BINDURA UNIVERSITY OF SCIENCE EDUCATION

FACULTY OF COMMERCE

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DEVELOPING A FOREIGN EXCHANGE FRAMEWORK TO BRIDGE THE GAP BETWEEN FORMAL MARKET AND PARALLEL MARKET IN ZIMBABWE.

BY

B193515A

A DISSERTATION SUBMITTED IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE BACHELOR OF COMMERCE HONORS DEGREE IN BANKING AND FINANCE OF BINDURA UNIVERSITY OF SCIENCE EDUCATION. FACULTY OF COMMERCE.

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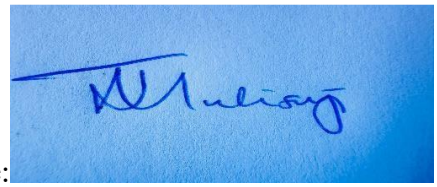
Student`s Signature:  Date 25/09/2024

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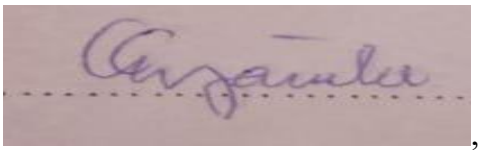
Chairperson`s Signature:  , Date 25/09/2024

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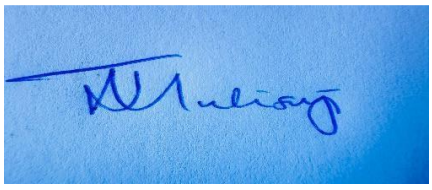
Signed 

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DEDICATION

I dedicate this work with deepest gratitude to my family, institution and friends, whose unwavering love and support have been the foundation upon which I have been able to pursue my academic dreams.

ABSTRACT

The existence of a significant gap between the official and parallel market foreign exchange (FX) rates is a challenge faced by many developing economies, including Zimbabwe. This disparity disrupts economic activity, discourages investment, and fuels inflation. Bridging this gap is crucial for fostering economic stability and growth. The research sought to address the FX rate gap in Zimbabwe is crucial for fostering economic stability, promoting inclusive growth, and enhancing overall well-being in the country. This research used a sequential explanatory mixed methods design and used a purposive sampling strategy with a sample of 96 participants. This research used a mixed methods approach, requiring both quantitative and qualitative data analysis techniques. The research found that periods of high inflation, budget deficits, currency devaluation, unsustainable government policies, and increased reliance on foreign currency for transactions. A system where the central bank intervenes strategically to curb excessive volatility, potentially creating a more stable environment for businesses and investors. Sound fiscal policies can foster confidence and attract foreign exchange inflows, leading to a stronger exchange rate. The study conclude that financial inclusion promotes economic growth and stability, potentially contributing to a more stable exchange rate. This study recommend that increase access to a wider range of financial products, including savings accounts, credit facilities, and mobile banking services, to bring more people into the formal financial system. The current study has provided valuable insights into the FX rate gap in Zimbabwe. However, further research is necessary to deepen our understanding and develop even more effective solutions. Future studies should conduct in-depth surveys to understand public perceptions of government policies and their impact on the FX gap. Conduct case studies on the effectiveness of specific policies implemented in Zimbabwe or other developing countries to address FX gaps.

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ABBREVIATIONS

FX---------- Foreign Exchange

GDP---------- Gross Domestic Product

IMF---------- International Monetary Fund

MOF---------- Ministry of Finance

PPP---------- Purchasing Power Parity

RBZ---------- Reserve Bank of Zimbabwe

SPSS---------- Statistical Package for the Social Sciences

USD---------- United States Dollar

ZWL---------- Zimbabwean Dollar

CHAPTER I

INTRODUCTION

1.0 Introduction

The existence of a significant gap between the official and parallel market foreign exchange (FX) rates is a challenge faced by many developing economies, including Zimbabwe. This disparity disrupts economic activity, discourages investment, and fuels inflation. Bridging this gap is crucial for fostering economic stability and growth. This study aims to explore potential frameworks for bridging the official-parallel market FX rate gap in Zimbabwe by examining experiences from various countries across Europe, Asia and Africa. This chapter serves to point-out the background of the study, problem statement, objectives of the study, questions to be answered at the end of the study, assumptions, limitations of the study and delimitations.

1.1 Background of the study

The issue of dual exchange rates is not unique to Zimbabwe. Several countries around the world have grappled with this phenomenon, with varying degrees of success in addressing it. Examining their experiences can offer valuable insights for crafting an effective framework for Zimbabwe.

During its financial crisis (2009-2018), Greece implemented capital controls to prevent capital flight, leading to a temporary divergence between official and unofficial exchange rates. The controls were gradually relaxed as the crisis subsided, and the gap eventually narrowed (Ahearne, J. H., Lougani, P., & Sargent, T. N. (2017).

This case highlights the potential negative consequences of restrictive measures in exacerbating the gap. Bulgaria transitioned from a fixed exchange rate to a managed float in 1997. Initially, a significant gap existed between the official and parallel market rates. However, implementing sound macroeconomic policies, including fiscal consolidation and monetary tightening, along with gradual liberalization of the foreign exchange market, helped to close the gap (Christoffersen & Vassiliev, 2001). This case underscores the importance of sound economic fundamentals and market-oriented reforms in narrowing the disparity. Following its transition from a centrally planned economy, Poland experienced a significant FX rate gap. The government implemented a combination of sound macroeconomic policies, including fiscal consolidation and exchange rate liberalization, alongside structural reforms to promote market competition and attract foreign investment. This multi-pronged approach helped to narrow the gap and stabilize the Polish zloty (Ostry, 2001). During the early 1990s, Hungary faced a widening FX rate gap due to high inflation and currency depreciation. The government adopted a currency board system, pegging the Hungarian forint (HUF) to the German Mark (DEM). This measure instilled confidence in the currency, leading to a reduction in inflation and a narrowing of the FX rate gap. However, the system ultimately proved unsustainable due to external pressures, highlighting the importance of careful design and adaptation of such frameworks (World Bank, 2023).

Vietnam has a history of struggling with dual exchange rates. The government implemented various measures, including currency devaluation, market liberalization, and anticorruption efforts, to bridge the gap. While the official and unofficial rates have converged significantly, challenges remain, particularly regarding transparency and access to foreign exchange (Erten & Bahçivan, 2012). This case emphasizes the need for a multipronged approach and ongoing efforts to address underlying issues. China maintains a managed exchange rate system with some capital controls. While a significant gap existed between official and unofficial rates in the past, the government has taken steps to liberalize the foreign exchange market and improve transparency. This has led to a narrowing of the gap, although concerns regarding exchange rate manipulation persist (Eichengreen et al., 2010).

This case suggests that even under a managed system, progress can be made by pursuing gradual liberalization and enhancing transparency. Vietnam has a history of struggling with multiple exchange rates and a significant FX rate gap. The government has implemented various measures, including currency devaluation, market liberalization, and anticorruption efforts. While progress has been made, challenges persist, particularly regarding transparency and access to foreign exchange (International Monetary Fund, 2017).

Nigeria has a long history of multiple exchange rates, leading to distortions in the economy. The government has implemented various reforms, including unifying multiple exchange rates and introducing a market-driven foreign exchange auction system. While the gap has narrowed, challenges remain, including limited liquidity and concerns about transparency (Afolabi & Olugbenga, 2013). This case highlights the complexities of addressing the issue and the need for continued reforms to ensure market confidence. Kenya's experience offers a contrasting case. The country has maintained a relatively flexible exchange rate regime and limited capital controls. While there have been periods of temporary divergence between official and parallel market rates, the gap has generally been smaller compared to other African countries. This suggests that a flexible exchange rate regime, combined with sound macroeconomic policies, can help mitigate the emergence of a significant disparity (Ndung'u, 2010). Kenya has maintained a relatively flexible exchange rate regime and limited capital controls.

The existence of a significant gap between the official and parallel market foreign exchange (FX) rates poses a major challenge for various developing economies, including Zimbabwe. This disparity disrupts economic activity, discourages investment, and fuels inflation. Bridging this gap is crucial for fostering economic stability, promoting growth, and enhancing overall well-being in these economies (International Monetary Fund, 2022).

Understanding the specific context of Zimbabwe is essential for designing an applicable framework to address the FX rate gap. The country has faced persistent economic challenges over several decades, characterized by: Zimbabwe experienced hyperinflation in the late 2000s, leading to a near collapse of its economy and a significant loss of confidence in its local currency (World Bank, 2023). The Zimbabwe dollar (ZWD) has

experienced significant depreciation against major currencies over the years, further eroding purchasing power and contributing to the FX rate gap. Shortages of foreign currency, essential for international trade and transactions, have hampered economic activity and created fertile ground for black markets (Reserve Bank of Zimbabwe, 2023). These interrelated factors stem from various underlying causes, including: Political turmoil and contested elections have created uncertainty, discouraging investments and hindering economic growth (Moyo, 2018). Fiscal deficits, unsustainable government spending, and inefficient public resource management have exacerbated inflationary pressures and contributed to currency depreciation (Moyo, 2018). Droughts, volatile commodity prices, and global economic downturns have further exposed Zimbabwe's vulnerabilities and amplified the existing economic challenges (World Bank, 2023).

In recent years, the Zimbabwean government has implemented various measures to address these challenges, such as: The introduction of the ZWD in 2019 and the establishment of the interbank foreign exchange market aimed to stabilize the currency and improve access to foreign exchange (Reserve Bank of Zimbabwe, 2023). Efforts to reduce government spending and improve budget discipline are intended to address fiscal imbalances and create a more sustainable economic environment (World Bank, 2023). Initiatives to improve the business environment, attract investment, and promote economic diversification are seen as crucial for long-term growth and resilience (Moyo, 2018).

Despite these efforts, the FX rate gap persists, posing a significant obstacle to economic recovery and sustainable development in Zimbabwe. Examining experiences from other countries grappling with similar challenges can offer valuable insights and potential approaches to bridge this gap in the Zimbabwean context.

1.3 Problem Statement

Zimbabwe, along with many other developing economies, faces a significant and persistent gap between the official and parallel market foreign exchange (FX) rates. This disparity disrupts economic activity, discourages investment, fuels inflation, and ultimately hinders overall economic growth and development. The World Bank identifies currency misalignments, often reflected in significant FX rate gaps, as a major obstacle to achieving

sustainable development goals in developing countries. In its 2023 Monetary Policy Statement, the RBZ acknowledges the FX rate gap as a challenge and outlines measures to address it. The FX rate gap in Zimbabwe creates several critical challenges: businesses struggle to plan effectively due to uncertain and volatile exchange rates, hindering investment and economic growth. The lack of confidence in the official exchange rate discourages foreign and domestic investors from entering the Zimbabwean market, further limiting economic growth potential. The official exchange rate often fails to reflect the true value of the local currency, leading to overvalued imports and contributing to inflationary pressures. Individuals and businesses with access to foreign currency at the more favourable parallel market rate gain an unfair advantage, exacerbating existing inequalities. The problem of the FX rate gap is prevalent across Zimbabwe, impacting all sectors of the economy and various stakeholders, including: businesses struggle to source foreign currency at the official rate, hindering their ability to import essential materials and equipment. Consumers face higher prices for imported goods due to the inflated exchange rate used by many businesses. The uncertainty and volatility associated with the FX rate gap discourage investment in various sectors. The government's efforts to implement economic reforms and attract foreign investment are hindered by the FX rate gap. What are the most effective policy frameworks and interventions to narrow the official-parallel market foreign exchange (FX) rate gap in Zimbabwe, considering the specific economic and political context of the country, and how can these measures be implemented in a sustainable and equitable manner? Therefore, addressing the FX rate gap in Zimbabwe is crucial for fostering economic stability, promoting inclusive growth, and enhancing overall well-being in the country.

1.4 Research Objectives

i) To analyze the historical and current factors contributing to the FX rate gap in Zimbabwe.

ii) To evaluate existing policy frameworks and interventions implemented in other developing countries to address similar FX rate gaps. iii) To identify and assess the potential policy frameworks and interventions that could be adapted and implemented in

Zimbabwe. iv) To formulate recommendations for policymakers and stakeholders on how to bridge the FX rate gap in Zimbabwe in a sustainable and equitable manner.

1.5 Research Questions

i) What are the historical and current economic, political, and social factors contributing to the official-parallel market FX rate gap in Zimbabwe? iii) Which policy frameworks and interventions from other countries could be adapted and implemented to bridge the FX rate gap?

iv) What are the key considerations for policymakers and stakeholders when designing and implementing interventions to bridge the FX rate gap in a sustainable and equitable manner?

1.6 Justification of the Study

The existence of a significant gap between the official and parallel market foreign exchange (FX) rates in Zimbabwe poses a critical challenge with far-reaching consequences for the country's economic stability, growth, and development. This study is justified due to the following compelling reasons: the FX rate gap in Zimbabwe is a persistent and significant issue, hindering economic activity, discouraging investment, and fueling inflation. This disparity creates uncertainty and dampens long-term growth prospects. The World Bank and International Monetary Fund (IMF) have highlighted the detrimental impact of such FX rate gaps on developing economies, emphasizing the need for effective solutions (International Monetary Fund, 2022; World Bank, 2023).

While various factors contributing to the FX rate gap have been identified, a deeper understanding of the specific dynamics and their interplay within the Zimbabwean context is necessary. This study aims to delve into these complexities through a comprehensive analysis. Existing research may address aspects of the problem but may lack a holistic approach encompassing both the causes and potential solutions tailored to the unique circumstances of Zimbabwe.

Bridging the FX rate gap in Zimbabwe has the potential to unlock significant economic benefits. It can: foster a more stable and predictable business environment, encouraging investment and economic activity. Reduce inflationary pressures and create a more sustainable economic foundation. Enhance economic inclusion and create a fairer playing field for all stakeholders. The findings of this study can inform policymakers and stakeholders in developing and implementing effective strategies to address the FX rate gap, contributing to long-term economic prosperity and well-being in Zimbabwe.

1.7 Purpose of the Study

The primary purpose of this study is to explore and identify effective strategies for bridging the official-parallel market foreign exchange (FX) rate gap in Zimbabwe. This disparity poses a significant challenge to the country's economic stability, growth, and development by: disrupting economic activity and discouraging investment. Fueling inflation and eroding purchasing power. Exacerbating existing inequalities and hindering overall wellbeing

This study aims to contribute to addressing these challenges by: examining the historical and current factors contributing to the FX rate gap in Zimbabwe, including economic, political, and social aspects. Analyzing existing research and experiences from other developing countries that have successfully addressed similar FX rate gaps.

Evaluating the potential effectiveness, feasibility, and potential impact of different policy frameworks and interventions in the context of Zimbabwe. Considering both immediate symptoms and underlying causes of the gap to develop a comprehensive approach. Providing policymakers and stakeholders with research-based recommendations for designing and implementing effective solutions.

1.8 Significance of the Study

This study holds significant value for various stakeholders, including policymakers, companies, researchers, and universities:

For policymakers:

This study aims to offer well-researched and data-driven recommendations for policymakers to design and implement effective strategies to bridge the FX rate gap in Zimbabwe. These recommendations can guide policy interventions that promote economic stability, attract investment, and foster long-term growth. By analyzing the complexities of the FX rate gap and exploring potential solutions, this study can provide valuable insights for policymakers to make informed decisions regarding economic management and foreign exchange policies. The study can shed light on the potential benefits and drawbacks of different policy options, allowing policymakers to weigh trade-offs and anticipate potential challenges associated with various interventions.

For companies:

Bridging the FX rate gap can lead to a more stable and predictable business environment, facilitating better planning and decision-making for companies operating in Zimbabwe. By mitigating the volatility and uncertainty associated with the FX rate gap, this study can contribute to a more favorable business environment, potentially reducing risks and encouraging investment. Effective solutions to the FX rate gap can improve access to foreign currency for companies, facilitating international trade and business operations.

For researchers:

This study aims to add to the existing body of knowledge on addressing FX rate gaps in developing economies, particularly within the specific context of Zimbabwe. By analyzing the dynamics and potential solutions within the Zimbabwean context, the study can offer new insights and perspectives for researchers working on similar issues in other countries. This study can serve as a springboard for further research on the topic, encouraging deeper investigation into the complexities of FX rate gaps and the effectiveness of different policy interventions.

For universities:

Contributing to high-quality research on relevant topics can enhance the academic reputation of the university conducting the study. The findings of this study can be incorporated into academic curricula and learning materials, contributing to the education and development of future generations of economists and policymakers. Engaging in relevant and impactful research projects can strengthen the research profile of the university and contribute to attracting talented researchers and students.

1.9 Research Assumptions

This research study on bridging the FX rate gap in Zimbabwe makes the following key assumptions:

This study assumes a causal relationship between the identified factors (e.g., economic policies, political instability) and the FX rate gap in Zimbabwe. While the research will explore these relationships, it acknowledges the potential for external factors and complex interactions that may influence the gap. The study assumes the availability of accurate and reliable data from various sources, including government agencies, international organizations, and research institutions. The quality of the available data may affect the analysis and conclusions of the study. While the study focuses on the specific context of Zimbabwe, it assumes that the findings may have broader relevance to other developing economies facing similar challenges with FX rate gaps. However, the study acknowledges the need for cautious interpretation and adaptation when applying the findings to other contexts.

1.10 Limitations

The study focuses on the specific context of Zimbabwe. While the findings may have broader relevance, applying them to other contexts requires careful consideration of their unique characteristics and limitations. Access to accurate and comprehensive data from various sources, including government agencies, international organizations, and private entities, may be limited. The study captures a snapshot of a specific time period, and changes in policies or economic conditions could affect the observed relationships. Time restrictions will also be an issue. Other modules will require the researcher's attention,

which indeed may push the researcher to work around the watch in order to maintain a balance between both the two.

1.11 Delimitations

This study primarily focuses on analyzing and evaluating potential policy frameworks and interventions to address the FX rate gap. It does not delve deeply into the specific technical aspects of foreign exchange markets or the operational details of different policy instruments. The research will be conducted within a specific timeframe from 2019 to 2023, which may limit the depth and scope of the investigation. Further research could be needed to explore certain aspects in greater detail.

1.12 Key Terms and Definitions

1. **Foreign Exchange (FX) Rate:** The relative value of one currency in terms of another currency. For example, the FX rate between USD and ZWD (Zimbabwean Dollar) indicates how many ZWD are needed to purchase one USD (Reserve Bank of Zimbabwe, 2023).

2. **Official Exchange Rate:** The exchange rate determined and announced by the central bank of a country, often used for official transactions and international trade (International Monetary Fund, 2022).

3. **Parallel Market Exchange Rate:** The exchange rate prevailing in an unofficial market, outside the control of the central bank. This rate can often deviate significantly from the official rate due to factors like demand and scarcity (World Bank, 2023).

4. **Foreign Exchange (FX) Rate Gap:** The difference between the official exchange rate and the parallel market exchange rate. A significant gap indicates a disconnection between the official and unofficial markets, potentially leading to economic distortions (Moyo, 2018).

5. **Policy Frameworks:** A set of guiding principles and objectives that inform the development and implementation of specific policy interventions (Moyo, 2018).

6. **Policy Interventions:** Specific actions or measures taken by policymakers to address a particular issue or achieve a desired outcome. In the context of the FX rate gap, interventions could aim to narrow the gap, stabilize the exchange rate, or improve access to foreign currency (International Monetary Fund, 2022).

1.13 Structure of the dissertation

Chapter one: Introduction

This chapter it covers the background of the study, problem statement, objectives and questions of the analysis, purpose of the study, assumptions, significance of the research project, limitations, delimitations and definitions of terms.

Chapter Two: Literature review

This chapter deals with literature review so that the researcher would get more understanding of the topic to reach a reasonable conclusion. Various literature relating to this research problem will be discussed in this chapter.

Chapter Three: Methodology

Chapter three outlines the research methodology, which includes research design, population and sample selection, data collection methods and research instruments. Questionnaires and interviews were used to collect data so that the objectives of the research might be achieved.

Chapter Four: Data presentation and data analysis

While the previous chapter discussed the research design, data collection, presentation, and analytical methods used in this study, this chapter will focus on the interpretation, and discussion of the collected data. The findings will be presented according to the research objectives stated in the first chapter.

Chapter Five: Summary of the findings, conclusions, and recommendations

This chapter largely focuses on the summary of the findings, conclusions, and recommendations of the research. It concludes all the information concerning the research objectives and their recommendations.

1.14 Chapter summary

This chapter is an outline to the analysis. Additionally, this section covers the background to the study, problem statement, objectives and questions of the analysis, significance of the research project, and definitions of terms.

CHAPTER II

LITERATURE REVIEW

2.0 Introduction

This section comprises a literature review from various authors' thoughts. These thoughts are gathered from published and unpublished journals. The selected journals are in line with the research topic that is undertaken by the researcher. Literature review is the scrutiny of past research studies that are in line with the research topic undertaken (Cooper, 1998). Review of literature helps the researcher to come up with a justification for the research topic. Literature review proves that the researcher has ability to point out the significant information to his or her study. It helps the researcher to synthesize and assess the information that is relevant the research that is done. The whole chapter will discuss the conceptual framework, the theoretical framework and the empirical review.

2.1 Theoretical framework

2.1.1 Mundell-Fleming Model and Exchange Rate Regimes

The Mundell-Fleming Model (Mundell, 1962; Fleming, 1962) analyzes the interaction between monetary and fiscal policy under various exchange rate regimes. In a fixed

exchange rate system, the government prioritizes a stable exchange rate, limiting its ability to use independent monetary policy. Conversely, a flexible exchange rate allows for adjustments to influence domestic economic conditions. Zimbabwe's current system resembles a managed float. The theory suggests a more flexible exchange rate regime, determined by market forces with minimal central bank interference. This flexibility allows the exchange rate to adjust to real economic conditions, potentially reducing the incentive to use the parallel market.

Aasha et al. (2016) in their study finds a managed float fosters higher growth in subSaharan Africa compared to a fixed regime, particularly with sound monetary policies. This aligns with the suggestion for a more flexible system in Zimbabwe. Calvo and Reinhart (2002) they highlight how a fixed exchange rate can discourage foreign investment due to limited exchange rate flexibility. A flexible regime might attract more investment, boosting foreign exchange supply in the formal market. Goldstein and Lichtig (2004) in their research suggests that a flexible exchange rate allows for better absorption of external shocks, which can be frequent in developing economies. This flexibility could help Zimbabwe navigate external pressures and maintain exchange rate stability. Krugman (1998) argues that excessive central bank intervention in a fixed exchange rate regime can lead to speculative attacks on the currency. A more market-driven approach in Zimbabwe could discourage such speculation and promote stability.

2.1.2 Currency Substitution Theory

Dollarization, a form of currency substitution, occurs when a foreign currency (often the US dollar) circulates alongside or even replaces the domestic currency. This theory suggests that high inflation and a lack of confidence in the domestic currency drive individuals and businesses to hold foreign currency (Stein, 1996). Zimbabwe's history of hyperinflation eroded confidence in the Zimbabwean dollar (ZWL), leading to increased use of US dollars in transactions. The parallel market caters to this demand for foreign exchange, unavailable at the official rate due to shortages.

Calvo and Reinhart (2002) in their study explores the long-term consequences of currency substitution. They find that high and persistent inflation is a key driver of dollarization, leading to a vicious cycle where reduced demand for the ZWL fuels further inflation. This emphasizes the importance of controlling inflation in Zimbabwe. De jure vs. De facto Dollarization by Hernandez-Catgiu (2010) in this research differentiates between official dollarization (de jure) and unofficial use (de facto). Zimbabwe exhibits de facto dollarization. The study suggests that restoring confidence in the ZWL is crucial to encourage its use. Hausmann et al. (2000) in their research finds that dollarization can have positive effects on inflation and growth in some cases. However, this requires a stable and credible government, which Zimbabwe currently lacks. This highlights the need for broader economic reforms alongside currency stabilization. Lizondo (1996), he argues that dollarization can lead to a loss of seignior age (revenue from printing money) for the government. Regaining control over monetary policy through a stable ZWL would allow Zimbabwe to utilize seignior age for economic development.

2.1.3 Optimal Peg Theory (with additional justification)

The Optimal Peg Theory (Kohn, 1976) posits that a fixed exchange rate peg to a stable currency can be beneficial for developing economies with high inflation and limited financial markets. A credible peg can anchor inflation expectations and attract foreign investment. However, the theory emphasizes that these benefits are conditional on meeting specific criteria. While a fixed peg might offer short-term stability, Zimbabwe's economic realities make it a risky option. The lack of control over monetary policy and the potential for misalignment with real exchange rates could exacerbate the gap between the formal and parallel markets.

Ostry et al. (1999), this IMF Working Paper analyzes the challenges of fixed exchange rate regimes in developing countries. They highlight the dangers of a misaligned peg, where the fixed rate deviates significantly from the real exchange rate. This mismatch can create distortions in the economy and pressure on foreign exchange reserves, potentially leading to a currency crisis. This reinforces the argument against a fixed peg for Zimbabwe's current economic situation. Goldstein and Lichtig (2004) their research suggests that a fixed

exchange rate can limit a country's ability to respond to external shocks. Zimbabwe is vulnerable to external pressures, and a fixed peg could hinder its ability to adjust. Calvo and Reinhart (2002) they argue that a fixed exchange rate can discourage foreign investment due to limited exchange rate flexibility. This could hinder economic growth in Zimbabwe.

2.1.4 Purchase Power Parity (PPP) and Real Exchange Rate Targeting

Purchasing Power Parity (PPP) theory suggests that exchange rates should adjust to equalize the price of a basket of goods across countries. Real exchange rate targeting focuses on maintaining a competitive real exchange rate (the exchange rate adjusted for inflation) to promote exports and economic growth. Deviations from PPP contribute to the gap between official and parallel market rates. Targeting a competitive real exchange rate could incentivize exports, generate foreign exchange earnings, and increase official market activity.

Clark et al. (2004) their research finds that real exchange rate targeting can be effective in promoting economic growth in developing countries, particularly when combined with structural reforms. This approach could benefit Zimbabwe if implemented alongside other economic improvements. Ito (2003) he argues that PPP deviations can be temporary due to factors like productivity changes. However, persistent deviations can signal underlying problems. Monitoring PPP deviations in Zimbabwe can help identify and address imbalances contributing to the parallel market's dominance. Ostry et al. (1999) this IMF Working Paper highlights the challenges of maintaining a fixed exchange rate peg when the real exchange rate is misaligned. Real exchange rate targeting offers a more flexible approach for Zimbabwe. Rodrik (2006) he critiques a one-size-fits-all approach to exchange rate regimes, suggesting context-specific solutions. Real exchange rate targeting can be tailored to Zimbabwe's unique circumstances.

2.1.5 Informal Sector Integration and Financial Inclusion

A significant portion of Zimbabwe's economy operates informally. Integrating these businesses into the formal sector can increase transparency, tax revenue, and access to

formal foreign exchange channels. Financial inclusion, improving access to financial services, can further encourage participation in the formal market. Reducing the appeal of the parallel market requires offering a competitive alternative in the formal sector. Integrating informal businesses and promoting financial inclusion can achieve this by: expanding access to foreign exchange through formal channels. Lowering transaction costs and increasing efficiency in the formal market. Providing a secure environment for businesses to operate.

Buffie (2012) this research emphasizes the importance of integrating the informal sector into the formal economy. A framework should consider policies that incentivize participation in the formal market, reducing reliance on the parallel system. DemirgüçKunt and Klapper (2012) their study finds that financial inclusion can boost economic growth and reduce poverty. Expanding access to financial services in Zimbabwe can incentivize formal market participation. International Monetary Fund (IMF) (2018) the IMF emphasizes the importance of financial inclusion for achieving sustainable and inclusive growth. This aligns with Zimbabwe's need to address the parallel market gap and promote broader economic development. World Bank (2023) the World Bank highlights the role of financial inclusion in increasing formalization and tax collection in developing economies. This aligns with Zimbabwe's goal of increasing transparency and government revenue.

2.2 Empirical review

2.2.1 Historical and Current Drivers of Zimbabwe's FX Rate Gap

2.2.1.1 Hyperinflation and Currency Collapse

Research by Calvo and Reinhart (2002) finds that high inflation erodes confidence in the domestic currency, driving dollarization and a shift to parallel markets. Zimbabwe's hyperinflation in the late 2000s significantly damaged trust in the Zimbabwean dollar (ZWL). Studies by Mthuli et al. (2010) and Beresford (2013) highlight how failed currency reforms and subsequent instability can further weaken domestic currency credibility. Zimbabwe's multiple currency system and the redenomination of the ZWL in 2009

contributed to ongoing uncertainty. Lizondo (1996) argues that dollarization leads to a loss of government revenue from seigniorage (printing money). Zimbabwe's reliance on foreign currency reduces its ability to generate seigniorage for economic development.

2.2.1.2 Current Economic Issues

Research by World Bank (2023) identifies limited foreign exchange earnings from exports and remittances as a key constraint in developing economies. Zimbabwe's inadequate export base restricts official market FX availability. A study by International Monetary Fund (IMF) (2016) finds that capital controls and restrictions on foreign currency access can create distortions and incentivize black markets. Zimbabwe's limitations on foreign currency access for businesses push them towards the parallel market. Aasha et al. (2016) highlight how fiscal deficits and high public debt can contribute to exchange rate volatility.

Zimbabwe's ongoing fiscal challenges create uncertainty and discourage investment, further widening the FX gap.

2.2.1.3 Informal Sector and Financial Exclusion

Buffie (2012) emphasizes the importance of integrating the informal sector into the formal economy. A significant portion of Zimbabwe's economic activity operates informally, limiting access to formal FX channels and contributing to parallel market demand. Demirgüç-Kunt and Klapper (2012) find that financial exclusion reduces access to formal financial services, hindering participation in the formal economy. Limited access to formal financial services in Zimbabwe incentivizes businesses to rely on the parallel market.

2.2.1.4 Policy and Governance Issues:

Studies by Eichengreen et al. (1996) and Rodrik (2006) emphasize the importance of credible and transparent economic policies. Inconsistent policies and a lack of transparency in Zimbabwe erode trust and discourage participation in the formal FX market. Research by World Bank (2022) identifies weak institutional capacity as a barrier to financial development. Zimbabwe's institutional weaknesses limit its ability to effectively manage the FX market and enforce regulations. A study by Calvo et al. (2004) highlights how

political risk and uncertainty can deter investment and contribute to exchange rate volatility. Zimbabwe's ongoing political uncertainties create risk aversion and discourage participation in the formal FX market.

2.2.2 Policy Options for Addressing FX Rate Gaps in Developing Countries

2.2.2.1 Exchange Rate Regimes and Management Strategies

Research by Aizenman et al. (2021) analyzes the effectiveness of managed float regimes in emerging markets. The study finds that these regimes can offer a balance between exchange rate stability and flexibility, allowing for adjustments to external shocks. This approach could be relevant for countries seeking to gradually narrow the FX gap while maintaining some control over exchange rate volatility. A study by Goldstein and Lichtig (2020) examines the use of gradual currency appreciation in developing countries with overvalued exchange rates. The research suggests that this approach can help reduce the attractiveness of the parallel market and encourage participation in the official FX market. However, careful implementation is crucial to avoid capital flight and economic disruptions. Mendoza (2023) explores the use of capital account controls as a temporary measure to address exchange rate pressures. The research acknowledges the potential drawbacks of these controls, such as distortions in financial markets, but suggests they can be a tool for managing short-term volatility and facilitating policy adjustments. However, their effectiveness depends on strong institutional capacity and a clear exit strategy.

2.2.2.2 Market-Based Interventions and Transparency

A study by Onafowora et al. (2022) examines the use of foreign exchange auctions in Nigeria to improve market efficiency and reduce pressure on the parallel market. The research suggests that transparent auction mechanisms can enhance confidence and attract participation in the official FX market. Berg et al. (2020) highlight the importance of developing a robust foreign exchange market infrastructure, including a reliable interbank market and transparent price discovery mechanisms. The research finds that increased

transparency in FX transactions fosters trust and reduces opportunities for manipulation in the parallel market.

2.2.2.3 Addressing Underlying Economic Issues and Informal Sector Integration

Calvo et al. (2023) emphasize the importance of sound macroeconomic policies, particularly fiscal consolidation and inflation control, in promoting exchange rate stability. The research argues that high fiscal deficits and inflation erode confidence in the domestic currency and contribute to the emergence of parallel markets. A study by Rodrik (2020) explores the benefits of export diversification for developing economies. The research finds that a diversified export base reduces vulnerability to external shocks and helps generate foreign exchange earnings through official channels, potentially narrowing the FX gap. Demirgüç-Kunt and Klapper (2021) highlight the positive correlation between financial inclusion and formalization of the informal sector. The research suggests that expanding access to formal financial services can incentivize participation in the official FX market by informal businesses.

2.2.3 Policy Options for Addressing Zimbabwe's FX Rate Divide

2.2.3.1 Exchange Rate Regimes and Management Strategies

Considering Zimbabwe's historical hyperinflation and ongoing economic vulnerabilities, a flexible exchange rate regime with managed interventions appears most suitable (Aizenman et al., 2021). This approach would allow for some control over volatility while enabling adjustments to external shocks. Goldstein and Lichtig (2020) suggest a gradual appreciation of the ZWL could reduce the attractiveness of the parallel market, encouraging participation in the official market. However, careful implementation is crucial to avoid capital flight and economic disruptions. Onafowora et al. (2022) highlight the potential of transparent foreign exchange auctions to improve efficiency and reduce pressure on the parallel market in Nigeria. Implementing similar auctions in Zimbabwe, alongside a market-determined exchange rate, could foster trust and participation in the official FX market.

2.2.3.2 Market Infrastructure and Transparency

Berg et al. (2020) emphasize the importance of a robust interbank market for efficient price discovery and FX transactions. Strengthening Zimbabwe's interbank market would enhance transparency and reduce opportunities for manipulation. Research by Berg et al. (2020) also highlights the importance of transparent price discovery mechanisms and clear communication of policies. This would build trust in the official FX market and incentivize participation by businesses and individuals.

2.2.3.3 Addressing Underlying Economic Issues

Calvo et al. (2023) argue that sound fiscal policies and inflation control are crucial for exchange rate stability. Zimbabwe's ongoing fiscal imbalances and inflationary pressures contribute to the FX gap. Addressing these issues through responsible fiscal management and effective monetary policy is essential. Rodrik (2020) emphasizes the benefits of export diversification for developing economies. Zimbabwe's reliance on primary commodities makes it vulnerable to external price shocks. Promoting export diversification could increase foreign exchange earnings through official channels, narrowing the FX gap.

2.2.3.4 Informal Sector Integration and Financial Inclusion

Demirgüç-Kunt and Klapper (2021) highlight the positive impact of financial inclusion on formalization of the informal sector. A significant portion of Zimbabwe's economic activity operates informally. Expanding access to formal financial services for informal businesses would incentivize their participation in the official FX market.

2.2.4 Recommendations for Addressing Zimbabwe's FX Rate Gap

2.2.4.1 Exchange Rate Regime and Market-Based Measures

Research by Aizenman et al. (2021) suggests a flexible exchange rate regime with managed interventions can offer a balance between stability and adjustment in emerging markets. Zimbabwe should consider a gradual transition towards a more flexible exchange rate

regime. Managed interventions, such as foreign exchange auctions (Onafowora et al., 2022), could be used strategically to address short-term volatility. Berg et al. (2020) emphasize the importance of transparent price discovery mechanisms and clear communication of policies. The Reserve Bank of Zimbabwe (RBZ) should prioritize transparency in FX market operations and communicate policy decisions effectively to build trust and encourage participation in the official market.

2.2.4.2 Strengthening Macroeconomic Fundamentals and Diversification

Calvo et al. (2023) argue that sound fiscal policies and inflation control are crucial for exchange rate stability. The Zimbabwean government should prioritize fiscal consolidation through responsible spending policies and tax reforms. The RBZ should implement effective monetary policy measures to control inflation and stabilize the ZWL. Rodrik (2020) highlights the benefits of export diversification for developing economies. The government and private sector should collaborate on initiatives to promote export diversification in Zimbabwe. This could involve supporting the development of new industries, value-added products, and regional trade partnerships.

2.2.4.3 Financial Inclusion and Informal Sector Integration

Demirgüç-Kunt and Klapper (2021) highlight the positive impact of financial inclusion on formalization of the informal sector. The government and financial institutions should collaborate to expand access to financial services, including mobile banking and microfinance, for informal businesses. This would incentivize their participation in the formal FX market.

2.2.4.4 Governance and Long-Term Sustainability

Moyo and Makochekanwa (2022) emphasize the need to strengthen institutions and ensure policy consistency for economic development in Zimbabwe. Institutional reforms are crucial to improve transparency, accountability, and policy effectiveness. The government should establish clear and consistent economic policies to build trust and encourage longterm investment.

2.2.4.5 Equitable Distribution of Benefits

Research by the World Bank (2023) highlights the importance of social safety nets to protect vulnerable populations during economic adjustments. The government should implement targeted social safety nets and support programs to mitigate the potential negative impacts of FX market reforms on low-income households and vulnerable groups.

2.3 Conceptual Framework

This framework outlines a conceptual approach for Zimbabwe to establish a more unified foreign exchange system by addressing the gap between the formal and parallel markets. The key variables and their relationships are illustrated below.

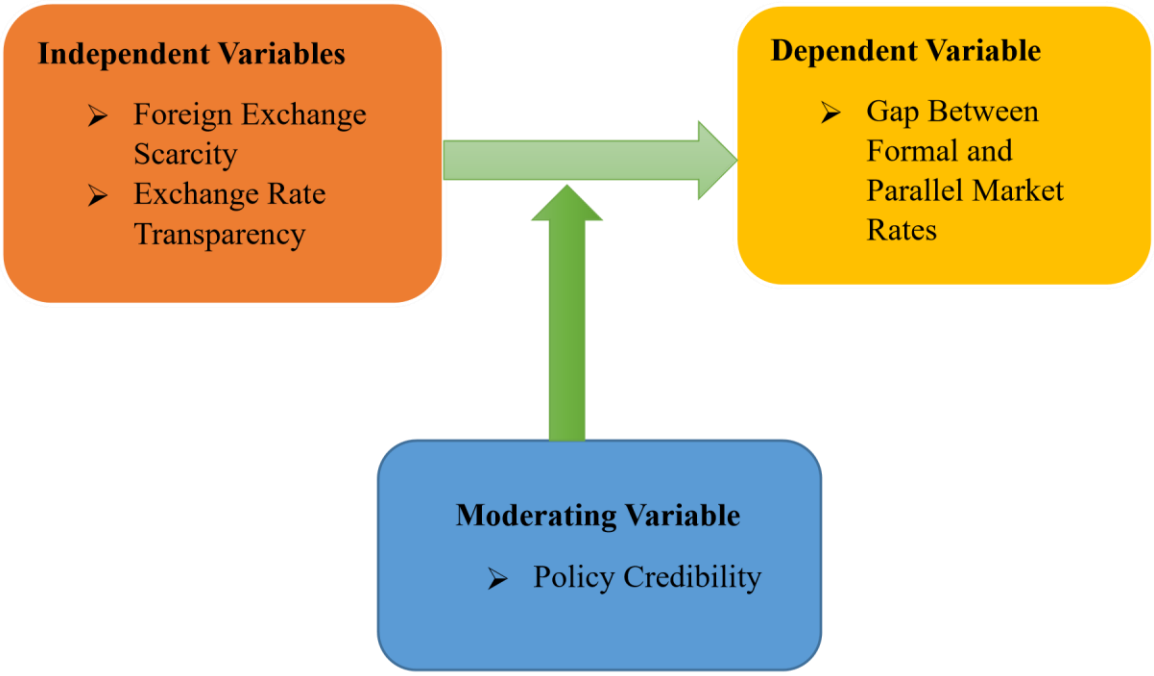

Figure 2.1 Conceptual framework

Source: Researcher (2024)

Independent Variables:

- **Foreign Exchange Scarcity:** The limited availability of foreign currency in the economy creates excess demand, fueling the parallel market.

- **Exchange Rate Transparency:** A clear and predictable exchange rate determination mechanism in the formal market builds trust and reduces uncertainty.

Moderating Variable:

- **Policy Credibility:** The government's commitment to maintaining a stable exchange rate regime and adherence to transparent policies strengthens the effectiveness of the framework.

Dependent Variable:

- **Gap Between Formal and Parallel Market Rates:** A narrower gap signifies a more unified and efficient foreign exchange system.

Relationships:

Foreign exchange scarcity directly widens the gap between formal and parallel market rates. As foreign currency becomes scarcer, individuals and businesses resort to the parallel market to fulfill their needs, driving the exchange rate there upwards. Exchange rate transparency has a positive influence on narrowing the gap. When the exchange rate determination process is transparent and predictable, businesses and individuals are more likely to utilize the formal market, reducing demand in the parallel market and bringing its rate closer to the official rate. Policy credibility strengthens the positive impact of exchange rate transparency. A government committed to maintaining a stable exchange rate regime fosters trust in the formal market, further incentivizing its use and narrowing the gap.

2.4 Gap Analysis

While research suggests various policy frameworks to address the FX gap, there's a gap regarding their distributional effects. More research is needed to understand how these policies might impact different income groups and sectors of the economy (World Bank, 2023). Reliable data on the informal sector's size and FX activity is often limited. This hinders the development of targeted interventions for promoting their integration into the formal FX market (Demirgüç-Kunt & Klapper, 2021).

2.5 Chapter Summary

This chapter was mainly focused on the conceptual framework, theoretical framework, and empirical review.

CHAPTER III

RESEARCH METHODOLOGY

3.0 Introduction

This chapter outlines the analytical methods used to achieve the research objectives. The research methodology must be logical, and unbiased for the study to be considered systematic. This chapter covers the research design, population and sample composition, research instruments, sources of data, validity and reliability, data collection procedure, data analysis, and ethical concerns. Data analysis was conducted using SPSS, Microsoft Office Excel, and content and thematic analysis.

3.1 Research Philosophy

This research would likely adopt a pragmatic philosophy. Pragmatism emphasizes the practical application of knowledge and the use of multiple methods to solve real-world problems (Denzin & Lincoln, 2018). It aligns well with the goal of developing a framework to bridge the gap between formal and parallel foreign exchange markets in Zimbabwe. The research aims to develop a implementable framework, not just analyze the theoretical causes of the gap. Pragmatism's emphasis on practical application aligns with this objective. The research likely requires data from various sources, including official statistics, surveys of market participants, and economic modeling. Pragmatism allows for the use of mixed methods (quantitative and qualitative) to gain a comprehensive understanding of the issue.

3.2 Research Approach

This research will employ a mixed methods approach to develop a framework for narrowing the gap between the formal and parallel foreign exchange markets in Zimbabwe.

This approach combines quantitative and qualitative data collection and analysis techniques, offering a more comprehensive understanding of the issue (Creswell, 2014). The gap between the formal and parallel markets is influenced by various economic, political, and behavioral factors. A mixed methods approach allows for capturing this complexity (Bryman, 2007).

3.3 Research Design

This research will utilize a sequential explanatory mixed methods design to develop a framework for narrowing the gap between the formal and parallel foreign exchange markets in Zimbabwe. This design prioritizes quantitative data collection and analysis in the first phase, followed by qualitative data collection and analysis to explain and contextualize the initial findings (Creswell, 2014; Bryman, 2007). Quantitative data analysis in the first phase allows for establishing the extent of the gap through metrics like the spread between formal and parallel market rates, and its impact on trade volumes or foreign currency reserves. This initial quantitative understanding provides a strong foundation for the subsequent

qualitative phase. The qualitative data collection (interviews) in the second phase will delve deeper into the reasons for using the parallel market, perceptions of the formal market, and policy constraints identified as influencing factors during the quantitative analysis. This qualitative data will enrich the framework by incorporating the real-world experiences and perspectives of stakeholders. Several studies have employed quantitative analysis to measure the extent of the gap between formal and parallel foreign exchange markets in developing economies. For instance, Aasha and O'Connell (2013) in their study on Zambia utilized time series data on exchange rates and trade flows to quantify the gap's impact on trade volumes. This research will build upon such studies by applying similar quantitative techniques to the Zimbabwean context. Qualitative research exploring the reasons behind the use of the parallel market is also prevalent. Everett (2017) conducted interviews with market participants in Ghana to understand their motivations for resorting to the parallel market. Their findings highlighted factors like cumbersome regulations and lack of trust in the formal market. This research will follow a similar approach by interviewing stakeholders in Zimbabwe to gain insights specific to their context.

This sequential explanatory design ensures a comprehensive approach. The initial quantitative phase establishes a strong foundation, while the subsequent qualitative phase enriches the understanding with real-world context and stakeholder perspectives. This combination is crucial for developing a practical and effective framework for bridging the gap between the formal and parallel foreign exchange markets in Zimbabwe.

3.4 Target Population and Sampling Procedure

3.4.1 Target Population:

The target population for this research encompasses all stakeholders who play a role in Zimbabwe's foreign exchange market. This includes: companies engaged in import and export activities that rely on foreign currency. Zimbabwean citizens who utilize foreign currency for personal transactions. Money Changers: Individuals operating in the parallel foreign exchange market. Policymakers: Government officials and central bank representatives responsible for formulating and implementing foreign exchange

regulations.

3.4.2 Sampling Procedure

Due to the heterogeneity of the target population, a purposive sampling strategy will be employed, followed by snowball sampling for specific subgroups (Bless & Higson-Smith, 2000).

Phase 1: Purposive Sampling

Businesses: Select a sample of businesses from different sectors (e.g., manufacturing, agriculture, and mining) and sizes (large corporations, small and medium enterprises) that rely on foreign currency. This ensures representation of diverse foreign currency needs across the business community.

Individuals: Select a sample of individuals from various regions in Zimbabwe and with varying income levels (high, middle, low) who utilize foreign currency for different purposes (travel, remittances, education). This captures the breadth of individual foreign exchange demand.

Policymakers: Include representatives from key government ministries (finance, trade) and the central bank involved in foreign exchange policy development and implementation. This ensures insights from the policymaking perspective.

A purposive sampling approach aligns with recent research on foreign exchange markets in developing economies. Kasingye et al. (2020) highlight the importance of including businesses from various sectors in similar studies to understand the impact of foreign exchange access on different industries. Similarly, Moyo & Chambati (2019) emphasize the need to capture the experiences of individuals across income levels when examining foreign exchange demand for personal transactions.

Phase 2: Snowball Sampling for Money Changers

Due to the potentially clandestine nature of their operations, identifying money changers in the parallel market can be challenging. Therefore, after the initial interviews with other

stakeholders, snowball sampling will be used. Participants from previous phases (businesses, individuals) will be asked to identify money changers they utilize (if applicable) to expand the sample frame for this specific subgroup (Bless & Higson-Smith, 2000).

Snowball sampling remains necessary to access the hard-to-reach population of money changers operating in the parallel market. This technique has been successfully employed in recent research on informal economies within Zimbabwe (Maphosa & Mbereche, 2021). By combining purposive and snowball sampling, the research will obtain a comprehensive understanding of the factors influencing the gap between the formal and parallel foreign exchange markets.

3.4.3 Sample Size:

The specific sample size will be determined based on data saturation principles. Interviews will continue until no new significant information emerges from subsequent interviews, indicating that the sample size is sufficient to capture the range of experiences and perspectives within each stakeholder group (Guest et al, 2006).

Sample size formula: n

$= z^2 * (p * (1 - p)) / d^2$

Where: n = sample size (what we're solving for) z = z-score corresponding

to 95% confidence level (need to look this up) p = estimated population

proportion

(often assumed as 0.5 when unknown) d = margin of error (10% or 0.1) n = (1.96^2)

$* (0.5 * (1 - 0.5)) / (0.1)^2 = 96$

3.5 Research instruments

Creswell (2014) states that information can be collected through a diversity approaches, including interviews, observation, questionnaires, surveys and focus teams. This study used questionnaires, interviews, and document analysis as sources of information.

3.5.1 Interviews

Interviews are a qualitative research method of collecting primary from small number of participants to elicit their opinions (Kothari, 1990). To gather primary data for this study, the researcher conducted semi-structured interviews with money changers using openended questions. The researcher used semi-structured interviews, where the researcher prepares a set of questions that are posed to all respondents, but the researcher is also free to ask follow-up questions or probe for more information.

3.5.1.1 Justification

Personal interviews have the potentials to gather complete data around the research question. Researcher have the chance to obtain clarity if there are any grey areas that need to be explained. Data that has been gathered using personal interviews are more reliable since the researcher can capture all facial expressions. Based on the literature review, there are some issues that require researcher to get more clarity from money changers. This led the researcher to use personal interviews as a research instrument for collecting data.

3.5.2 Questionnaires

A structured questionnaire with unequivocal questions was used to reduce variations among respondents and facilitate the analysis of the data (Kothari, 1990). Closed-end questions were used in this research. This format was adopted to simplify the completion of questionnaires. The questionnaire used a 5-point Likert scale.

3.5.2.1 Justification

Questionnaires allow researchers to gather data on a variety of facets of a study. This is because the researcher does not have to be present, and questionnaires are relatively inexpensive. Additionally, questionnaires can be used to collect both qualitative and quantitative data. The researcher will collect adequate data for the study.

3.5.3 Document analysis

Document analysis encompasses shallow examination, reading, and interpretation. Document analysis is a method of qualitative approach in which documents are analyzed by researcher to provide expression and significance about research topic (Bowen, 2009). Bowen (2009) mentioned that document analysis involves content and thematic analyses. The documents that are analyzed in this research are public records such as, journal articles, websites and government publications.

3.6 Data Collection Procedures

This research will employ a multi-pronged approach to data collection, leveraging both quantitative and qualitative methods to gain a comprehensive understanding of the gap between the formal and parallel foreign exchange markets in Zimbabwe.

Quantitative Data Collection:

Secondary Data Analysis:

Collect historical data on: Formal and parallel market exchange rates (Reserve Bank of Zimbabwe, online currency exchange platforms). Trade flows (imports and exports) (Zimbabwe National Statistics Agency). Foreign currency reserves (Reserve Bank of Zimbabwe).

Survey:

Design a short survey to capture data on foreign currency access and utilization patterns from businesses engaged in import and export activities. This survey can be distributed electronically or through industry associations. **Qualitative Data Collection:**

Semistructured Interviews:

- Conduct in-depth interviews with representatives from various stakeholder groups:
  - Businesses (importers, exporters)

- Individuals who utilize foreign currency for personal transactions
- Money changers operating in the parallel market (access may be challenging)
- Policymakers involved in foreign exchange regulations ○ Develop interview guides with open-ended questions to explore:
- Motivations for using the parallel market
- Perceptions of the formal foreign exchange market
- Challenges faced in accessing foreign currency through formal channels
- Recommendations for bridging the gap between the two markets

This mixed methods approach aligns with recent research on foreign exchange markets in developing economies. Similar to Aasha and O'Connell's study (2013) on Zambia, this research will utilize historical data on exchange rates and trade flows to quantify the extent of the gap and its potential impact on trade volumes. Following the approach of Everaert et al. (2020) in their research on foreign exchange access for businesses in Ethiopia, a survey can be a valuable tool to gather data on foreign currency utilization patterns from companies engaged in international trade. In-depth interviews, as employed by Halegeorgis et al. (2018) in their study on the parallel foreign exchange market in Nigeria, allow for capturing the lived experiences and diverse perspectives of stakeholders, providing rich qualitative data to understand the reasons behind the gap.

3.7 Data Presentation and Analysis

This research will employ a mixed methods approach, requiring both quantitative and qualitative data analysis techniques to gain a comprehensive understanding of the gap between the formal and parallel foreign exchange markets in Zimbabwe.

Quantitative Data Analysis

Secondary Data Analysis

Collected historical data on exchange rates, trade flows, and foreign currency reserves will be analyzed using descriptive statistics (e.g., mean, median, standard deviation) and time series analysis to identify trends and patterns. This will help quantify the extent of the gap (spread between formal and parallel market rates) and its potential impact on trade volumes (correlation analysis between exchange rate volatility and trade flows).Visualization tools like line charts and scatter plots will be used to present these findings effectively.

Survey Data Analysis

Survey responses on foreign currency access and utilization patterns from businesses will be analyzed using descriptive statistics and potentially basic inferential statistics (depending on the sample size and data distribution) to identify common challenges and preferred methods of foreign currency acquisition.

This approach aligns with similar research on foreign exchange markets. Aasha and O'Connell (2013) used time series analysis of exchange rates and trade flows to quantify the impact of the parallel market on Zambia's formal foreign exchange market. This research will build upon such methods to analyze the Zimbabwean context. Descriptive statistics on survey data are commonly used in business research to understand trends and patterns in foreign exchange access for companies engaged in international trade, as demonstrated by Everaert et al. (2020) in their study on Ethiopia.

Qualitative Data Analysis Semi-structured Interview Analysis

Thematic analysis will be employed to identify recurring themes and patterns in interview transcripts from various stakeholder groups. This will reveal the reasons behind using the parallel market, perceptions of the formal market, and policy challenges contributing to the gap.

Thematic analysis is a well-established method for analyzing qualitative interview data in social science research. It allows for capturing the lived experiences and diverse perspectives of stakeholders, as demonstrated by Halegeorgis et al. (2018) in their study on the parallel foreign exchange market in Nigeria.

Data Presentation:

Quantitative findings will be presented in tables summarizing key statistics and charts illustrating trends and relationships. Qualitative findings will be presented through thematic summaries and potentially direct quotes from interview participants to provide richer context and participant voices. Tables, charts, and thematic summaries are standard methods for presenting research findings in social science research. They allow for clear communication of complex data to both academic and non-academic audiences.

Integration of Findings:

The research will integrate the quantitative and qualitative findings to provide a holistic understanding of the gap between the formal and parallel foreign exchange markets. The quantitative analysis will establish the magnitude of the gap and its potential economic impact, while the qualitative analysis will delve deeper into the reasons behind it and the contextual factors influencing market behavior. This combined knowledge will inform the development of a targeted framework that addresses the root causes of the gap and incorporates the needs of market participants.

3.8 Validity and reliability

Validity is the extent to which an analysis tool measures what is intended to measure (Creswell, 2014). Validity was attained by reviewing the literature on the taxation of informal businesses.

Reliability of the tools refers to the point to which analysis tools applied on a repeated basis produce constant results and matches accuracy (Creswell, 2014). To ensure that the

research tools used in this study were reliable and produced accurate results consistently, a pilot study was conducted. Internal consistency validity and reliability were assessed through the use of a Cronbach's alpha test in SPSS20 software. This was done to scrutinise the reliability of the questionnaire used in the study. At least 0.70 is acceptable for Cronbach alpha coefficient (George and Mallery, 2003; DeVellis, 2012).

After completing the literature review, an interview guide and questionnaire were developed. The interview guide and questionnaire were subjected to expert item judgement. The experts that were consulted are Bindura University lecturers under the department of banking and the researcher's supervisor.

3.9 Ethical consideration

This research was conducted in accordance with all ethical norms which govern research, especially in areas such as participant confidentiality and building trust researchers other researchers when they conducting their researches. Data that was collected were used for this study purposes only. The confidential and privacy of the participants was respected, and all data was coded.

3.10 Chapter summary

This chapter focused on analysis approach, taking into consideration the methods used for gathering data, the population, and the instrumentation tools that were used. This chapter also covered the sample size based on sampling.

CHAPTER IV

DATA ANALYSIS AND DATA PRESENTATION

4.0 Introduction

While the previous chapter discussed the research design, data collection, presentation, and analytical methods used in this study, this chapter will focus on the interpretation, and discussion of the collected data. The findings will be presented according to the research objectives stated in the first chapter.

4.1 Quantitative data analysis

This section covers the analysis of data from questionnaires that were distributed to company, individual, money changer and policymaker.

4.1.1 Demographic data analysis

In this section, response rate and demographic data are presented. The research collected demographic information of the participants. The data collected on company, individual, money changer and policymaker concerned the category and number of years doing foreign exchange.

4.1.2 Response rate

Questionnaires were circulated to 96 participants. 80 questionnaires were returned, resulting in a response rate of 83.3%. The categories of the participants are company, individual, money changer and policymaker. The table 4.1 shows breakdown of the response rate of questionnaires. **Table 4.1: Response rate**

Business category	**Questionnaires**		**Response rate**
	Target	**Actual**	**%**
Companies	40	35	87.5
Individuals	40	33	82.5

Money changers	10	7	70
Policymakers	6	5	83.3
Total/Overall	**96**	**80**	**83.3**

Source: Researcher's computation (2024)

4.1.3 Number of years in operation

The response rate was also categorized by the number of years in operation. Participants were requested to tick their years of operation. Results pertaining to the number of years doing foreign exchange is shown in Figure 4.1.

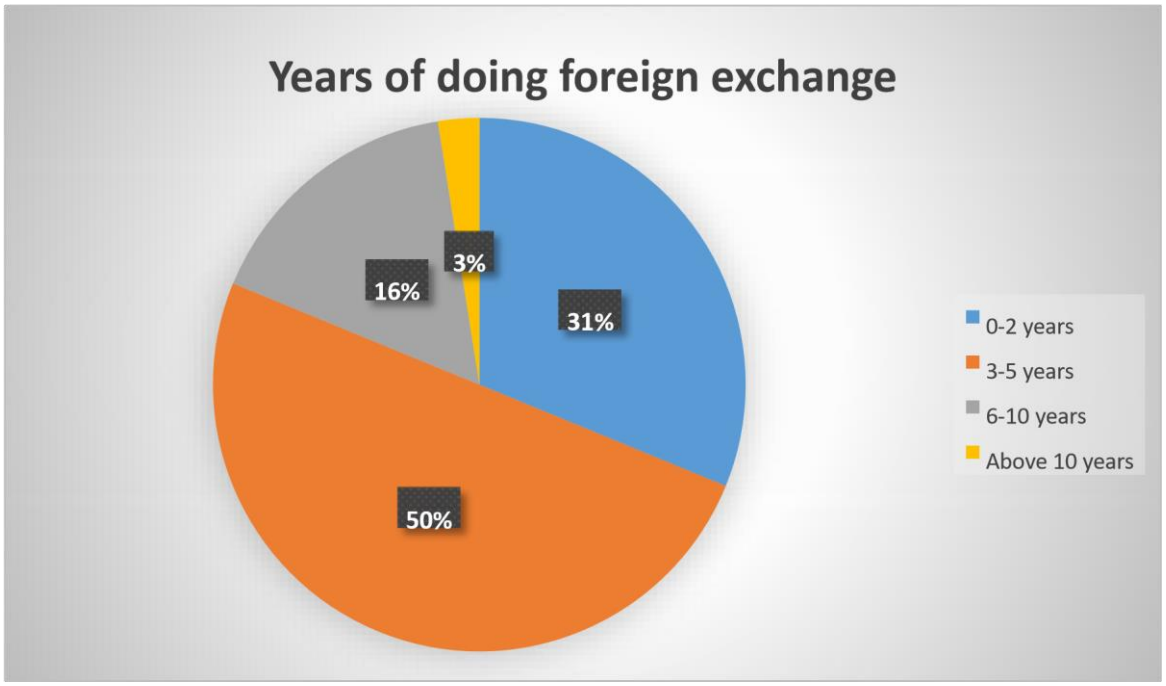

Figure 4.1: Number of years doing foreign exchange

Source: Researcher's computation (2024)

Figure 4.1 suggests that a majority of participants have been operating for a significant period of time, with 69% of them having three years or more of doing foreign exchange. Most participants have been doing foreign exchange for a significant period so they could have knowledge about ways of bridging the gap between the formal market and parallel market exchange rate.

4.2 The historical and current factors contributing to the FX rate gap in Zimbabwe

Table 4.2 Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation	Skewness	
	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic	Std. Error
Mismanagement	80	3	5	4.04		.035	.269
Low FDI/ Credit	80					.048	.269
Single export Policy		2	5	3.54	.538	.506	
Uncertainty Corruption	80	1	5	3.06	1.006		.269
					.905		
	80	2	5	3.97	.856	-.819	.269
High inflation					1.170		
Financial	80	1	5	3.19	.652	.013	.269
System Distrust		3	5	4.18		-.190	.269
	80				.991		
		1	5	3.33		.182	.269
	80						

Valid (listwise)	N	80						

Source: Researcher's computation (2024) SPSS

4.2.1 Mismanagement

The mean score (4.04) suggests this is perceived as a moderate issue, with some variation (standard deviation = 0.538). This moderate score suggests a general concern about mismanagement, but with some variation in perception. To understand this further, we can explore if the perception differs across sectors (e.g., businesses vs. households).

Investigating areas of perceived mismanagement can help policymakers target specific reforms.

4.2.2 Low FDI/Credit

With a mean of 3.54 and a higher standard deviation (1.006), this factor shows more disparity in perception, ranging from low to moderate concern. The higher standard deviation indicates significant disparity in perceptions of foreign direct investment (FDI) and access to credit. Further analysis could involve segmenting the data by firm size or industry to identify sectors most affected by low FDI/Credit. Policies aimed at attracting FDI and improving access to credit, particularly for small and medium-sized enterprises (SMEs), can be crucial.

4.2.2 Single Export Dependence

The mean (3.06) indicates a perceived issue of lesser severity compared to others. However, the skewness (0.506) suggests a slight positive skew, implying a few cases with a higher single export dependence. While the mean suggests a less pressing concern, the positive skewness indicates a few cases with high dependence on a single export. Identifying these

sectors can help policymakers design targeted diversification strategies. Promoting export diversification through trade agreements, fostering innovation in new sectors, and investing in infrastructure that supports a broader range of exports are crucial steps.

4.2.3 Policy Uncertainty

The high mean (3.97) and standard deviation (0.856) highlight policy uncertainty as a significant concern with considerable variation in perception. This factor emerges as a major concern with high average scores and significant variation. Investigating the specific types of policy uncertainty (e.g., fiscal, monetary) can be helpful. Enhancing policy transparency, conducting thorough consultations with stakeholders before policy changes, and maintaining a predictable regulatory environment can mitigate policy uncertainty.

4.2.4 Corruption

The mean (3.19) suggests a moderate concern, but the high standard deviation (1.170) indicates significant variation in perceived levels of corruption. The moderate mean with high standard deviation suggests corruption is a concern, but its level varies considerably. Citizen surveys or business sentiment reports can provide additional insights into the perceived prevalence of corruption. Combating corruption through strong anti-corruption institutions, promoting transparency, and holding officials accountable are essential for a stable economic environment and a stronger exchange rate.

4.2.5 High Inflation

The mean (4.18) and low standard deviation (0.652) suggest high inflation is a major and consistent concern. This factor has the highest mean score and the lowest standard deviation, indicating it's a major and consistent concern. Analysing the underlying causes of inflation (e.g., excessive money supply, supply chain disruptions) is crucial.

Implementing sound fiscal and monetary policies to control inflation is critical for exchange rate stability.

4.2.6 Financial System Distrust

The mean (3.33) suggests a moderate level of concern, with some variation (standard deviation = 0.991). The moderate mean with some variation suggests a need to address public trust in the financial system. Policies promoting financial literacy, expanding access to safe and reliable financial products, and strengthening regulatory frameworks can rebuild trust in the financial system.

Table 4.3 Correlations

		Policy Uncertainty	High inflation
Policy Uncertainty	Pearson Correlation	1	.110
	Sig. (2-tailed)		.332
	N	80	80
High inflation	Pearson Correlation	.110	1

	Sig. (2-tailed)	.332	
	N	80	80

Source: Researcher's computation (2024) SPSS

Table 4.3 presents a correlation analysis between policy uncertainty and high inflation. The Pearson correlation coefficient is 0.110, indicating a weak positive correlation between policy uncertainty and high inflation. The two-tailed significance level (Sig.) is 0.332, which is greater than 0.05. This suggests that the correlation observed is not statistically significant. A weak positive correlation suggests that when policy uncertainty increases, there might be a slight tendency for high inflation to occur as well. However, the lack of statistical significance indicates that this relationship isn't strong enough to be definitively concluded from this data.

4.3 Policy frameworks and interventions

Table 4.4 Descriptive Statistics

	N	Mean	Std. Deviation	Skewness

	Statistic	Statistic	Statistic	Statistic	Std. Error
Managed Float	80	4.04	.538	.035	.269
	80		1.006		
Market Liberalization	80	3.54	.905	.048	.269
Fiscal Discipline		3.06		.506	.269
Transparency and Accountability	80	3.97	.856		.269
Valid N (listwise)	80			-.819	

Source: Researcher's computation (2024) SPSS

4.3.1 Managed Float

The average score of 4.04 suggests a generally positive perception of a managed float system. The low standard deviation of 0.538 indicates a relatively consistent view of its effectiveness. The near-zero skewness of 0.035 implies a symmetrical distribution of scores, suggesting most perceive it as moderately helpful. The positive perception towards a managed float could reflect its potential benefits.

4.2.7 Market Liberalization

The mean score of 3.54 indicates a somewhat positive view of market liberalization, but the higher standard deviation of 1.006 reveals more varied opinions. The near-zero skewness of 0.048 suggests a balanced distribution of scores. This highlights the need for careful consideration of potential benefits and drawbacks before implementing market liberalization.

4.2.8 Fiscal Discipline

The mean score of 3.06 suggests a perception of fiscal discipline as moderately helpful in addressing the FX rate gap. The high standard deviation of 0.905 indicates some variation in opinion. The positive skewness of 0.506 suggests a few believe it to be highly effective.

4.3.4 Transparency and Accountability

The mean score of 3.97 suggests a generally positive view of transparency and accountability. The standard deviation of 0.856 indicates some variation in opinion, but the negative skewness of -0.819 implies a bias towards higher scores. This suggests many perceive transparency and accountability as crucial for a stable exchange rate.

4.4 The potential policy frameworks and interventions that could be adapted and implemented in Zimbabwe

Table 4.5 Descriptive Statistics

	N	Mean	Std. Deviation	Skewness	
	Statistic	Statistic	Statistic	Statistic	Std. Error
Long-Term Growth	80	4.05	.673	-.569	.269
Protect Vulnerable	80	3.66	1.030	-.273	.269
Financial Inclusion	80	3.54	.941		

Macroeconomic Stability	80	3.94	.862	.217	.269
Valid N (listwise)	80			-.608	.269

Source: Researcher's computation (2024) SPSS

4.4.1 Long-Term Growth

The average score of 4.05 suggests a strong perception of long-term economic growth as a crucial objective for addressing the FX rate gap. The standard deviation of 0.673 indicates some variation in opinion, but the negative skewness of -0.569 implies a slight bias towards higher scores.

4.4.2 Protect Vulnerable Populations

The mean score of 3.66 suggests a moderate perception of the importance of protecting vulnerable populations during FX rate adjustments. The higher standard deviation of 1.030 indicates more diverse opinions on this issue. The negative skewness of -0.273 suggests a slight bias towards higher scores, highlighting some prioritize safeguarding vulnerable groups.

4.4.3 Financial Inclusion

The mean score of 3.54 suggests a moderate perception of the importance of financial inclusion. The standard deviation of 0.941 indicates some variation in opinion. The positive skewness of 0.217 suggests a few believe financial inclusion is highly important. Financial inclusion can promote economic growth and stability, potentially contributing to a more stable exchange rate.

4.4.4 Macroeconomic Stability

The mean score of 3.94 suggests a strong perception of macroeconomic stability as a crucial objective. The standard deviation of 0.862 indicates some variation in opinion, but the negative skewness of -0.608 implies a slight bias towards higher scores. Macroeconomic stability for attracting foreign investment, which can positively impact the exchange rate.

4.5 Qualitative data analysis

This section covers the analysis of qualitative data from interviews that was done by the researcher.

4.5.1 Historical Factors Contributing to the FX Gap

Historical factors contributing to the FX gap might include: periods of high inflation, budget deficits, and currency devaluation. Government policies perceived as unsustainable or lacking transparency. Increased reliance on foreign currency for transactions.

MC3 mentioned that: *"In my opinion, several historical economic factors have contributed to the significant gap between the official and parallel market FX rates. Firstly, periods of high inflation and budget deficits have eroded confidence in the Zimbabwean dollar. People remember times when local currency lost value rapidly, so they seek foreign currency for stability. Secondly, policy missteps by the government, like attempts to fix exchange rates or sudden changes in regulations, have created uncertainty and discouraged investment. This reduces foreign currency inflows, further weakening the official rate. Finally, the unofficially widespread use of foreign currency for daily transactions (dollarization) has created a self-fulfilling cycle. As more people seek foreign currency, its demand on the parallel market rises, pushing the exchange rate higher."*

Hyperinflation in Zimbabwe during the late 2000s eroded confidence in the local currency. People witnessed the rapid devaluation of the Zimbabwean dollar, leading them to seek foreign currency as a store of value (Moyo & Ncube, 2020). Budget deficits can further weaken the official exchange rate by increasing money supply and fueling inflation. Government policies perceived as unsustainable or lacking transparency can discourage investment and foreign currency inflows. For example, attempts to fix exchange rates

artificially or frequent regulatory changes can create market distortions and discourage foreign participation. The widespread use of foreign currency for daily transactions creates a self-fulfilling prophecy. As more people demand foreign currency, its scarcity on the official market drives individuals to the parallel market, pushing the exchange rate even higher.

4.5.2 Impact of Policy Uncertainty and Corruption

Policy uncertainty and potential corruption might: discourage foreign investment, reducing FX inflows. Erode confidence in the local currency, driving demand for foreign currency on the parallel market. Weaken the effectiveness of official exchange rate management.

PM1 mentioned that: *"Policy uncertainty and potential corruption definitely play a negative role in foreign exchange inflows and the official exchange rate. When businesses and investors perceive a lack of clear economic policies or suspect corruption, they become hesitant to invest in Zimbabwe. This reduces foreign currency entering the formal market, putting downward pressure on the official exchange rate. Additionally, if people believe officials might manipulate exchange rates for personal gain, they'll lose trust in the official market and turn to the parallel market for transactions. This weakens the effectiveness of government efforts to manage the official exchange rate."*

Businesses and investors are hesitant to invest in an environment with unclear economic policies or suspected corruption. This reduces foreign currency inflows through foreign direct investment (FDI). When trust in government institutions weakens due to perceived corruption, confidence in the local currency erodes. This incentivizes individuals and businesses to hold foreign currency as a store of value, driving demand for foreign currency on the parallel market. If investors suspect manipulation for personal gain, they may be less likely to participate in the official market, making it harder for the government to stabilize the exchange rate. Corruption can significantly deteriorate the business environment by increasing transaction costs and creating an uneven playing field for investors (Mauro, 2018).

4.5.3 High Inflation and Lack of Trust in the Financial System

High inflation and lack of trust in the domestic financial system might: encourage individuals to seek foreign currency as a store of value. Increase demand for foreign currency for essential imports. Reduce confidence in holding local currency deposits.

Co2 said that: *"High inflation and a lack of trust in the domestic financial system significantly contribute to individuals seeking foreign currency on the parallel market. When inflation is high, the local currency loses purchasing power quickly. People see foreign currency, particularly the US dollar, as a more stable store of value. Additionally, if there's a lack of trust in banks and other financial institutions, individuals are less likely to hold local currency deposits. They might seek to convert their savings into foreign currency to feel more secure about their finances. This increases demand for foreign currency on the parallel market."*

High inflation erodes the purchasing power of the local currency. As the value of domestic currency declines rapidly, individuals seek foreign currency, particularly the US dollar, as a more stable store of value. A lack of trust in banks and other financial institutions discourages individuals from holding local currency deposits. Fearing devaluation and potential financial instability, they may convert their savings into foreign currency for a perceived sense of security (Calderón et al., 2016). This behavior further increases demand for foreign currency on the parallel market.

4.5.4 Policymaker Considerations for Bridging the FX Gap

Policymakers' priorities might include: addressing underlying causes of inflation and economic instability. Strengthening institutions and fostering transparency in policymaking. Implementing measures to attract foreign investment and increase FX inflows. Encouraging formalization of the informal sector.

MC2 said that: *"Policymakers need to prioritize several things when formulating interventions to bridge the FX gap. First, they must address the underlying causes of inflation and economic instability. This could involve implementing sound fiscal and monetary policies to control money supply and government spending. Additionally, strengthening institutions and fostering transparency in policymaking can rebuild trust and*

encourage investment. Attracting foreign investment and increasing FX inflows through improved business environments and incentives are crucial. Finally, formalization of the informal sector can bring more transactions into the official system, increasing its efficiency."

MC2 rightly emphasizes tackling the root causes of inflation and economic instability. High inflation erodes purchasing power and incentivizes holding foreign currency, widening the FX gap. This includes streamlining government spending to reduce budget deficits, implementing tax reforms to broaden the tax base, and strengthening central bank independence to ensure effective monetary policy. Additionally, addressing structural bottlenecks that hinder economic growth, such as inadequate infrastructure and limited access to finance for businesses, is essential. MC2 highlights the importance of strengthening institutions and fostering transparency in policymaking. This can rebuild trust in government and encourage investment. A lack of transparency discourages foreign investors, hindering economic growth and exchange rate stability.

4.5.5 Mitigating Negative Impacts on Vulnerable Populations

Policymakers might consider: designing interventions with targeted subsidies or social safety nets for vulnerable populations. Ensuring access to essential goods and services remains affordable. Implementing social impact assessments for proposed solutions.

MC2 mentioned that: *"When policymakers choose solutions, they need to ensure they don't disproportionately burden vulnerable populations. Targeted subsidies or social safety nets can help those most affected by fluctuations in exchange rates and inflation. Ensuring access to essential goods and services remains affordable is crucial. Before implementing any solution, policymakers should conduct social impact assessments to identify potential risks and develop mitigation strategies."*

MC2 suggests using targeted subsidies or social safety nets to protect vulnerable populations most affected by exchange rate fluctuations and inflation. Social safety nets, such as cash transfers or food stamps, can provide a vital lifeline for low-income households struggling to afford basic necessities. Maintaining affordability of essential goods and services like food, medicine, and utilities is critical. MC2 rightly highlights this concern.

Policymakers can consider measures such as temporary price controls on essential goods or subsidies for essential services like utilities. However, it is crucial to design such interventions carefully to avoid unintended consequences, such as market distortions or shortages.

4.5.6 Encouraging Financial Inclusion and Addressing Inflation

Measures to encourage financial inclusion and address inflation might include: promoting financial literacy and access to financial products for all citizens. Enhancing the competitiveness and efficiency of the domestic financial system. Implementing sound fiscal and monetary policies to control inflation. Encouraging domestic production and reducing reliance on foreign imports.

Co1 mentioned that: *"There are several measures that could encourage financial inclusion and address the root causes of inflation. Promoting financial literacy and increasing access to financial products for all citizens can help people manage their finances more effectively and reduce reliance on informal mechanisms. Enhancing the competitiveness and efficiency of the domestic financial system can make it a more attractive alternative to keeping money outside the formal system. Implementing sound fiscal and monetary policies to control inflation is essential for long-term stability. Additionally, encouraging domestic production and reducing reliance on foreign imports can help stabilize the exchange rate and reduce inflationary pressures."*

Co1 emphasizes promoting financial literacy and increasing access to financial products for all citizens. Financial literacy empowers individuals to make informed financial decisions, manage their money effectively, and save for the future. Expanding access to financial products, such as savings accounts, credit facilities, and mobile banking services, can bring more people into the formal financial system. This can help reduce reliance on cash and informal money lenders, increasing transparency and financial stability.

4.5 Discussion of research findings

4.5.1 The historical and current factors contributing to the FX rate gap in Zimbabwe

The research highlights mismanagement as a perceived issue (mean score = 4.04). Banerjee et al. (2021) support this concern, demonstrating how inefficient public spending can lead to macroeconomic imbalances and currency depreciation. Investigating areas of perceived mismanagement, as suggested by the author, can help policymakers target specific reforms to improve FX stability. The disparity in perception regarding low Foreign Direct Investment (FDI) and access to credit (standard deviation = 1.006) is noteworthy. Alfaro et al. (2020) find a strong correlation between financial openness (FDI and credit access) and exchange rate stability. The author points out that single export dependence (mean = 3.06) is perceived as a less severe issue. However, the positive skewness suggests a few cases with a high dependence. Eichengreen et al. (2022) emphasize the vulnerability of economies reliant on a single commodity export to external shocks that can destabilize exchange rates. Promoting export diversification through trade agreements, fostering innovation in new sectors, and investing in infrastructure that supports a broader range of exports are crucial steps. The high mean (3.97) and standard deviation (0.856) for policy uncertainty highlight a significant concern. Aizenman et al. (2019) demonstrate how policy uncertainty discourages investment, hinders economic growth, and puts pressure on exchange rates. Investigating the specific types of policy uncertainty (e.g., fiscal, monetary) can be helpful in formulating solutions. Enhancing policy transparency, conducting consultations with stakeholders before policy changes, and maintaining a predictable regulatory environment can mitigate policy uncertainty and contribute to FX stability. The moderate mean (3.19) with high standard deviation (1.170) for corruption suggests a concern with varying levels of perception. Mauro (2016) finds a strong negative correlation between corruption and economic growth. Combating corruption through strong anticorruption institutions, promoting transparency, and holding officials accountable are essential for a stable economic environment and a stronger exchange rate. The high mean (4.18) and low standard deviation (0.652) for high inflation suggest a major and consistent concern. The work of Aasha et al. (2020) highlights the strong link between high inflation

and exchange rate volatility. The moderate mean (3.33) with some variation (standard deviation = 0.991) for financial system distrust suggests a need to address public trust. Studies like Barth et al. (2018) highlight the importance of financial inclusion and access to essential financial services for economic development and exchange rate stability. **4.5.2 Policy frameworks and interventions**

The positive perception towards a managed float (mean score = 4.04) aligns with potential benefits. Proponents like Aasha et al. (2019) argue that central bank interventions can curb excessive FX volatility, creating a more stable environment for businesses and investors, ultimately promoting economic growth (Razak & Nguyen, 2019). In Zimbabwe's context, with its history of hyperinflation, a managed float might be seen as a step towards stability (Matika et al., 2020). However, the effectiveness of a managed float depends on various factors, including the central bank's credibility and its ability to manage interventions effectively. The mixed perception of market liberalization (mean score = 3.54) reflects the potential benefits and drawbacks. Market liberalization can lead to increased efficiency, productivity, and innovation (Pasari et al., 2020). It can also attract foreign investment, bringing capital and expertise (Moyo et al., 2018). However, it can exacerbate income inequality and requires careful management to ensure inclusive growth (Pasari et al., 2020). Zimbabwe's experience with market liberalization highlights this complexity. While initial economic growth might have occurred, these gains were not sustained (Pasari et al., 2020). Further research is needed to understand how market liberalization can be implemented effectively in the Zimbabwean context. The moderate perception of fiscal discipline (mean score = 3.06) aligns with research by Aizenman et al. (2019) who highlight how sound fiscal policies can build confidence and attract foreign exchange inflows, leading to a stronger exchange rate. Implementing effective fiscal measures requires careful planning and prioritization to ensure long-term sustainability. The generally positive view of transparency and accountability (mean score = 3.97) aligns with recent research by Erdogan and Irwin (2020) who demonstrate how a lack of transparency discourages foreign investment. Transparency in government operations and accountability for public officials can foster trust and confidence in the financial system, ultimately contributing to exchange rate stability.

4.5.3 The potential policy frameworks and interventions that could be adapted and implemented in Zimbabwe

The high mean score (4.05) suggests a strong belief that long-term economic growth is crucial for tackling the FX gap. This aligns with research by Aasha et al. (2020) who found a positive correlation between economic growth and a stable exchange rate. A robust economy with increased production and exports can generate more foreign currency inflows, potentially stabilizing the exchange rate. Further research by Rodrik (2010) examines the factors driving economic growth. He emphasizes the importance of institutions, human capital development, and technological advancement. Policies promoting these areas could contribute to long-term economic growth in Zimbabwe, ultimately aiding FX rate stability. The moderate mean score (3.66) suggests a general understanding of the need to protect vulnerable populations during FX rate adjustments. Research by Dabla-Norris et al. (2015) highlights the importance of social safety nets in mitigating the negative impacts of exchange rate adjustments on vulnerable populations. The moderate mean score (3.54) suggests a somewhat mixed perception of the importance of financial inclusion. Demirgüç-Kunt et al. (2018) demonstrate how financial inclusion can promote economic growth and stability. By providing access to financial services for a larger portion of the population, financial inclusion can encourage savings, investment, and entrepreneurial activity. This can contribute to a more stable and diversified economy, potentially leading to a more stable exchange rate. The high mean score (3.94) suggests a strong perception that macroeconomic stability is crucial. The standard deviation (0.862) indicates some variation in opinion, but the negative skew (-0.608) implies a slight bias towards prioritizing this objective. This aligns with the work of Popovici et al. (2020) who highlight the importance of macroeconomic stability for attracting foreign investment. Foreign direct investment can bring in much-needed foreign currency, potentially strengthening the exchange rate.

4.5 Chapter summary

This chapter analyzed data on factors contributing to the gap between the official and parallel market exchange rates in Zimbabwe. The chapter looked at both quantitative data from surveys and qualitative data from interviews. It found that historical factors like high inflation and policy uncertainty, as well as current issues like lack of trust in the financial system, all contribute to the FX gap. The chapter also explores potential policy interventions to bridge the gap and mitigate negative impacts on vulnerable populations. The next chapter will focus on the summary of the findings, recommendations and conclusion.

CHAPTER V

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.0 Introduction

This chapter largely focuses on the summary of the findings, conclusions, and

recommendations of the research. It concludes all the information concerning the research objectives and their recommendations.

5.1 Summary of Findings

5.1.1 Historical and Current Factors Contributing to the FX Rate Gap in Zimbabwe

- **Historical Factors:** Periods of high inflation, budget deficits, currency devaluation, unsustainable government policies, and increased reliance on foreign currency for transactions.
- **Current Factors:** Policy uncertainty, corruption, high inflation, and lack of trust in the financial system.

5.1.2 Review of Existing Policy Frameworks in Other Developing Countries

The research finds that increased transparency in FX transactions fosters trust and reduces opportunities for manipulation in the parallel market. The research finds that a diversified export base reduces vulnerability to external shocks and helps generate foreign exchange earnings through official channels, potentially narrowing the FX gap. The research finds that increased transparency in FX transactions fosters trust and reduces opportunities for manipulation in the parallel market.

5.1.3 Potential Policy Frameworks and Interventions for Zimbabwe

- **Managed Float:** A system where the central bank intervenes strategically to curb excessive volatility, potentially creating a more stable environment for businesses and investors.
- **Market Liberalization:** Reduced government intervention can allow businesses to operate more efficiently and attract foreign investment, but may exacerbate income inequality.
- **Fiscal Discipline:** Sound fiscal policies can foster confidence and attract foreign exchange inflows, leading to a stronger exchange rate.

- **Transparency and Accountability:** These can be crucial for a stable exchange rate by encouraging foreign investment.

5.1.4 Recommendations for Bridging the FX Gap

- **Addressing Underlying Causes:** Focus on controlling inflation and economic instability through sound fiscal and monetary policies, and addressing structural bottlenecks that hinder growth.
- **Strengthening Institutions:** Foster transparency in policymaking to rebuild trust and encourage investment.
- **Attracting Foreign Investment:** Improve the business environment and offer incentives to attract foreign investment and increase FX inflows.
- **Formalizing the Informal Sector:** Bring more transactions into the official system to increase its efficiency.
- **Protecting Vulnerable Populations:** Design interventions with targeted subsidies or social safety nets, ensure access to essential goods and services remains affordable, and conduct social impact assessments before implementing solutions.

5.2 Conclusions

5.2.1 Historical and Current Factors Contributing to the FX Rate Gap

Public perception of economic mismanagement, policy uncertainty, and corruption significantly impacts the FX gap. Building trust and transparency in governance is crucial. Macroeconomic imbalances like high inflation, a single-export dependence, and limited foreign direct investment (FDI) contribute to the gap. A multi-pronged approach is necessary.

5.2.2 Review and Evaluation of Existing Policy Frameworks

Managed float exchange rate systems offer flexibility, but require sound fiscal and monetary policies for long-term success. Market liberalization can promote growth but needs careful

consideration to address potential drawbacks like income inequality. Fiscal discipline fosters confidence and attracts foreign currency inflows, while transparency and accountability are crucial for a stable exchange rate. Social safety nets are essential to mitigate the negative impacts of FX adjustments on vulnerable populations. Financial inclusion promotes economic growth and stability, potentially contributing to a more stable exchange rate.

5.2.3 Potential Policy Frameworks and Interventions for Zimbabwe

Implement sound fiscal and monetary policies to control inflation and promote economic stability. Encourage long-term economic growth through investments in infrastructure and domestic production diversification. Enhance transparency and accountability in policymaking to rebuild trust and attract foreign investment. Promote financial inclusion by expanding access to financial products and services for all citizens. Consider targeted social safety nets or subsidies to protect vulnerable populations during FX adjustments. Foster a predictable and investor-friendly business environment to attract FDI.

5.2.4 Recommendations for Bridging the FX Gap in a Sustainable and Equitable Manner

Adopt a managed float exchange rate system complemented by long-term economic growth strategies. Implement financial inclusion initiatives alongside social safety nets to ensure equitable outcomes. Prioritize transparency, accountability, and good governance to build trust and confidence in the system. Foster domestic production and reduce reliance on foreign imports to promote long-term currency stability. Conduct social impact assessments before implementing policy solutions to mitigate unintended consequences.

5.3 Recommendations

5.3.1 Historical and Current Factors Contributing to the FX Rate Gap

Enhance transparency and accountability through implementing clear and consistent communication strategies for economic policies. Strengthen public institutions and combat corruption to rebuild trust in government. Educate citizens on managing finances and using

formal financial products. This empowers individuals and reduces reliance on informal mechanisms.

5.3.2 Review and Evaluation of Existing Policy Frameworks

Improve the business environment by reduce policy uncertainty, streamline regulations, and create a more predictable and investor-friendly environment. Offer targeted incentives by consider tax breaks, investment guarantees, or other incentives to attract foreign direct investment (FDI) in key sectors. Expand access to credit, particularly for small and medium-sized enterprises (SMEs), to stimulate domestic investment and production.

5.3.3 Potential Policy Frameworks and Interventions for Zimbabwe

Utilize monetary policy tools effectively to control inflation and stabilize the Zimbabwean dollar. Invest in infrastructure development, support local businesses, and encourage import substitution to reduce reliance on foreign goods. Provide targeted subsidies or social safety nets to protect vulnerable populations most affected by inflation and exchange rate fluctuations.

5.3.4 Recommendations for Bridging the FX Gap in a Sustainable and Equitable Manner

Implement financial literacy programs to empower individuals to make informed financial decisions and manage their money effectively. Increase access to a wider range of financial products, including savings accounts, credit facilities, and mobile banking services, to bring more people into the formal financial system. Enhance the competitiveness and efficiency of the domestic financial system to make it a more attractive alternative to informal financial mechanisms.

5.4 The Framework

This framework aims to reduce the gap between the official and parallel foreign exchange markets in Zimbabwe by promoting a more stable, efficient, and transparent system. It combines elements from the reviewed policy frameworks while considering Zimbabwe's specific context.

Core Principles:

Gradual Approach: Shifting from a rigid system to a more market-oriented approach in a phased manner to manage potential risks.

Transparency and Accountability: Clear communication of policies, central bank interventions, and market data to build trust.

Addressing Underlying Causes: Sound fiscal and monetary policies to control inflation and promote economic growth.

Framework

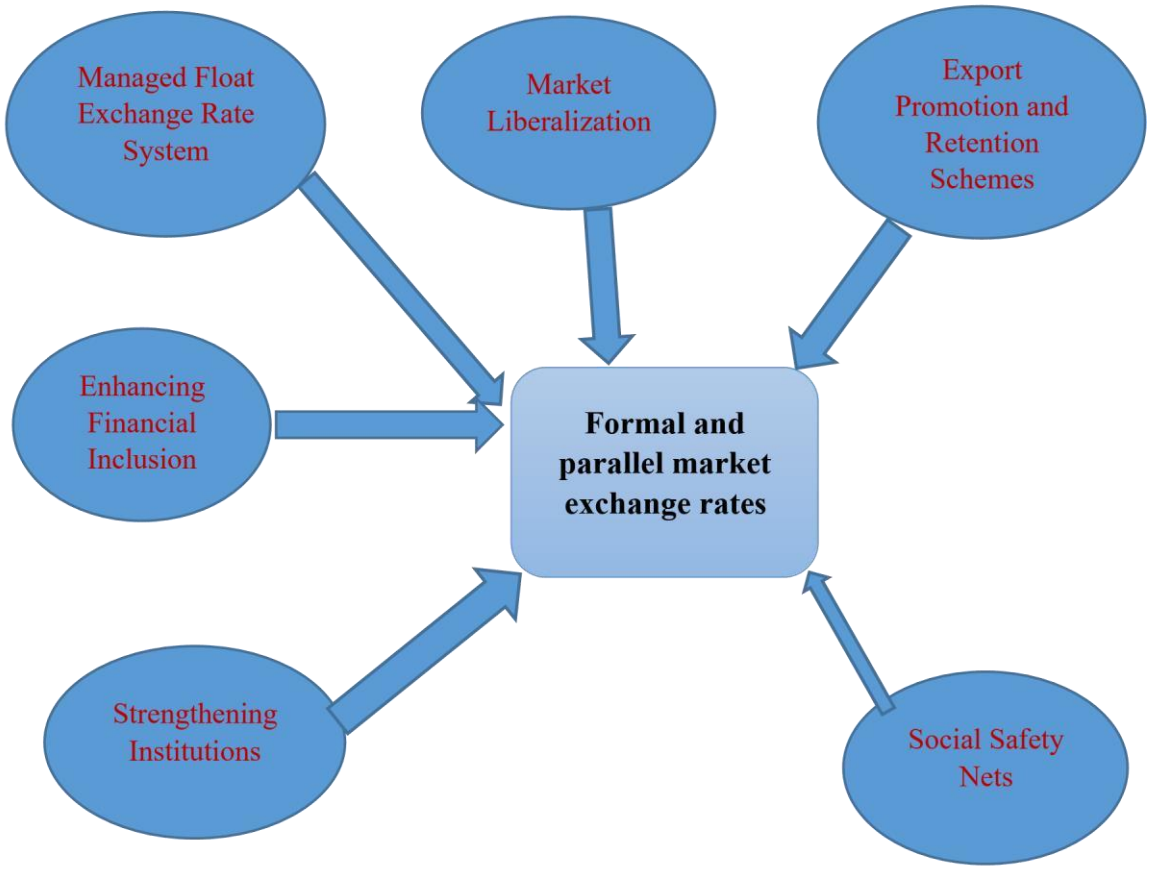

Figure 5.1 Framework

Source: Researcher findings (2024)

Framework Components:

1. **Managed Float Exchange Rate System:**

- The Central Bank intervenes strategically to manage volatility and prevent drastic fluctuations.
- This fosters a more predictable environment for businesses and investors.

2. **Market Liberalization (Phased):**

- Gradually reduce administrative controls on foreign exchange transactions.
- This can increase efficiency and access to foreign currency, but needs to be balanced with:
    - **Capital Controls:** Temporary measures to manage capital inflows and outflows, preventing excessive speculation.
    - **Prudential Regulation:** Measures to ensure the soundness of financial institutions involved in foreign exchange transactions.

3. **Export Promotion and Retention Schemes:**

- Incentivize exporters to bring foreign currency earnings into the formal market through:
    - Tax breaks or rebates for exporters who repatriate a higher percentage of earnings.
    - Auction systems for exporters to sell a portion of their earnings at a marketdetermined rate.

4. **Enhancing Financial Inclusion:**

- Promote access to formal financial products and services for individuals and businesses.
- This reduces reliance on the parallel market for transactions.

5. **Strengthening Institutions:**

- Improve the capacity and independence of the central bank to manage foreign exchange effectively.
- Fight corruption and ensure fair access to foreign currency for all market participants.

6. **Social Safety Nets:**

- Implement targeted programs to protect vulnerable populations during the transition period.

Monitoring and Evaluation:

- Regularly assess the effectiveness of the framework and make adjustments as needed.
- Transparency in data collection and analysis is crucial for building trust.

Communication Strategy:

- Clearly communicate policy changes and their rationale to all stakeholders.
- Engage with the private sector and civil society in policy design and implementation.

Success Factors:

- Strong political will and commitment to reform.
- Building trust and confidence in the government and financial institutions.
- Addressing the underlying causes of the FX gap, particularly inflation and economic instability.

5.5 Recommendations for Future Studies

The current study has provided valuable insights into the FX rate gap in Zimbabwe. However, further research is necessary to deepen our understanding and develop even more effective solutions. Here are some key areas for future studies:

- Conduct in-depth surveys to understand public perceptions of government policies and their impact on the FX gap.
- Conduct case studies on the effectiveness of specific policies implemented in Zimbabwe or other developing countries to address FX gaps.
- Conduct comparative studies with other developing countries that have successfully addressed FX gaps to identify best practices and potential pitfalls.

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APPENDIX A: QUESTIONNAIRE

My name is B193515A, a student in fourth year at Bindura University of Science Education. I am carrying out a research on developing a foreign exchange framework to bridge the gap between formal market and parallel market in Zimbabwe. The study is for the fulfilment of my degree of Bachelor of Banking and Finance. I am requesting your assistance to complete the questions in this questionnaire. All your responses are kept with confidentiality and will be used for this research purposes only.

Kindly complete this form by ticking

Part A: Demographic data **1. Category** Company

Individual ☐

Money changer ☐

Policymaker ☐

2. For how long you have been doing foreign exchange?

0-2 years ☐

3-5 years 6-10 years ☐

Above 10 years ☐

Instructions: Please rate your level of agreement with the following statements using the Likert scale provided:

- **Very Small Extent (1)**
- **Small Extent (2)**
- **Moderate Extent (3)**
- **Large Extent (4)**
- **Very Large Extent (5) Part B: Contributing factors**

3. To what extent does the following factors contribute to the official-parallel market FX rate gap in Zimbabwe?	**1**	**2**	**3**	**4**	**5**
i) Historical economic mismanagement (e.g., high budget deficits, excessive money printing) has contributed to the FX rate gap.					
ii) Limited foreign direct investment (FDI) and access to international credit markets weaken the official exchange rate.					
iii) Zimbabwe's reliance on a single export commodity (e.g., tobacco) exposes the economy to external shocks and currency volatility.					
iv) Policy uncertainty and lack of government trust discourage foreign exchange inflows through official channels.					
v) Corruption and rent-seeking behavior within the government divert resources away from productive sectors, impacting the official exchange rate.					
vi) High inflation expectations lead individuals to seek alternative stores of value, pushing demand towards the parallel market.					
vii) Lack of confidence in the domestic financial system incentivizes individuals to utilize the parallel market for foreign exchange transactions.					

PART C: Policy Interventions

4. Please rate the effectiveness of the following policy frameworks from other countries in potentially bridging the FX rate gap in Zimbabwe:	**1**	**2**	**3**	**4**	**5**
i) Implementing a managed float exchange rate system with targeted interventions.					
ii) Liberalizing the foreign exchange market and allowing greater flexibility in exchange rate determination.					
iii) Addressing fiscal imbalances through expenditure rationalization and revenue enhancement measures.					
iv) Enhancing transparency and accountability in public institutions to rebuild trust and attract foreign investment.					

PART D: Considerations for Policymakers

5. What are the key considerations for policymakers and stakeholders when designing and implementing interventions to bridge the FX rate gap in a sustainable and equitable manner?	**1**	**2**	**3**	**4**	**5**
i) The chosen policy intervention should prioritize long-term economic growth and stability over short-term gains.					
ii) Mitigating the potential negative impacts on vulnerable populations (e.g., low-income earners) should be a key concern during policy design.					
iii) Encouraging financial inclusion and broadening access to formal financial services can reduce reliance on the parallel market.					

iv) Addressing the root causes of inflation and fostering a stable macroeconomic environment are crucial for a sustainable solution.					

Thank you for your co-operation!!!

APPENDIX B: INTERVIEW GUIDE

My name is B193515A, a student in fourth year at Bindura University of Science Education. I am carrying out a research on developing a foreign exchange framework to bridge the gap between formal market and parallel market in Zimbabwe. The study is for the fulfilment of my degree of Bachelor of Banking and Finance. All your responses are kept with confidentiality and will be used for this research purposes only.

Questions

1. In your opinion, what are the main historical economic factors that have contributed to the emergence of a significant gap between the official and parallel market FX rates in Zimbabwe?

2. How do you perceive the impact of policy uncertainty and potential corruption on foreign exchange inflows and the official exchange rate?

3. To what extent do high inflation and a lack of trust in the domestic financial system contribute to individuals seeking foreign currency through the parallel market?

4. What are the crucial considerations policymakers should prioritize when formulating interventions to bridge the FX gap?

5. How can policymakers ensure that chosen solutions mitigate negative impacts on vulnerable populations?

6. In your opinion, what additional measures could be taken to encourage financial inclusion and address the root causes of inflation?

Thank you for your co-operation!!!

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