Zimbabwe: Bond Notes a Total Disaster - Hanke

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On November 11 last year, the Zimbabwe Independent (ZI) -- the country's leading business and investigative newspaper -- interviewed world-renowned currency expert **Steve Hanke** a professor of Applied Economics and co-director of the Institute for Applied Economics, Global Health, and the Study of Business Enterprise at the Johns Hopkins University in Baltimore, United States, on the implications of Zimbabwe's decision to introduce bond notes as well as the country's poor showing on the World Bank Ease of Doing Business rankings.

Brimming with vast knowledge and experience on global currencies, Hanke warned Zimbabwe was heading for disaster due to the bond notes, which he described as the "new Zim dollar". His history speaks for itself. Hanke is a senior fellow and director of the Troubled Currencies Project at the Cato Institute in Washington, DC, a senior advisor at the Renmin University of China's International Monetary Research Institute in Beijing, a special counsellor to the Centre for Financial Stability in New York, and a contributing editor at Globe Asia magazine and at Central Banking in London.

He is also a member of the Charter Council of the Society of Economic Measurement and of Euromoney Country Risk's Experts Panel. Hanke has served as an advisor to various governments, including Albania, Kazakhstan, and Yugoslavia and played an important role in establishing new currency regimes in Argentina, Estonia, Bulgaria, Bosnia-Herzegovina, Ecuador, Lithuania, and Montenegro. He has conducted a lot of research on Zimbabwe's hyperinflation which ended in 2008 and one of his most recent books is Zimbabwe:

Hyperinflation to Growth (2008). Due to the deteriorating currency, liquidity and cash crises Zimbabwe is at the moment battling with, we decided to reproduce the interview. Find excerpts below:

World-renowned currency expert Steve Hanke

ZI: There has been a lot of debate whether or not bond notes are in fact a currency. As an expert, what is your take on this?

SH: Bonds notes are another form of currency but very low quality. They are definitely currency; anything you can use to purchase something with is a currency. Now, there are all kinds of restrictions on bond notes. For example, you can't purchase imports, which makes it a poor quality currency. It's unlike a dollar which you can use to buy anything in the world. You can go to Johannesburg (South Africa) and pay for a taxi with a dollar and the driver will accept but that won't happen with bond notes.

You know they are inferior from day one because government is in a way arguably offering a subsidy for people to take the bond notes which means the bond notes are trading at a discount to the US dollar even before they start circulating.

ZI: What is the best way to manage liquidity and cash crises for a multi-currency economy that is largely dollarised, given the demand for the US dollar?

SH: The liquidity crisis has been created by the government and the bond notes. When they started talking about the bond notes, it created a run on the banks because everyone wanted dollars because they were afraid they were not going to be able to get dollars.

The government created the liquidity crisis, the liquidity crisis is completely a function of government. The government is incompetent and has no one to run this aspect of banking.

By even talking about the bond notes, the government created a bank run.

First of all, government should have never talked about the bond notes and, secondly, they should never issue the bond notes.

When (President Robert) Mugabe signed the papers for the bond notes he signed his death warrant, this might be the end.

ZI: In your opinion, what is the likely impact of bond notes on the Zimbabwean economy?
SH: I think you know that is completely inconsistent with the notion of a dollarised economy. It has never been done in a dollarised economy, about 33 of them in the world. When I say dollarised, the economies don't necessarily use the US dollar, but they use some foreign currency rather than the local currency, for example, in Montenegro where they use the Euro and of course the dollar has been used in over a 100 years in Panama.

None of them have ever introduced a parallel currency and that is what the bond notes are -- they are an inferior currency to the dollar and you can see that by the fact that the government has to offer a subsidy to people who are using it of up to 5%.

It is a way to completely contaminate the currency system; it's like putting poison in a bloodstream of a person.

ZI: What is the likely effect of this?

SH: Zimbabwe will probably implode now, the economy is in terrible shape as everyone knows; it has been mismanaged for decades now and is a complete disaster. I think the introduction of the notes, rather than solving any problems, will lead to indiscipline and an implosion of the economy. No one understands really what they are doing and that's the problem.

It's like a doctor who has a sick patient and is just experimenting with drugs that they don't know anything about.

So you have that going on in the economy and, by the way, dollarised economies -- I studied all 33 dollarised economies do much better than comparable economies that are not dollarised. So if it wasn't for dollarisation, Zimbabwe would be in much worse shape than it is right now.

ZI: Where does Zimbabwe sit right now in the world?

SH: I have seen a lot of commentary about the World Bank doing business in Zimbabwe and I have been involved in those studies for a long time even before doing business was started. What you have is Zimbabwe, out of 190 countries in the world that are ranked, is ranked 161 overall and 183 in starting a business. It's nearly impossible to actually start a business, there is so much government regulation and red tape surrounding everything to a point you can't start a business in the formal sector, it's too costly.

ZI: In your opinion, what are the reasons for Zimbabwe's poor rankings globally?

SH: Out of a number of things, the fundamental problem is we have what I call a Marxist Mugabe, who has been leading the country for many decades. So you have a Marxist overall way on essentially everything that is going on. If you read the Communist Manifesto, you will pretty much see what the game plan for Zimbabwe is and what's going on.

Every country that's applied the Communist Manifesto has collapsed, including the Soviet Union.

ZI: What is Zimbabwe's way out of this quagmire?
SH: Going back to the doing business, the only way that Zimbabwe can really improve is, number one, they should stop the issue of bond notes immediately before it contaminates the system and cause the economy to collapse while retaining pure dollarisation and the second thing they should do is to go on a structural reform. To have structural reform, you have to throw away the Communist Manifesto and this will require a complete regime change and a different way of thinking.

ZI: Can you paint a picture of the benefits of reform by way of ditching this so-called Marxism for Zimbabwe?
SH: I have done some calculations and have some numbers on the Doing Business; if you increase right now the score for Doing Business which is 47 to 52 then the GDP (Gross Domestic Product) per capita would go up from US$1 081 to US$1 591 and then if you increase the score to 57, you move up from US$1 591 to US$2 342. The potential if you actually adopt the best practices for the 10 categories that are analysed in Doing Business and be among the best in the 190 countries that are covered you would increase your score to 97, so from 47 you go to 97 and the GDP per capita would reach up to US$51 592 eventually.

So if ever you want out of poverty and improve the standard of living in Zimbabwe, you know exactly how to do it.

You essentially have to get rid of all government policies that exist in Zimbabwe that are holding back business and if you did that you would improve your score from 47 to the best number possible and I have given you an example of GDP per capita.

ZI: What would be the impact of reforms in general to Zimbabwe's standing in the world in terms of Doing Business?
SH: That's almost exactly what I have just given you. There will be an increase in these scores going from a low score of 47 in the 10 categories which has you sitting on position 161, but the key thing is the score, not the country ranking.

Zimbabwe only accumulated 47 points and that's very low and the top country with the best practice gets 97, so if you jump from 47 where GDP per capita now is US$1 081 and increase by 10 points the income will go to US$2 342. As such, just by increasing 10 points, you would double per capita income. To do that you have to get rid of all the policies government imposes as well as regulations, taxes and so forth that are being imposed in Zimbabwe and pushing you down to 47. In other words, you have terrible economic policies, the worst in the world, almost because you are almost at the bottom.

If hypothetically you could increase your score to 97, which is like the best place, then your per capita income will jump up to US$51 592, which is a huge boom in prosperity.

ZI: How long would it take to achieve these best practices?
SM: That wouldn't happen overnight, it would take some time. You could see the benefits right at the end of the tunnel if you actually made some reforms. Let me give you some examples, Zimbabwe is ranked 183 out of 190 and has scored 49,13 in starting a business. Zimbabwe has 10 procedures to start a business and it takes 91 days while the average number of procedures in Sub-Saharan Africa is only 7,9 and it takes 27,3 days to start a business so even by Sub-Saharan African standards you are way behind.

Let me give you another example here, to get a licence from the municipality it takes 34 days, which is very long and you take about 248 days to get a construction permit and that's very long. Getting electricity takes another 65 days.

ZI: In summary what is your advice to Zimbabwe around improving its Doing Business environment?
SH: I would summarise it in this way, the common theme in Doing Business analysis is you have got to reduce the time and cost required to start a business and deal with construction and electricity; that would drastically improve your scores from 47 to 57 and GDP per capita would go up.

You have got to adopt a free market model. You have an old Marxist model that's killing the economy and has been killing it for decades and making everyone poor.

If you adopt the Communist Manifesto, it's a formula for making everyone poor.

ZI: How about your recommendations on the bond notes again in summary?
SH: The key thing on the bond notes and I told the number two of the central bank (Kupikile Mlambo) that the bond notes issue will be a complete disaster and I recommended against it.

The main thing to remember is stability might not be everything, but everything is nothing without stability. The bond notes are going to introduce enormous instability in the economy and I think you will see Zimbabwe implode into chaos; that's the formula for introducing instability in an economy.

ZI: Zimbabwe has suffered a liquidity crisis since dollarisation in 2009 and it became more pronounced after Mugabe's 2013 election victory which was a huge blow to foreign investor confidence. This cash crisis was visible by late 2015, so is it accurate to argue the bond notes caused the cash crisis?

SH: Every word that is uttered about bond notes is like adding fuel to the fire and the fire is the bank run, that's why you have the liquidity problem.