To Dollarize or not to Dollarize?
A Preliminary Comparison of Some Dollarized Economies

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Abstract

Panama is a typical example of official dollarization adopted by an independent country. The use of US dollars in Panama is often considered as a strength in that foreign trade and other international financial transactions are made relatively smoother and more efficient. The absence of exchange rate risk also works as an advantage for some sectors including finance. Furthermore, dollarization reduces the transactions costs on foreign trade.

Ecuador abandoned its national currency and adopted US dollars as legal tender in 2000. El Salvador implemented the official dollarization in 2001. There are a number of cases of unofficial dollarization, for example, in Costa Rica, Guatemala, and the Philippines. In a small open economy, the main strength of issuing a national currency lies in the fact that the government can retain its ability to try to control directly the terms of trade. Hence the lack of autonomous control of the nominal exchange rate in Panama, Ecuador, and El Salvador creates a potential source of instability in adjusting the international trade. Costa Rica, Guatemala, and the Philippines can maintain the price competitiveness of their exports by adjusting the nominal exchange rate.

As long as there is a possibility that Costa Rica, Guatemala, or the Philippines is occasionally hit by shocks unrelated to the US economy, the advantage of issuing a local currency should exceed the alternative gains. Added to these advantages is the significant seignorage income accruing to the government.

If the economy is more stable, free from high inflation and macroeconomic volatility, Ecuador and El Salvador can have reasons to revert to official de-dollarization. Even Panama could gain by adopting its own paper currency in the future. Advocates of official dollarization of Costa Rica, Guatemala, or the Philippines have yet to prove that reliable evidence exists in favor for that policy option.

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