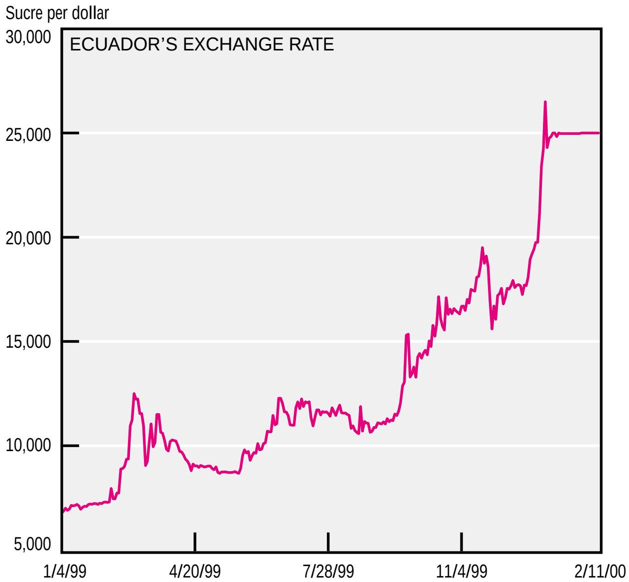
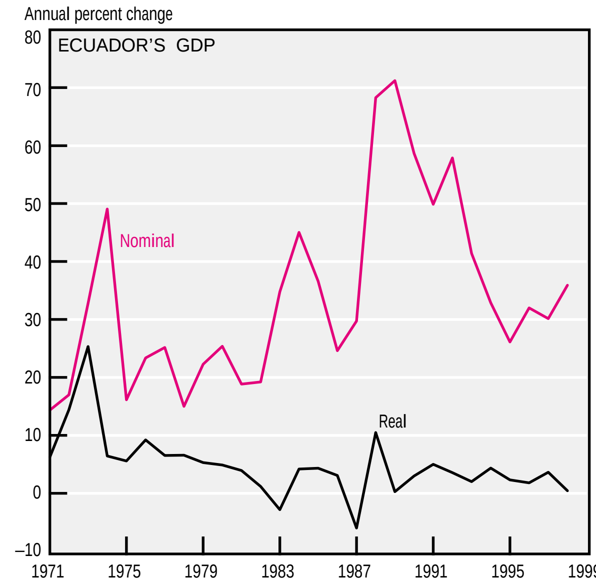
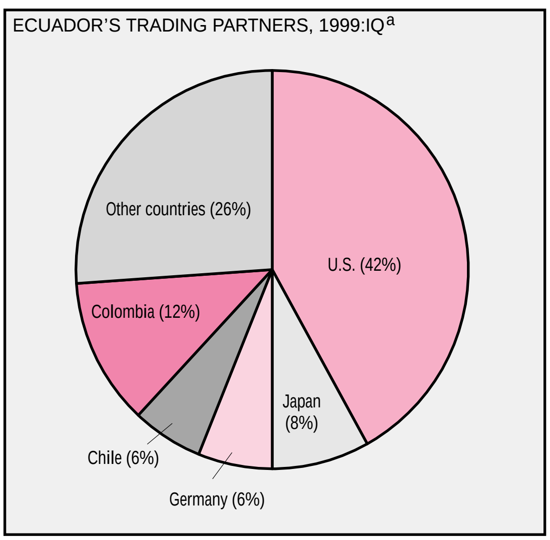
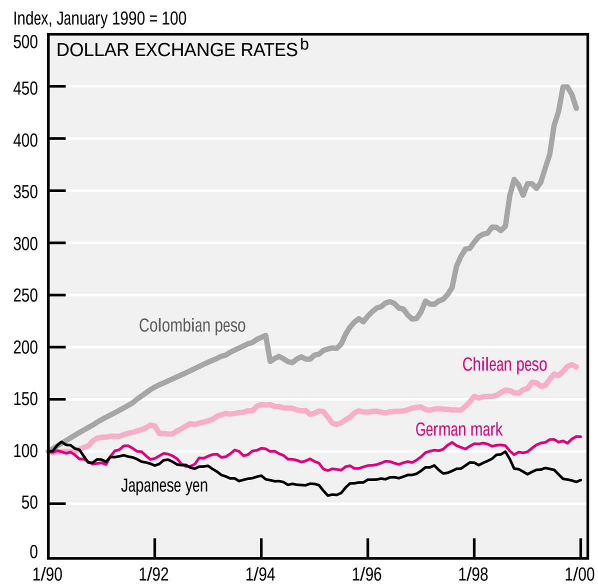
Dollarization and Ecuador's Sucre









a. Total trade is the sum of exports and imports.
b. Units of foreign currency per dollar.
SOURCES: Board of Governors of the Federal Reserve System; and International Monetary Fund, *International Financial Statistics.*

On January 9, 2000, the president of Ecuador proposed official dollarization as a way to halt the rapid depreciation of the country's currency (the sucre), prevent hyperinflation, and establish economic stability.

Official dollarization occurs when a country adopts a foreign currency as legal tender, either exclusively or predominantly. Today, 13 of the 29 officially dollarized countries use the U.S. dollar as their predominant currency. By doing so, they relinquish monetary sovereignty and link their inflation rates to U.S monetary policy. In return, these countries assure themselves a rate of inflation close to that of the U.S. Dollarization precludes governments in emerging markets from using inflation as a revenue source. Sound monetary policies improve the prospects for real economic growth.

The U.S. accounts for 42% of Ecuador's foreign trade. This is more than the U.S. share of foreign trade for Argentina (17%), which maintains rigid links between the peso and the U.S. dollar, but smaller than the trade share for Mexico (80%), whose currency is not formally tied to the dollar. Linking the sucre to the dollar would expose Ecuador's trade to fluctuations in dollar exchange rates. A dollar appreciation could reduce the country's trade balance, forcing Ecuadorans to reduce prices and wages in order to reestablish their trade competitiveness.