## **Contents**

1	A Primer on Dollarization — 1
1.1	Introduction — 1
1.2	Asset vs Currency Substitution — 2
1.3	Official and Partial Dollarization — 3
1.4	Measuring the Degree of Partial Dollarization 7
1.5	Causes of Dollarization — 7
1.6	Dollarization and Banking Dollarization 13
1.7	A Brief History of Dollarization Around the Globe — 20
1.7.1	Latin America — 20
1.7.2	Transition Economies — 24
1.7.3	Asia — 27
1.7.4	Sub-Saharan Africa — 27
1.8	Exchange Rate Regimes and Dollarization — 27
2	Pros and Cons of Dollarization — 32
2.1	Introduction 32
2.2	Arguments in Favor of Dollarization — 32
2.2.1	Inflation Reduction — 34
2.2.2	Fiscal Discipline — 35
2.2.3	Reduction in the Cost of Borrowing — 35
2.2.4	Lower Transaction Costs — 36
2.3	Benefits of Partial Dollarization — <b>38</b>
2.3.1	Encourages Saving — 38
2.3.2	Promotes Financial Deepening — <b>39</b>
2.4	Arguments Against Dollarization — 40
2.4.1	Costs of Dollarization under Full Dollarization — 40
2.4.1.1	Loss of Monetary Policy — 40
2.4.1.2	Inability to Act as a Lender of Last Resort — 40
2.4.2	Costs of Dollarization under Partial Dollarization — 40
2.4.2.1	Increased Foreign Exchange Rate Risk for the Banking System — 41
2.4.2.2	Mismatch of Foreign Currency Assets and Liabilities 41
2.4.2.3	Increased Default Risk — 41
2.4.2.4	Monetary Policy Challenges — 42
3	What Causes Dollarization? — 45
3.1	Introduction — 45
3.2	Inflation and Dollarization — 45
3.3	Transmission Mechanisms — 47
3.3.1	The Trade Channel —— 48
3.3.2	The Credit Channel — 48



3.3.3	Liability Channel — 49
3.3.4	Evidence on Currency Substitution Theory — 53
3.4	De-Dollarization Hysteresis — 54
3.5	New Ideas — 58
3.5.1	Inflation in Collective Memory — 58
3.5.2	Minimum Variance Portfolio (MVP) Theory 59
3.5.2.1	The MVP Model — 60
3.5.2.2	Evidence that Supports the MVP Theory 62
3.5.3	Institutions Argument — 63
4	The Impact of Dollarization on Banking Systems — 67
4.1	Introduction — 67
4.2	Why Do Governments Allow Foreign Currency Accounts and Foreign
	Currency Lending in the Banking System? —— 68
4.3	Banking Risks in a Partially Dollarized Economy — 70
4.3.1	Currency Mismatch Risk — 70
4.3.2	From Currency Mismatch Risk to Default Risk — 73
4.4	Empirical Evidence — 78
5	Dollarization, Financial Deepening
	and Financial Inclusion —— 83
5.1	Introduction — 83
5.2	What We Know about Financial Depth and Dollarization: A Review —— 83
5.3	Financial Inclusion — 93
5.4	Bitcoin: The New Future Form of Dollarization? — <b>102</b>
6	Policy Interventions in Dollarized Economies — 105
6.1	Introduction — 105
6.2	Monetary Policy in Partially Dollarized Economies — 106
6.3	Regulatory Attitudes Toward Dollarization in the Aftermath of the
	Financial Crisis —— <b>109</b>
6.4	Case Study: Turkey — 112
7	Conclusions — 121

References — 125

Index — 129