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The movement toward dollarization and a possible monetary union has gathered strength in Central America with passage of legislation in Guatemala permitting free circulation of the dollar and other hard currencies. Meanwhile, confusion reigned during the first weeks of dollarization in El Salvador. In December 2000, El Salvador adopted legislation (Ley de Integracion Monetaria) to fully dollarize beginning Jan. 1, 2001 (see NotiCen, 2000-12-14).

The measure was promoted as a fast way to lower interest rates, attract foreign investment, and reduce inflation. Implementation of the law, however, proved a headache during the first weeks of January. The Guatemalan legislature passed a more limited form of dollarization with the Ley de Libre Negociacion de Divisas. Claiming that passage of the bill was of "national urgency," the governing Frente Republicano Guatemalteco (FRG) pushed the bill permitting free circulation of the dollar. With opposition party support, Congress passed the bill Dec. 19 without the customary second and third debates.

Abandoning his reservations about dollarization, President Alfonso Portillo said changes in the bill before passage had removed his concerns and that the bill would improve the economy. He promised to sign it early in 2001. The law goes into effect May 1. The law permits free circulation of the dollar and other hard currencies in bank transactions, paying salaries, and for any business purpose. Unlike the Salvadoran law, it does not contemplate the disappearance of the national currency the quetzal nor does it set a fixed rate of exchange.

Some opposition legislators objected to the bill arguing that it favored some sectors over others, that it undercut the Banco de Guatemala (central bank), and that it was unconstitutional. One deputy said he received a death threat for speaking out against the bill. Finance Minister Manuel Maza Castellanos had opposed the bill within the administration because he thought the economy was not ready for the change. His principal objection was that the government had not put its finances in order, particularly improving tax collection and stabilizing the exchange rate.

Gert Rosenthal, a former official of the UN Economic Commission on Latin America and the Caribbean (ECLAC) and current Guatemalan ambassador to the UN, warned against moving from free circulation of foreign currencies to full dollarization. Challenging the claim that dollarization would stabilize the financial system and attract foreign investment, Rosenthal said the same thing could be accomplished by adopting "a coherent economic policy." Furthermore, he said, if Guatemala tied its economy to the dollar and tomorrow there was a decline of the yen or euro against the dollar, Guatemalan exports would be less competitive in world markets. The new law has the blessing of the business community, but with some reservations.

Luis Fernando Montenegro, president of the business association Comite Coordinador de Asociaciones Agricolas, Comerciales, Industriales y Financieras (CACIF), said the law would

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"energize trade and the economy." But CACIF wants to see Portillo stabilize the economy to make free circulation work. The Federacion de la Pequena y Mediana Empresa (FEPYME) said the law would encourage the repatriation of capital and increase investment. And Fanny de Estrada of the Asociacion Gremial de Exportadores de Productos No Tradicionales (AGEXPRONT) said dollarization would make international payments more efficient.

Confusion reigns in El Salvador

At the end of December, Salvadoran economy officials said preparations for the switch to dollars were complete. Banks had trained employees and automatic-teller machines were stocked with dollars. However, entering its first month of dollarization, El Salvador found itself in a state of confusion as everyday transactions were slowed by struggles to convert colon values to dollars and to make change in an unfamiliar currency. School children were memorizing the multiples of 8.75 the fixed ratio of the colon to the dollar. Minister of Education Evelyn Jacir de Lovo said children would be taught to convert currencies to protect them from becoming victims in the marketplace. She added that pamphlets explaining dollarization were being prepared for schools.

Critics of the government's handling of dollarization say no educational campaign for adults was carried out to prepare them for dollarization, which went into effect five weeks after President Francisco Flores first announced it in November. More than 22% of Salvadorans are illiterate and many cannot calculate currency transactions even in colones. The pamphlets the education minister referred to have yet to be delivered to schools and, in some grades, instruction in currency conversion will be postponed until new social-studies textbooks become available. No training was provided for teachers to handle currency conversion in the school curriculum, said teacher representatives. Some teachers said they did not know what a dollar was worth in colones.

The daily El Nuevo Diario reported consumers reluctant to use the dollar partly out of a sense of injured nationalism and partly out of fear of making small miscalculations in currency conversions that could translate into big losses in colones. Newspapers reported that bus drivers, store clerks, and street vendors were either unable to properly calculate the conversion or to make change. Some solved the problem by simply keeping the change.

Many sightings of counterfeit dollars were reported. Adding to concerns about fake dollars was the confusion caused by the redesign of the US bills that began in 1996, so that two versions of each denomination are now in circulation. Some businesses posted signs saying, "Here we are Salvadorans, and we only accept colones." Though it is illegal under the new law to refuse payment in dollars, many businesses, private schools, and vendors would not take dollars because they were unsure how to covert or they ran into resistance from confused clients and customers.

By the end of the first week, the Legislative Assembly had begun inquiries into charges that supermarkets and other large businesses had unjustifiably raised prices, indicating that inflation was one of the immediate effects of dollarization. Farabundo Marti para la Liberacion Nacional (FMLN) Deputy Manuel Melgar charged that, in converting prices to dollars, businesses were rounding out prices in their favor, "generating losses and confusion."

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A move is afoot to pressure Antonio Mendez, director of the consumer-protection agency Direccion de Proteccion al Consumidor (DPC), to crack down on price gouging. Bus companies belonging to the Asociacion de Empresarios de Autobuses Salvadorenos (AEAS) announced their refusal to accept dollars in payment of fares. The association says that the US$0.17 fare set by the government cheats them out of a tenth of a colon, which could add up to a loss of US$1,942 per day.

Dollarization law faces court test

Meanwhile, the law is facing at least three court challenges. The opposition party Centro Democratico Unido (CDU) filed suit in the Corte Suprema de Justicia (CSJ) asking the court to throw out the law on grounds of unconstitutionality. The basis of the suit lies in alleged contradictions in the law and with the argument that dollarization undermines the powers of the Banco Central de Reserva (BCR). The suit argues that under the Constitution, the state not the US Federal Reserve Bank is obliged to regulate monetary policy. The Fundacion de Estudios para la Aplicacion del Derecho (FESPAD) filed a similar suit, and the FMLN is reportedly preparing its own suit.

In early January, Ecuadoran President Gustavo Noboa called a summit for the first week in March with the presidents of the three Central American nations using or moving toward the dollar: Guatemala, Panama, and El Salvador. Ecuador dollarized its monetary system in September 2000 (see NotiSur, 2000-09-15).

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