

Latin American economic policy during the 1990s has been guided by the “Washington Consensus,” which embodied the orthodox model’s espousal of free trade and economic liberalization (Williamson 1990). Macroeconomic performance improved over the last decade of the 1980s, aided by new capital inflows. However, Birdsall and de la Torre (2001, 6) note that “in economic growth, poverty reduction, income distribution, and social conditions the results were discouraging.” This outcome is no surprise to institutionalists and those not committed to the orthodox model (Lichtenstein, 2000; Schneider, 1999; Went 2000;).

The Washington Consensus left the issue of exchange rate regime open, suggesting “that achieving a ‘competitive’ exchange rate is more important than how the rate is determined” (Williamson, 1990, 13-14), although floating rates had “some support in Washington...as the more important (principle)” (Williamson 2000, 13). However, Felix (1997/8) documented increased exchange rate volatility and its detrimental effect on trade, investment, financial stability and macroeconomic policy in Latin America. Taking a Keynesian perspective, he pointed to capital mobility after the demise of Bretton Woods as the main contributor to this discouraging performance. Orthodox economists placed the onus on bad domestic policy or faulty choice of exchange rate regime. After the collapse of the pegged rates in the Asian miracle economies, orthodoxy demanded that countries operate in a bi-polar world, either floating their currencies or adopting a hard peg such as dollarization (Fischer, 2001a). In addition, the successful European transition to the Euro, active research on optimal currency areas (Panizza, Stein and Talvi, 2000; Courchene and Harris 2000), and widespread use of the dollar in Latin America combined to suggest dollarization as a solution to the problems noted by Felix. Ecuador undertook official dollarization in 2000 when it destroyed its own currency, the sucre, and adopted the dollar. El Salvador converted all financial instruments to dollars and Guatemala now allows transactions to be carried out in any currency. Both assumed that the dollar would soon displace their domestic currencies. This experience suggests that dollarization may become progressively easier for other countries. Indeed, there are numerous predictions of a completely dollarized Western Hemisphere (Schuldt, 2001; Trejos, 1999; Tuculet, 2001).

Will other countries in the Western Hemisphere implement official dollarization this decade? Could Latin America become an official dollar bloc, with the dollar as the common currency? Alternatively, will dollarization be a momentary phenomenon, whose promise is tarnished by the economic performance of countries that have chosen hard pegs?¹

In answering these questions, I use the methodology of “pattern models” described in Wilber and Harrison (1978). My model, and point of departure, is to characterize Latin America’s international financial relations as a “dollar bloc,” an informal but powerful system that binds their currencies to the dominant currency, the dollar (Jameson, 1990). This relation, and its supportive institutions such as the IMF and the World Bank, dominates Latin America’s international economic relations. Whether official dollarization becomes the general choice of exchange rate regime in Latin America in this decade depends on the extent to which dollarization becomes one of the rules of the dollar bloc; it is a question of the institutional evolution of the dollar bloc (Jameson 2001).

I structure the argument as follows. In the first section I place dollarization in historical context, since dollarization is path dependent and the historical experience will affect how the dollar bloc evolves. In the main body of the paper, I examine the most extreme contemporary dollarization program, that of Ecuador. Any future dollarization decision will not result from bloodless calculation of costs, benefits, and optimality of the chosen exchange rate regime. Rather, issues of power and of the political goals of actors and institutions will play the dominant role. In turn, they will be heavily influenced by contemporary experience with dollarization. I treat Ecuador's experience in four dimensions. I document the Ecuadorian macro-economic performance that spawned dollarization, and I then describe the powerful interests that developed and pushed dollarization as the preferred response to its economic problems. Next, I assess Ecuador's economic performance under dollarization, which leads finally to a discussion of possible alternative policies. I conclude that dollarization has had a number of positive elements; however, both the contemporary economic performance and the future prospects for Ecuador are modest and completely dependent on external trends. Dollarization has not addressed the central economic issues of Ecuador. In the final section, I conclude that dollarization will not become a policy of choice for dealing with the problems of exchange rate instability, unless the major international players begin to push and support that policy. There are few signs at present of pressure in this direction.

DOLLARIZATION PAST AND PRESENT

ECUADOR'S DOLLARIZATION

ARE THERE ALTERNATIVES FOR DOLLARIZED ECUADOR?

WILL LATIN AMERICA DOLLARIZE?