

Dollarization in zimbabwe essay sample



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The small African nation of Zimbabwe gained independence in 1980, and it was in the same year that the Zimbabwean dollar replaced the Rhodesian dollar at par rate as the official state currency. In its younger years Zimbabwe was seen by many as a contender to give South Africa a tough fight for the top spot in Africa for economic supremacy. No one could have predicted what was to follow. Zimbabwe entered the 21st century on the verge of being labeled a failed state. A title it was about to receive courtesy of an economic slump rarely seen in the Sub-Saharan African continent.

Hyperinflation had a firm grip on the nation's economy within the early years of the new Millennium such that inflation was at 24000%. The 100 trillion dollar notes were being used as toilet paper and crowds swept the nation holding signs that said "broke billionaire, help! ". Hyperinflation is a phenomena in which the domestic currency of a state becomes so much devalued that it barely has any value left, in other words hyperinflation results due to the excess supply of domestic currency in the national money market.

This results in an imbalance of demand and supply of money which eventually leads to inflation spiraling out of control. There have been around 29 such cases of hyperinflation in recent memory. Hyperinflation is primarily a monetary phenomenon that has been tackled by various governments with different strategies. Zimbabwe turned to the dollarization of its economy to counter this economic disease. The focus of this paper will be to analyze the underlying causes which lead to Zimbabwe dollarizing, and the subsequent effectiveness of this strategy. Cause of Hyperinflation and eventual Dollarization. Long economists for a decade.

Though there are a few areas on which experts disagree, there also exist reasonably well established reasoning for the economic downfall of the small African nation. A frequently cited reason is the extravagant and many will argue non feasible agricultural policy put in place by the government in 2000. The brain behind the implementation of this policy was the then president Robert Mugabe. Mugabe saw that over 80% of Zimbabwean land was owned by the white minority. In Mugabe's eyes this undermined the native population as they were being deprived of economic opportunities .

Seeking to amend this trend Mugabe drove off well experience farmers from their land and replaced them with a work force that lacked the expertise and equipment to make a value contribution to the agricultural sector. Zimbabwe had always been a agrarian economy with 40% of foreign exchange revenue depending on farm produce. This sudden change cause a massive shortage in agricultural produce, which in turn caused exports to nose dive resulting in a huge BOP deficit and eventual budget deficit. Output dropped to levels which were unprecedented, and Zimbabwe became an imported of food.

This ruthless attitude towards the white minority lead a large decrease in tourism which was another high contributor of Zimbabwe's foreign currency reserve. The blatant disregard for property rights caused a reduce in foreign investment and aid due lack of confidence in the economy. This contracted the supply side of the economy which further fuelled inflation. For the first time, in 2001 , the inflation rate was over 100%. Another direct result of the fall in output of agricultural produce was an increase in nemployment rate, which rose to an astounding 80%.

This high level of unemployment choked household income growth and aggregate demand had fallen drastically. Individuals could no longer save and so investment had dried up. To compound these problems the reserve bank of Zimbabwe was initial policy, which meant the state would then have to rely on imported food, which in turn, squeezes importers of raw materials who cannot get access to foreign exchange. So not only has the agricultural capacity been destroyed, what manufacturing capacity the economy had is being barely utilised.

As a consequence GDP growth started to contract at 8% per year and the economies potential capacity started to erode. In light of all this the government's next move would shock the world. It increased spending and relied heavily on quantitative easing. The injection of more money in an already overwhelmed economy, devalued the currency even more and prices rose, setting the country on an almost certain path towards inflation and ultimately hyperinflation. The blunder that was the "land reforms" undertaken by Mugabe's government can also be analysed graphically through Fig.

A. As seen, the growth and fluctuation of national GDP is no different than that of any other progressive country until the year 2000 with the exception of 1993 when the country was hit by a severe drought. The dip in the early 2000 and the resulting downward trend is a direct result of the land reforms put in place by Mugabe's government. There were however events preceding the implementation of the devastating agricultural policy that contributed towards the downfall of the Zimbabwean dollar and eventual dollarization of the state.

Again it was a decision made by the Mugabe administration that would turn out to be a vital blow to the economic prosperity of Zimbabwe. Mugabe lead his country into the second Congo war in 1998. From the outset a vast number of Zimbabwean ministers were against entering the war. At this point in time Zimbabwe was already at 30% inflation and could not afford to enter a costly enterprise such as a war. The government had not raised enough taxes to take such a risky move and also lacked the budget.

The Congo overnment refused to pay for Zimbabwe's involvement in its civil war and what an added deficit to an already lacklustre economy. In order to fund its war efforts the government printed more of its own currency which further devalued it. Inflation rose and so did prices. Due to the increase in inflation unemployment soared and GDP fell at increasing rate. The two events mentioned above had the largest hand to play in the decline of Zimbabwe's economic performance.