

**“Dollarization Process in Latin America:
Ecuador and El Salvador Cases”**

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Introduction

The purpose of this paper is to introduce the reader to an issue that is becoming increasingly important to the worldwide economy: official dollarization. The current trend of the so-called dollarization process is gaining unprecedented strength. Different countries with very distinct economic, social and even historical backgrounds are resorting to this process in order to tackle a myriad of macroeconomic difficulties of different nature that range from the lack of fiscal discipline, hyperinflation, the need to open their financial markets to the creation of new independent countries or administered territories. The globalization process constitutes a major key element in this new trend. The leaders of a significant number of countries seemed to be convinced that the benefits of dollarization will outweigh the potential drawbacks of adopting the dollar as legal tender: the allure of stability (political and financial), foreign investment, international financial integration might have failed to portray a more realistic outlook on this matter. Financial ‘globalization’ may entail global vulnerability. A recession in the United States may actually trigger an international contagion. Thus, one of the purposes of this paper is to illustrate that dollarization is not an unconditional promise of benefits nor a mean to insulate a given economy from external shocks but rather it must be deemed as a well-thought out and planned alternative, if not a radical one.

There are different degrees of dollarization that range from the unofficial (or de facto dollarization) that has existed for a significant period of time to the official dollarization (as in the case of Panama, Ecuador and El Salvador), surprisingly there is little literature on this specific topic. The only well documented case of official

dollarization is the Panama's case. However, it is important to bear in mind that there were a series of historical, political and even geographical reasons for adopting the dollar as a legal tender in said country. This particular reason set this case apart, in the sense that nowadays; there are countries that adopt the dollar for strictly macroeconomic reasons. One of the factors that have created an apparent suitable environment for this process (that would be unthinkable few years ago) is the end of the definition of Nation-State as the Westphalia Treaty established it. Actually, from a historical point of view, the clear delimitation (in all senses) of what an "independent country" should be will be viewed as a temporary trend in the current of universal history. Now, the overlapping of jurisdiction, the need for political and economic alliances (such as the creation of the Euroland and the euro), the end of the Cold War, or a bipolar world¹ have changed the fashion in which we should see the deterioration of borders and the return of a more complex world, i.e., a multipolar world where the role and influence of even remote actors (including 'political/military/financial world outcasts') will certainly influence the present and future events.

The role that the international financial organizations –within the frame of a new International Law conception– exerts a great deal of influence on this 'integration.' Organizations such as the International Monetary Fund, World Bank and the Inter-American Development Bank are standing behind any initiative to provide technical as well as financial support to those countries that are dollarized.² There is a social impact that is rarely mentioned in all the sources that I researched. From a personal point of view, it seems that the authors of most essays and works on official dollarization have failed to understand the impact that a process of this nature may have upon the population of a country being dollarized. It is my belief that there must not only be a series of "pre-

¹What comes after the 'Post-Cold War' World? Naming a New Era. The New Middle Ages. Martin Van Creveld. Foreign Policy. Summer 2000. In this article the following is stated: "A process of political disintegration set in, first in several of the former empires, then in numerous other countries –including one of the two superpowers. By the year 2000 the number of states had more than trebled. From Indonesia to Scotland, and from the former Soviet Union to southern Africa, the process most characteristic of our age is political splintering, decentralization, even disintegration." P. 39.

² There will be a mention of the projects and the coordination of these programs in this paper. The coordination of these entities, for instance, is unprecedented. This is due in part as a result of a restructuring of functions on the part of the World Bank and the IMF –in particular– based on their performance in the Asian Crisis 97-98. The "Report of the International Financial Institution Advisory Commission" (IFIAC 2000) is the blueprint for reforming the IMF, the World Bank, and other multilateral development banks. This report is known as the "Meltzer Commission Report."

requirements” (even though Ecuador’s dollarization didn’t have many of those) but there must be an educational effort on the part of the government. Illiteracy might become an obstacle in the successful enactment of not only laws but of new ‘rules of the game.’ Most Latin American countries do not enjoy labor mobility and being dollarized means assuming a totally new labor sense, which they might not be prepared to handle.

Dollarization is not only an economic issue –from my point of view- but rather the product of exportation that entails a series of concepts not known in different societies, e.g., individualism which is an inherent characteristic of the United States society but not of many countries (not only of the Western Hemisphere but in other continents). Regardless of these factors, a general outlook of the proper sequencing of dollarization will be included –from a potential strategy towards dollarization.³ The enactment of different bodies of law (including the International Monetary Stability Act of 2000 by the United States Congress) will be discussed. Issues of sharing *seignorage* and different proposals to deal with this problem will be presented, for instance the U.S. Treasury authorities are reluctant to discuss the sharing of *seignorage*. Arguments against and in favor of the dollarization process are presented briefly taking into account the cost and benefits of implementing the U.S. dollar as a legal tender. In the last section of this paper, four basic questions will be addressed: (1) Should Latin American Countries dollarize? (2) Which countries are likely to benefit from dollarization? (3) What does dollarization offer emerging market countries? (4) Full dollarization: fad or future? Lastly, a concise outlook on the perspective of dollarization will be offered, stating arguments that portray positive and negative aspects of this rather fascinating issue.

³ Ricardo Hausmann, former Economist Chief of the Inter-American Development Bank is one of the leading authors on official Dollarization. His work is constantly cited in most of the sources that I searched.