of assets started as a result of the lack of peso denominated financial alternatives in a chronic inflation country. The process of inflation that started in the 50's deteriorated the confidence of the population in the national currency.</li> <li>At the same time, interest rate ceilings and the lack of inflation indexed assets forced savings out of national currency and into dollar denominated assets.</li> </ul>	<ul style="list-style-type: none"> <li>In 1969 the government created a wage indexed unit of account, in what constituted the first attempt to compete against the dollar.</li> <li>Stock of the wage indexed unit of account investment grew steadily until it reached 1,6% of GDP in 1979.</li> <li>Then the Public Mortgage Bank, urged by cash-flow problems, defaulted on the adjustment mechanism of long term wage indexed papers.</li> <li>The CPI instruments of Public Mortgage Bank used monthly indexation (instead of daily) and the papers had little liquidity. Then, the papers were lagged two months on inflation.</li> <li>This default killed the market, and the public reliance on the Public Mortgage Bank.</li> </ul>

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<b>Panama</b>	<b>1904</b>	<ul style="list-style-type: none"> <li>• The introduction of the US dollar as the domestic currency followed the country's secession from Colombia in 1903, which was backed by the United States.</li> <li>• Type of dollarisation – de jure.</li> <li>• Panama has a domestic currency, the balboa (1 balboa = US\$1), but it circulates only as coins.</li> </ul>	<ul style="list-style-type: none"> <li>• Panama's economic performance has been better than average for Latin America (Schuler, 1999). Year on year inflation averaged 3.5% from 1971 to 1997, which was lower than in any other Latin American country and the United States.</li> <li>• Per capita growth averaged 1.7% in the same period.</li> <li>• Since the 1970s, the financial sector has constituted Panama's economic development. The capital account is entirely open, and banks have been free to invest excess funds in Panama or abroad.</li> <li>• Until the mid-1980s, gross foreign assets increased from basically zero to more than USD 25 billion.</li> <li>• In 2001 the banking sector, including a well-developed offshore centre, accounts for approximately 14% of Panama's output.</li> <li>• Fiscal policy has been expansionary, largely financed by extensive foreign borrowing. Thus, the external debt/GDP ratio has been close to 100%.</li> <li>• Migration from Panama to the United States have been limited i.e. between 100 000 and 200 000.</li> <li>• Remittances are said to reach between USD20 and 170 million and are not a major source of financing for the country's imports.</li> <li>• Panama's openness ratio stands at around 75%, with roughly 35% of trade with the anchor country -USA</li> </ul>



