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Mixed Reaction to Dollarization

by LADB Staff

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Six months after the government began the free circulation of US dollars, US\$163 million, or one-third of the currency in circulation, is now in dollars. Polls show reluctant acceptance of the dual currency system, but critics say it benefits only bankers. The dollarization law (Ley de Integración Monetaria) went into effect Jan. 1. It set the exchange rate within a narrow band of 8.2 to 8.75 colones to the dollar and ended the printing of the national currency (see NotiCen, 2000-12-14). The amount of national currency in circulation has shrunk by 40%, according to the Banco Central de Reserva (BCR).

Last year, Jorge Schafik Handal of the opposition Farabundo Martí para la Liberación Nacional (FMLN) predicted that the colon would disappear within six months. At the present rate of replacement, the colon could disappear by April 2002 say BCR officials. BCR president Rafael Barraza insists, however, that replacing the colon is not part of the dollarization plan and that the ultimate goal is the permanent circulation of both currencies.

Interest rates are down, remittances up

Economy officials are saying that the experiment has been beneficial, citing a drop in interest rates and an increase in dollar remittances from the US. The cost of borrowing for housing dropped four percentage points in the 12 months ending June 30 and is now at 11.7%. Short-term credit is around 11.65%. BCR figures show that dollar remittances rose 13.3% in the first five months of dollarization, bringing in a total of US\$763.2 million. New investments, especially in the maquila sector, have also risen in the same period, and non-coffee exports rose by 7.6%, said a BCR report. With 65% of its exports going to the US, Barraza sees no likelihood of moving away from the dollar. However, a debate has begun regarding the future role of the euro as a reference currency.

European Commission analysts expect the euro to become the dominant currency in much of the world outside of the European Union (EU). Twelve countries in Central Europe and the Mediterranean are awaiting membership in the EU. They and other countries are already moving toward the euro.

The Argentine legislature recently approved a plan to use the euro as one of its reference currencies (see NotiSur, 2001-06-29). "For the moment, El Salvador will remain in the dollar zone," Barraza said. Despite official satisfaction with the dollar, some Salvadorans claim it has brought them no benefits, and up to 80% say they prefer the colon, according to recent polls. The currency reform, planned in secret, unveiled in November 2000, and quickly passed by the Legislative Assembly, allowed little time for Salvadorans to become accustomed to the new system. That accounts for some of the dissatisfaction with the dollar. But the extensive plans for rapid economic growth and poverty reduction that accompanied the government's efforts to promote dollarization have not been realized. Those plans were canceled by the devastating earthquakes in January and February.

Economist Alvaro Trigueros of the Universidad Centroamericana (UCA) thinks dollarization is fundamentally flawed and calls it "a mistake." Trigueros told the Inter Press Service that dollarization benefits bankers but does not address fundamental economic problems such as poverty, the low level of competitiveness, and insufficient foreign investment. The FMLN opposed dollarization from the start and has been promoting the colon as a symbol of sovereignty. The party began organizing protests against dollarization last November, arguing that the dollar hurts small businesses, makes money laundering easier, and does not have popular support. Most Salvadorans tell opinion pollsters and the media that they have no choice but to use the dollar in at least some transactions, but the government interprets that as popular acceptance.

The administration has struck back at its critics. Secretary of the Presidency Juan Jose Daboub said the FMLN was unable to oppose dollarization by democratic means and turned to protests to "create a climate of instability." The administration has sent letters out from the Fondo Social para la Vivienda flailing opponents for using the issue as an excuse to attack the government. In January, the FMLN ordered all municipal governments under its control to refuse payments in dollars.

Since November, the Sala de lo Constitucional of the Corte Suprema de Justicia (CSJ) has agreed to hear three suits asking that the Ley de Integracion Monetaria be declared unconstitutional. One suit was filed by the Centro Democratico Unido (CDU), another by the FMLN, and the third by the Fundacion de Estudios Juridicos para la Aplicacion del Derecho (FESPAD).

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