A dollarized currency regime limits a government’s ability to serve as a lender of last resort in a banking crisis. Dollarized countries cannot create money to rescue the banking system because they can’t create dollars at all.

A dollarized country also sacrifices its seigniorage, which is the profit a country makes from printing money. It costs three cents to print a $100 bill, but that bill can purchase $100 worth of goods and services. In a nondollarized economy, the central bank holds international reserves in interest-bearing instruments, such as U.S. Treasury bills. Under dollarization, a country loses the interest earned from these types of instruments.

Dollarization is not the only route to fiscal and monetary credibility. Price stability and low inflation. But its supporters argue that it may be a more viable route than others.

— William C. Gruben

Sherry L. Kiser