

## **Introduction**

As the financial crisis in Argentina deepened in spring 2002, SOAC organized a conference on dollarization in Latin America and its implications for national sovereignty and development. Co-sponsored with FIU's Latin American and Caribbean Center and the Center for Economic Studies and International Trade (INTEGRAL) of Buenos Aires, Argentina, "Dollarization and Latin America: Quick Cure or Bad Medicine?" discussed different countries' experiences with dollarization and broader policy concerns. As the large turnout at the March 4 conference made clear, the Argentina collapse has lent new urgency to evaluating the wisdom of the decision taken by many Latin American and Caribbean countries to link their fortunes to the US dollar.

The panelists included prominent academics from the US and Latin America, as well as policy makers who played a key role in their countries' decisions to dollarize. While Argentina was the main focus of the program, it also included case studies of four other countries that have adopted or contemplated some degree of dollarization: Ecuador, El Salvador, Cuba and Mexico. In each case, policy makers have considered dollarization to help achieve such benefits as lower interest rates and devaluation risks, increased capital mobility, a decline in inflation, greater financial intermediation and diversification. But dollarization also brings with it attendant risks, by limiting governments' ability to respond to economic shocks. The panelists emphasized that for dollarization to be successful and sustainable, it must be accompanied by significant financial reform.

The Argentine case took center stage with a presentation by Andrew Powell, former chief economist of that country's Central Bank, who summarized the pitfalls of dollar-peso convertibility. He noted that although this policy was successful for a while, warning signs that it was time to end it included persistent current account deficits and questionable fiscal discipline. In his view, dollarization in Argentina was, to some extent, a missed opportunity. If enacted in 1999, when the first signs of crisis became apparent, it could have reduced the economy's default risk and increased confidence and investment. Powell was quick to add, however, that it would not have solved problems of competitiveness and fiscal shortcomings unrelated to growth. Some proponents of dollarization argue that it is still a good option for Argentina today, but Powell maintained that the first priority is developing an independent monetary policy. Ultimately, he pointed out, the ability to overcome Argentina's many challenges will depend on political will and skillful management, as well as US and IMF generosity.

The conference's keynote speech was delivered by Manuel Enrique Hinds, former minister of finance of El Salvador and one of the architects of that country's dollarization program. He presented the Salvadoran experience as a case apart. Unlike other countries, such as Ecuador, El Salvador's decision to accept the dollar was not spurred by macroeconomic problems, Hinds argued. In fact, El Salvador was already one of the few Latin American countries to enjoy an investment grade rating. Its motive in dollarizing the economy was the microeconomic advantages of integration into the world financial system. Hinds emphasized that the issue for developing countries is not so

much dollarization, but development. He acknowledges that dollarization is not the only solution and, as most of the panelists cautioned in their presentations, it must be accompanied by the elements to make it sustainable. The key to development, he concluded, lies not in exchange rate regimes, but in reform.

In addition to evaluating the experience of dollarization in Latin America, the conference dealt with the US perspective on this phenomenon. David Altig of the Federal Reserve Bank of Cleveland discounted fears that dollarization will insinuate other countries' problems into US financial decisions, pointing out that domestic policy is already influenced by foreign concerns. At the same time he cautioned against the potential for too much dollarization, citing the benefits of competition in monetary regimes as in trade. In contrast, Benjamin Cohen of the University of California- Santa Barbara argued that official dollarization is not in the interest of the United States. He maintained that a widespread trend toward dollarization in the hemisphere would bring few gains for this country and some potential losses. Informal dollarization already brings the US increased seigniorage earnings, fewer balance of payment constraints, increased status and prestige, and political influence in the form of command over purchasing power. Formal dollarization, Cohen argued, would have a minimal effect on seigniorage and transaction costs, and if countries that adopted it were not prepared the currency switch could also backfire and make the US a focus of economic discontent.

A full text of these and other conference presentations can be found in the pages that follow. Additional information about the program and panelists, including selected PowerPoint presentations and background articles, is available on SOAC's website, [www.americasnet.net](http://www.americasnet.net).