

Dollarization in Cambodia



Dollarization occurs when a country uses US Dollar or other currency instead of or along with local currency. The picture of dollarization can be as follows: using dollar for bank Deposit, paying debt, buying goods and service, measuring national budget. 1 There are three types of dollarization: official, semi-official, and unofficial. Official dollarization occurs when a country uses dollar as the legal currency instead of domestic currency. For example, Panama is the dominant official dollarization adopter. It has no domestic currency published at all. The second type is Semi-official dollarization. Some countries in the world use US dollar and domestic currency at the same time; in other words, they use bimonetary systems. This allows people to make deposit in US dollar, do some transaction, but it only acts as a second role in paying wage, tax, electricity, and daily expense. Adopting this system, the central bank can place its own monetary policy. Cambodia, Lao, and Haiti are the examples of semi-dollarized countries. Third, in unofficial dollarization, some countries' majority wealth is held in foreign currency and people can use US dollar substituting domestic currency either legally or illegally. In short, when a country uses other currency besides its own to substitute the three functions of the monetary, it is theoretically that the country has been dollarized formally, semi-formally or informally.

2. World Dollarization Implication

There are two main aspects of dollarization. Dollarization is the subject of not only the economic or also of Politics. Economists think that money is only just public goods which consist of three functions: means of exchange, store value and unit of account and its purpose is only to ease the economic transaction. Dollarization is the symbol of the US power influence country

money. The US aid for the reconstruction of Western Europe after the World War II and many other countries, the role of US in world stage became more important. Then after the abolishment of Gold Standard in 1971, the US dollar also became the main currency in the world. Because of shock of financial crisis, some countries adopt dollar US to reduce the risk and create stability. For, those countries adopting dollarization is only another term for fixed exchange rate compared to US dollar without much effort². Comparing to developing country currency, it is more reliable, valuable and profitable in doing trade, storing value, and making transaction. However, some countries use other currency with similar quality such as Germany mark, Japanese yen and now Euro in Europe.

Beside economic value, money contains purchasing power which is the heart of politic. The power has distributed to the creator, the exchanger, and especially the controller. Thus, distribution of money does not only create hierarchy of people but it also creates hierarchy in the world. ³ However, for some other countries dollarization is the heart of political interest. For instance, using US dollar in Latin America implies its dependence on US and also shows its inferior. East Timor adopt US dollar as its official currency to prevent Indonesian influence. In short, dollarization can be characterize into both economic and politics. Through both means the dollarization is becoming new influence of US in the world.

3. Dollarization in Cambodia Dollarization

According to IMF the proportion of Dollar in economic circulation is 90% which is indifferent for a decade ago. In an article dollarization in Cambodia, and policy options on the way forward, Menon (1998) concluded that “...

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dollarization is not the problem, but is merely symptom. The problem (or the cause) is a lack of confidence in the riel, whilst the symptom (or the effect) is the use of another currency such as the US dollar. 4” Dollarization in Cambodia is the result of both past and present economic and political status. Dollarization in Cambodia is the direct legacy of the destruction of economic and financial

Institutions after the 1970s, economic mismanagement in the 1980s, and the large inflows of US Dollars during the UNTAC period in the early 1990s.

Today, in Cambodia the US dollar still serves all three functions of money: it is widely used as a medium of exchange, store of wealth, and unit of account. The fact that dollarization is not the real problem but it is the lack of confidence in riel can be rooted as far as the Khmer Rouge Regime. In 1975 the revolution of Khmer Rouge took over the Cambodia political and economy. Influenced by the Marxism, to make Cambodia a communist country the Pol Pot abolished riel currency as well as stopped the national bank operation and thus hoped to fill the gap of the rich and the poor. Cambodian people lived in hardship without any personal business activity, any means of store value or exchange, or private ownership. Fortunately, in 1979 the population was saved; however, this country returned to the state of traditional economy using barter system. Then, not until 1980 did riel currency appear again. Experiencing shock in 1975 when their saving money became scraps in only days, Cambodian people later preferred to use other means such as gold, silver, jewelry for exchange. Most people used riel currency for only small transactions and not over 50\$ saving. When the dollar was introduced again in the 1990s, it is generally accepted along with previous gold and silver money.

As much 1.7 billion US million dollars has poured in Cambodia through UN peace keeping activity, the UNTAC. This situation paved the way for Cambodian economy to depend on the stronger money US dollar and Cambodia was easily the most highly dollarized country in Asia, and one of the highest in the world. The share of dollars in currency circulation is highest in Cambodia, estimated at about 90 percent. Nowadays Dollar still plays major role in business transaction, and the major deposit in bank. The existence of dollarization in Cambodia is also expected to last. Another reason for Cambodia in accepting dollarization is just a pressure of its country as a developing economy. Even though Cambodia has done three decades or reconstructing the economy, reducing political and economic uncertainty, there are more actions to be done to get out of dollarization. While growth and political uncertainty greatly has been reduced, Cambodia remains a low income country with significant inequality and poverty, and some degree of political uncertainty remains. For example, political turmoil in 1997 combined with Asian financial crisis would have been more even more threatening to Cambodia if it had not been dollarized.

4. Conclusion

As many states have problem in both economic and political stability and weak monetary system people will consider using another currency which is more stable and valuable in most situation. In the serious case some countries do not have own currency at all but US dollar. As the US has strong monetary regime its currency impress those developing states to use US dollar; therefore, US may somewhat influence those state in both economic and political. Some states may be dollarized in order to create financial stability;

however, they are unsure what can US do with dollarization for politics. Cambodia is not the exception. Since 1970s and had been attracted to new currency US dollar in since 1990s. Until now, the degree of dollarization has changed only a little. Dollarization was injected so gradually that people get accustomed to it despite the government effort to de-dollarize in the last decade. Cambodia economic and politic problems still fuel dollarization existence. Next issue is to discuss the advantage and disadvantage in Cambodia.

MC2: Situation of Dollarization in Cambodia Today and Its Cost and Benefit

After the two decade of United Nation Transnational Authority in Cambodia (UNTAC) operated peace keeping activity and introduce dollarization in Cambodia, with high economic performance with average two digits GDP growth and considerable political stability Cambodia should have come out of dollarization already. However, Cambodia's economy is still highly and increasingly dollarized which urge the government to critically consider whether to de-dollarize by comparing its cost and benefit.

The status of Cambodia dollarization today is not far different from the 1990s¹. The dollar still serves three functions in this economy: making transaction, storing value and being used as unit of account. The cash dollar in circulation in Cambodia is 90% of all value of transaction which is similar as a decade ago. Dollar has been widely use for private sector wage payment, medium of international trade and also purchase large value products. Moreover, dollars also dominate the currency deposit as storing value instrument in Cambodia. According to the National Bank, the foreign

currency deposit in broad money (M2) is accounted for 75% in 2006 increasing from 54% in 1998. Furthermore, 97% of bank deposit is in term of dollar. The recent increase in dollarization is the result of two main points the higher economic growth and recent political stability has contribute to more dollarization. When the investor think Cambodia is a good place to invest they will inject more dollar investment. In addition, the open trade economy also allows Cambodia to do more trade with other countries using dollar as medium of international trade exchange.

Long before this happen the issue of dollarization has been discussed on cost and benefit but at this time it is even more critical to figure out that the cost of dollarization is more than benefit in Cambodia². The benefit of dollarization in Cambodia can be encouraging saving, preventing capital flight, providing low risk of currency and exchange rate devaluation. First, the dollarization increasing saving when there is a better currency that is more reliable, therefore, people will tend to save in the bank in dollar to increase their wealth as well as lubricate the economy. Second, this also prevent hot money go out Cambodia in a short time of return from investment because investor still deposit money in local bank and transfer to their homeland at any time when there is high portion of dollar deposit in the bank. Last but not least, dollarization provides security from the risk of currency devaluation and exchange rate depreciation. When the local money face inflation or depreciation the dollar holder will not worry about the value of asset they hold in dollar. On the other hand, those benefits are little comparing to cost of dollarization. First of all, riel is the national symbol of states sovereignty so using dollar is really affect sovereignty and national

identity. Second, When Cambodia use dollar as dominate to riel currency, the national symbol has been eroded because the people do not trust their own government. Instead of get easily affected by local inflation, the dollar holder get easily affect by dollar instability especially in recent years. Thus, it means that Cambodia is somewhat dependence on the US federal monetary policy. Finally, dollarization make local monetary policy less effective, in other word, the central bank cannot use its own currency to fully stabilize price and economy. When government want to print more money it will not increase much in the economy because most of transaction done by dollar and the government also cannot control the interest rate since the most deposit is in dollar not riel. Government also cannot get inflation tax (print money to finance short term deficit but let go the inflation) to finance the government budget especially in hard time. 3 Being unable to use inflation tax or seignior age to support emergency needs the government of Cambodia is estimate to loss seignior age to be \$682 million at the end of 2004, with an additional \$61 million lost annually. and especially in the case of paying the military, the Barry Eichengreen (1994): “ Money can be printed to pay soldiers, to purchase materiel, and to underwrite the other costs of a war of national defense without having to wait for tax returns to be filed or for a foreign loan to be extended.” As the state sovereignty and being able to use own policy is very important the cost burden by dollarization above have already exceed the benefit. Thus it is time for Cambodian government to get more effort in de-dollarized campaigned despite the problem of lack of both commitment and capacity. In short, even though the economy and politic of Cambodia has improved the dollarization has not

been eliminated but it increases because of the more free market mechanism. However, dollarization has imposed more cost such as hindering Cambodia from using its own monetary policy, eroding national sovereignty and being not able to finance government budget deficit which is far more significant than the benefit such as creating price stability, encouraging saving and discouraging capital flight. This is the high time for Cambodia government to respond to those issues. Cambodia cannot stay aside from dollarization as it shows the higher level. The Cambodia government has to show its commitment and strengthen capacity to combat dollarization either locally or regionally.

MC#3: Policy Option for De-dollarization in Cambodia

The government of Cambodia has realized that the current situation of dollarization in

Cambodia has higher cost than benefit. The cost is that dollarization has weakened domestic

monetary policy capacity to manipulate the financial and monetary system while the benefit has

gone to price stability and trade and investment integration. The Cambodian government has;

therefore, allowed the side effect of US federal policy to influence its economy for a long time

either good or bad. Thus, it is high time for Cambodia to strengthen de-dollarization. There are

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two main procedures in de-dollarization which are domestic policy and regional policy.

However, this paper will cover only the possibility of policy option done by the Government of

Cambodia alone. The suggested policies to de-dollarized Cambodia economy are full

dollarization, currency board agreement, and continue Interim policy reform.

However, the latest

seems most preferable.

The first choice of Cambodia is to move forward to full dollarization following the

precedential example in Latin American economy especially Panama.

Adopting this policy,

Cambodia has a great save in transaction cost, is easy to integrate itself in the regional and global

economy by trade and capital flow and also maintain high price stability.

However, full

dollarization seems not the right choice for Cambodia. Since Cambodian economy does not

closely related to US and thus it does not allow Cambodia to keep track with US economy easily.

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Moreover, giving up riel currency implies sacrificing more seigniorage benefit to US and has no

more ability to use own monetary policy as the lender of last resort of domestic commercial

bank. Moreover, the government of Cambodia hasn't showed any commitment to turn to keep

dollar as legal tender. The Minister of Ministry of Economic and Finance, Mr. Keat Chhun at the

Launching Cambodian Economic Forum in 2006 said "...However, it should be seen that the

Royal Government is now implementing de-dollarization. ...Our economy must be based on

national currency, which should be based on a basket of foreign currencies and consistent with

the integration of our economy into regional and world economy." It is not likely that Cambodia

take a reverse policy from its commitment.

Second policy is to create currency board agreement in Cambodia. A currency board is a

monetary authority, unlike central bank, issue domestic currency that is always convertible to

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foreign currency at a fixed exchange rate on the basis of 100%. This means that if 1\$ = 4000 riel,

the currency board needs 10\$ reserve to issue 40000 riel. The currency board makes profit by

gaining interest from its foreign reserve by the expense of cost in circulating local currency. The advantage of CBA is the gaining of seigniorage benefit over the dollarization that makes country

loss in that. Although Currency board seems a good choice but it needs too much effort from

Cambodia and also has side effects. There is an estimated that riel is 10% of the currency of

circulation and the official reserve is triple of this which is equal to 30%.

Thus, it means that

Cambodia needs to triple the reserve to collect all dollars in circulation.

Therefore, currency board

may lead to a mass government debt. Is there any other way that

Cambodia can get more

official reserve?

Finally, the last alternative for de-dollarization is to use interim policy.

Interim policy is

to set objective of de-dollarization in longer term and accelerate reform. In this approach, the

government of Cambodia should left the monetary system as they are on the one hand; and

increase macroeconomic stability which increase riel confident and demand as well as restore

riel-friendly environment on the other hand. First of all, National Bank of Cambodia plays an

important role in this policy. NBC is the last resort of loan of commercial bank, so NBC provide

riel as a mean to refinance. Then Cambodia government should promote the use of riel currency

as a mean of exchange with security and low cost. Last, the NBC can use Treasury bill to attract

the riel financial market by providing higher interest than dollars saving.

Beside the role of the

bank, the tax policy reform is also taken into account. Demand of riel can be raised when there

is obligation to pay all kind of tax in riel. Thus, when there is more tax collection in riel implies

more demand in riel. Besides, the adaptations of existing institutions that allow ease the

dollarization is important. For example, the minimum wage law in Cambodia is identified as

dollar not riel and the most international organizations operating in Cambodia preferred to pay

salary in dollars only while in other countries the government required the international

organizations to pay 30%-40% in local currency. Moreover, there are also surplus demands of riel

in microfinance that cannot be fulfilled. It is estimated that microfinance industry demand Riel

120 billion in 2008, but the supply is not enough. Thus, it is important to resolve the

dollarization-friendly condition above by removing any status barrier for dollarization although

there is a certain portion in dollars paying in wages and salaries and increasing the supply of riel in

microfinance industry.

One can criticize that the Cambodian government has done a lot in reform for macroeconomic

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stability but the result is still high dollarization in today economy. Cambodia has

enjoyed high growth, average two digit growth in last five year, despite the distraction from the

global financial crisis in 2008, yet there still the same dollarization. In addition, to restore

attract demand in riel as a secure and low transaction cost currency is not good because the

commercial bank has promote it by giving higher interest rate than dollar deposit already. The

problem is not focus on what have Cambodian has done, instead it is important to know what

else needed to achieve long-term goal of de-dollarization. Moreover, gradually de-dollarization

process can ease the economy adaption. As result, when the Cambodia reach the macroeconomic

stability the authority can take advantage of strong financial system to increase confident in riel

and thus to de-dollarized.

In conclusion, Dollarization in Cambodia is not the matter that easily to settle because

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there is a high link between citizens who prefer dollarization as the result of being not confident in

riel and weak financial institutions and a high loss in the government which is the coordinator

between those two. Among the suggested policies in de-dollarization which are full dollarization,

currency board agreement and interim policy, the last choice is likely the best option for

Cambodia because it represents the appropriate capacity of the state as well as allows people to

increase confidence and demand in riel considerably. However, the previous effort in this policy

is not enough so Cambodia needs a higher commitment and capacity in this policy. On the other

hand, domestic policy alone may not be enough to deal with the dollarization which is the result

of capital and trade integration. Therefore, regional cooperation in combating dollarization can

be the future choice for Cambodia.

MC4: Subregional Cooperation in Dedollarization.

Cambodia, Laos and Viet Nam have shared common characteristics as the newly

emergence economy. Firstly, the three countries or so called CLV countries have transformed

from central planned economy to free and open market economy during 1980s and 1990s.

Because of the experience of price instability, fragile monetary and exchange rate policy and

the underdeveloped or non existence of financial market make all countries similarly tend to

use Dollar alongside the local currency despite the different level of dollarization. Although

dollarization has contributed to price exchange rate stability, it is not the good choice for them in

long-term because the government has lost much seigniorage, benefit and also the role of last

resort of lender of central bank. CLV has tried their own method to de-dollarize to cope with

short-term coming problems by their own reform so as to gain currency confidence and also improving

financial institution. Those policies seem to need much effort and time and CLV to achieve

alone, therefore there is also another choice of sub-€ regional cooperation among CLV countries

such as exchange rate regime and single currency area.

For CLV cooperation in monetary and exchange rate policy to combat both depolarization and monetary system sustainability which includes price stability, financial

stability and exchange rate stability, CLV have to create cooperation environment as a

precondition. First, they have to create a network of policy makers, economist elites, officials,

and researcher from all level of government and financial institution to take close surveillance

on CLV economic performance and discuss the possibility of new policy.

Moreover, the

networks should make a regular meeting information exchange, checking progress and also

make consultant the possible area in economic integration in the region.

Secondly, CLV

countries should create strong connection of capital market among them.

There are two

possible alternatives for this. The Viet Nam should allow the Cambodian and Laos company to

list its stock market or the CLV can create common bond market of CLV

sub-€ region. To develop

capital market in CLV countries they also need to make a joint regulation and supervisory to

ensure transparency to investors and they need to reduce foreign exchange restriction among

the three countries to reduce exchange rate risk among investor too.

After achieving the above precondition in monetary and exchange cooperation above,

CLV have two choices which are exchange rate cooperation and monetary cooperation to

multilaterally combat dollarization.

First of all, consider the possible of future exchange regime in ASEAN+3 in the East Asian

economic community, the CLV exchange rate cooperation can be pilot project of the bigger

picture of cooperation. CLV countries should consider the joint peg of currency to Dollar or

currency basket of currency famously Dollar, Euro and yen while the weight of currency

depends on the trilateral discussion. This common peg to Dollar is a good choice for CLV

countries because of several reasons despite some difficulties. First, the stable exchange rate to

Dollar has showed the strength of currency against outside fluctuation thus gain credibility of

currency. Second, CLV already adopt restricted fluctuation of currency against Dollar and those

main trading partner, China also already peg to Dollar. By doing this the three countries will

have less transaction cost in changing their currency to Dollar when they are doing trade and at

the same time their currency will get confident from people since it is stable with Dollar. On the

other hand, when CLV peg to the basket of currency including Dollar, Euro and Yen, the CLV

country can reduce risk when there is currency shocked in US. Instead of relying solely on

exchange rate stability with Dollar, CLV reduce the risk by depend on two more major

economies, Europe and Japan. There is no correct proportion of the three currencies in the

currency basket, yet it depends on the economic relation of CLV to the Gâ€ 3 (US, Europe and

Japan) and also their own negotiation. Besides, CLV can move further to subâ€ regional currency

board which ensures the stronger peg to foreign currency thus they get more seigniorage

benefit. However, they need much more effort to achieve this. First, they have to create a

stronger cooperation in coordinating currency policy. Second, they need more foreign reserve

to run currency board and it needs high legal endorsement to get people use local currency.

In addition to cooperation in Exchange rate regime, it is also important that CLV cooped

to create monetary regime. The CLV common currency is a long term goal they require many

effort from CLV to improve the credibility among public of currency as well as effective

institution to handle the transitional change of currency and strong political will of CLV leaders.

Besides, the CLV currency area can be established only after the Asian Currency Unit (ACU) is

which is similar to European Currency Unit, has been created in ASEAN+3.

When there is

common peg to ACU in ASEAN+3 economy, the CLV will change to peg ACU and they can create

their own sub-regional common currency in lower level to increase their voice in ASEAN

cooperation, in addition to the benefit for Exchange rate regime. However, some scholar

suggests this option is difficult to achieve at least in short and medium term because there are

many political sensitive issue to overcome, weak institution, and flexibility of people.

In summary, in order to cooperate with each other so as to de-dollarize their economy

CLV countries have two choices of Exchange rate regime and single currency. Those policies

are only achievable when CLV countries have strong foundation of cooperation in critical areas

such as economic consolidation and information sharing, joint assessment and so on. They can more

benefit from this cooperation rather than taking action individually however it is only a long-term

goal for them. In prospect there is still possibility to get out dollarization when CLV are

determined enough in cooperation.

MC#5: Dollarization and Implication of Financial Architecture Reform

Cambodia among CLV is solely dollarized countries in the world which face the

problems. Dollarization is the common problem in developing countries such as Latin America

also. Thus the case of dollarization in Cambodia can also reflect the situation of the change of

financial architecture that affect the financial and monetary system in the world. Dollarization is

the symptom of weak ability of domestic financial structure, historical price in stability and

political problems urges people to use foreign currency. While the government the seigniorage

benefit and role of last resort of lender the people enjoy the stability of money in deposit as

well as trade and investment. Rooted from the globalization there are three main debates in

global financial system:

1. Does dollarization good for developing country?
2. Should states liberalize people choice in using currency they like or impose people to

choose national fiat money?

3. Should IMF play important role in the world exchange rate stability?
 - Does dollarization good for developing country?

Dollarization can give price and exchange rate stability in low cost in most emergence

market economy. Hanke recommend developing countries to use dollarization in case that the

states do not have strong monetary and fiscal policy to tighten currency value in long term

should use dollarization as monetary institution. The above idea is not raised by him alone

Some scholars also propose choice of dollarization because of several reasons.

First, considering

the financial and debt crisis during 1980s and 1990s in much part of the world and thus leads to

increase of high inflation, currency devaluation and mass capital outflow by foreign investors.

When developing country dollarization they can stabilize the currency, exchange rate. When

those countries use a high confident and good quality currency like dollar in economy is no

possibility of a sharp depreciation, and sudden capital outflows because of investor unconfident

is also omitted. Second, dollarization can highly reduce transaction cost and integrate

developing economy closer to US. Thirdly, the stability of dollar in the economy as currency in

developing countries will encourage people to save more and foreigners to invest more.

However, dollarization is costly. Governments of developing countries need to sacrifice

seigniorage benefits in a dollarized economy and the central bank loses its role as lender of last

resort to the commercial bank in case there are liquidity problems. Moreover, the state will lose

its sovereignty in terms of monetary policy and exchange rate policy. Thus, it is a critical decision

to whether or not to dollarize in developing countries because they have to compare the

benefits of dollarization with the cost of bearing it as well as balancing internal risk with external

risk.

- Should states liberalize people's choice in using the currency they like or impose on people to

choose national fiat money?

According to Laurence H. Meyer, a member of the Board of Governors of the Federal

Reserve System when there is more global financial integration the government should increase

role in market discipline, regulation and also supervision in money and also exchange rate.

The states should improve the international capital standard, market discipline. The state has

monopolized the authorization on Money discipline by introduces national currency to show

the self-help system in term of currency and also gains seigniorage benefit. However, Randal

Kroznor, an economist at the University of Chicago's Graduate, rejects the role of government

in currency circulating. He claim that private regulation found in private actors such as clearing

house, credit rating agency, trader, capitalist investor, and others has provided stability and

innovation because they work closely to financial and currency market. He advises that the

government should reduce the intervention in the financial and monetary system and let the

dynamic private sector to regulate the system. In short, while some scholar support

government role in regulation the currency market, some ot