Bond Notes: The creation of a two-tier economy under the multi-currency system in Zimbabwe

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16 May 2016

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Abstract

The introduction of bond notes by the Reserve Bank of Zimbabwe will result in the creation of a two tier economy under the multicurrency system in Zimbabwe; an economy for the rich characterized by the use of the United States Dollar, and an economy for the poor characterized by the use of the bond notes. Initially bond notes will be easily exchangeable for United States Dollars, however with time foreign currency will become difficult to access and a black market will emerge. The levels of poverty and inequality in Zimbabwean society will increase.

Key words: bond notes, multicurrency system, dollarization, Zimbabwe

1. Introduction

The Reserve Bank of Zimbabwe announced plans to introduce bond notes in Zimbabwe on 4 May 2016 [1]. The bond notes were to be backed by a USD $200 million facility from the Africa Export-Import Bank (Afreximbank) and set to be at par with the United States Dollar [1]. The introduction of the bond notes by the Reserve Bank of Zimbabwe was in response to cash shortages in the Zimbabwean economy which started at the end of January 2016 [2]. As a response to the crisis of ‘cash shortages’ which had arisen in the country, the Governor of the Reserve Bank of Zimbabwe announced at a press conference measures to deal with cash shortages and to simultaneously attempt to stimulate the slowing economy of Zimbabwe using export incentives.

2. Background: Causes of Zimbabwe’s economic problems during the multicurrency regime.

The economy of Zimbabwe went through a boom period following the introduction of a multicurrency system on 29 January 2009 [3]. Business confidence in the operating environment in the country remained persistently positive from one quarter to the next for three and a half years until the last quarter of 2012 [3]. At the end of 2012 revenue growth of major companies within the Zimbabwean economy started to stagnate, and in the subsequent quarters revenues declined as a result of falling demand [3]. The causes of the slowing economy of Zimbabwe post introduction of the multicurrency system can be attributed to two main factors; namely corporate mismanagement and government policymaking.

2.1 Corporate Mismanagement

The majority of Zimbabwean companies were spectacularly mismanaged with the advent of the multicurrency system. Zimbabwe’s economy stabilized with the introduction of the multicurrency system in January 2009; hyperinflation, foreign currency shortages and commodity shortages which had plagued businesses since 2000 became a thing of the past [4]. Consumer incomes rose in real terms as both public and private sector remuneration changed to United States Dollars [4]. However a large number of companies in Zimbabwe struggled to achieve high capacity utilization and as a result most products were imported from South Africa [5]. Prior to the economic troubles Zimbabwe faced which began in 2000, the country had a strong manufacturing base and was self-sufficient in supplying the local market with basic goods such as foodstuffs, toiletries, clothing and footwear [5]. The failure to restart Zimbabwe’s manufacturing base upon stabilization of the economy can be directly attributed to corporate mismanagement.

The fundamental form of corporate mismanagement which faced Zimbabwean companies was a failure by management of a number of Zimbabwean companies to formulate a long-term vision and strategy for their companies. Faced with a completely different operating environment in which it was much easier to do business, management of a number of Zimbabwean manufacturing entities simply converted their entities into distributors of South African made products in order to make quick profits. This phenomenon may be attributable to two factors, firstly the mediocre quality of management which remained in Zimbabwean companies when the economy collapsed and highly skilled and experienced personnel emigrated, and secondly a culture of short-term decision making which emanated from the hyperinflationary era. Some large Zimbabwean manufacturing entities which were cornerstones of the economy's manufacturing base were suddenly led by executives who had no experience running companies competitively within a stable operating environment. These executives were mostly personnel who joined the ranks of the companies post 2000, often in middle management roles, and had rose to the top of their respective companies as experienced staff left the country as a result of deteriorating economic conditions. A psyche of short term decision making prevailed as a result of experiences during the hyperinflation era, and as a result such management had neither long term vision nor strategy to postulate the future of their companies in five to ten years' time.

As a result of management's failure to strategize for the long term, a multitude of opportunities for positioning Zimbabwean companies for sustainable growth were wasted. Quick profits made at the advent of dollarization were used to pay excessive remuneration to company executives. Loans sourced for recapitalization of manufacturing entities were used to buy luxury cars and houses for company executives and directors. Numerous cases of excessive remuneration and/or financial improprieties were reported in various private and state owned corporations [6]. The effects of mismanagement became increasingly evident in 2013 as companies faced cash flow problems; companies failed to remunerate staff on time, failed to service loans and there were a large number of company failures leading to increased unemployment [7]. This scenario continued right through 2014, and in July 2015 an even greater number of workers lost their jobs as a result of a precedent set by the Supreme Court of Zimbabwe which ruled that companies could lawfully terminate contracts of employees at any time without offering them packages provided employees were given at least three months' notice[8] . The economy of Zimbabwe was set in a death spiral characterized by falling demand which led to more company failures, further unemployment and further falling demand. The number of company failures accelerated excessively in the last two quarters of 2015, possibly as a direct result of massive job losses as a result of the June 2015 Supreme Court of Zimbabwe ruling.

The death of the formal sector in Zimbabwe resulted in the emergence of a large informal economy which sourced manufactured products from outside the country, mainly from South Africa, for resale at a mark-up in Zimbabwe. The many poor in Zimbabwe ceased buying groceries at supermarkets and started buying groceries from tuckshops and street vendors who individually purchased their stock from South Africa. The tuckshops and street vendors would sell the exact same product for much less because they did not pay tax and had no overhead costs, and furthermore goods were often smuggled into the country to avoid paying customs duties and tariffs. Tuckshops and street vendors do not bank a day's earnings as formal businesses do - contrary to the belief that 'cash shortages' in Zimbabwe were caused by a few small Asian owned shops and businesses, cash shortages within the formal economy in Zimbabwe were caused by the increased informal nature of the economy.

2.2 Government Policymaking

The most beneficial policy announced by the Government of Zimbabwe for the country's economy since 2000 was the introduction of the multicurrency system in January 2009 and the abandonment of the Zimbabwe Dollar. For the first time in a decade Zimbabwe experienced real economic growth in 2009 (5). Business and investor confidence remained high up to the end of 2012. However following the July 2013 elections, the newly re-elected Zimbabwe African National Union Patriotic Front (ZANU-PF) led Government of Zimbabwe eroded business and investor confidence in one key policy area namely, the indigenization policy.

The indigenization policy was introduced by the Government of Zimbabwe to empower previously disadvantaged black indigenous population of Zimbabwe by reserving at least 50% ownership of companies operating in Zimbabwe for black indigenous Zimbabweans. Although the intents of the indigenization policy to empower the majority black Zimbabweans were noble, continuously shifting positions on policy implementations created massive uncertainty within the business and investor community [9]. There were numerous pronouncements on how the indigenization policy was to be implemented, most of which shifted within six months of their announcement; or were completely done away with when a new cabinet minister for the government ministry in charge of indigenization was appointed.

The uncertainty created by inconsistent pronouncements on how the indigenization policy was to be implemented cannot be understated. Companies operating within the country whose type of business required large capital expenditure, for example in mining or manufacturing, could not plan investments in the face of uncertainty on how the indigenization policy was to be implemented. Furthermore foreign based entities that were planning to set up operations in Zimbabwe as foreign direct investment had to halt any intended investments until there was certainty on how the indigenization policy was to be implemented. The uncertainty regarding the manner in which the indigenization policy was to be implemented not only halted new capital investments, but it led to capital flight because of the increasing country risk profile of Zimbabwe in the historic context of the chaotic indigenization of land – the Land Reform and Redistribution Programme – which was implemented by the Government of Zimbabwe from 2000 [5]. A halting of new investments and capital flight only contributed to increased unemployment and falling demand, feeding the death spiral of the formal sector and increasing the informal nature of the economy.

3. Hypothesis: Introduction of Bond Notes under the multicurrency system will result in the creation of a two-tier economy in Zimbabwe

The introduction of bond notes by the Reserve Bank of Zimbabwe will result in the creation of a two-tier economy in Zimbabwe; an economy for the rich characterized by the use of the United States Dollar, and an economy for the poor characterized by the use of bond notes. A small section of Zimbabwean society, namely the political and business elite, and employees of non-governmental organizations, will retain access to the United States Dollar. The majority of Zimbabwean society which is directly or indirectly dependent on civil servant salaries or funding from the state will only have access bond notes from the Reserve Bank of Zimbabwe.

Initially bond notes will be easily exchangeable for United States Dollars, however with time United States Dollars will become difficult to access. The poor will inevitably need to make purchases of imported goods such as consumer products from South Africa for resell in the informal sector or second hand motor vehicles from Japan, using United States Dollars. A black market for exchanging United States Dollars for bond notes will emerge as a result.

The economy for the rich characterized by the use of the United States Dollar will thrive at the expense of the economy of the poor characterized by the use of bond notes. Real wages paid to employees will decline whilst those with access to the United States Dollar will fully exploit the black market for profit. The levels of poverty and inequality in Zimbabwean society will increase.

The sectors of the Zimbabwean economy where bond notes will come into full use, were almost all transactions will be in bond notes, will be those sectors were the Government of Zimbabwe exercises direct control such as state owned enterprises, state aided institutions and municipalities, as well as those sectors dependent on the mass market such as the informal sector, low income retailers and local transport. In essence payments for services such as water, electricity, public healthcare, public education and local transport will largely take effect in bond notes. In addition transactions within low income retailers such as supermarkets and other retail outlets located in the poorer districts of cities and in the countryside, as well as transactions within the informal sector - will take place using bond notes. The price of petrol, diesel and liquid petroleum gas may be payable in bond notes but at ever fluctuating prices dependent on the black market rate of United States Dollars.

The sectors of the Zimbabwean economy which will resist the use of bond notes and continue demanding payments in United States Dollars will be those sectors were the Government of Zimbabwe has difficulty exercising influence over. These sectors will be those dominated by private sector entities and whose products and services may be considered luxuries, for example electronic goods, imported furniture, new and used motor vehicles, upmarket supermarkets and other retail outlets and entertainment.

The use of bond notes may however revive local manufacturing. Much lower real wages, electricity tariffs, municipality tariffs and government taxes payable in bond notes may result in much lower costs of production. Lower costs of production, coupled with unaffordability of imported products in the mass market, may become incentive for developing local manufacturing in the long term. The resuscitation of local manufacturing will only occur on two conditions; firstly the restoration of business and investor confidence by the Government of Zimbabwe, and secondly the sourcing of corporate management with the competencies to develop supply chains and processes which enable competitive local manufacturing.

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