Governance: "Carrots versus Sticks" or "Carrots and Sticks"

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“What do America and Poland have in common? In America, you can buy everything for dollars and nothing for zlotys. In Poland, it is exactly the same.”

This was a common joke in Poland in the 1980s, a reflection of dollarization in a former communist country.

Think about the following scenarios:

1. In Canada, you cannot buy healthcare in the private sector if the service is available in the public sector (universal healthcare), no matter how much you dislike the service in the public sector.

2. Imagine that in Ghana, the government were to ban private hospitals, clinics, and schools and forced everyone to consume services in the public sector.

Canada is able to ban private healthcare (for services available in the public sector) because it has maintained the quality of healthcare in the public sector at a sufficiently high level (the carrot). The power of the state to punish its citizens (using sticks) is legitimized when the state fulfills its side of the bargain. In fact, the state's use of carrots makes it easier for it to use the stick because if the carrot is sufficiently good, not many people will have the incentive to break the law. This means that the state will have enough resources to apply the stick efficiently (i.e., without using too much effort). The ban and the attendant use of the stick as an enforcement mechanism become incentive-compatible policies. The point is that optimal policy, especially in **economic or pecuniary matters**, must involve a combination of carrot (rewards) and sticks (punishment). If you only rely on sticks, you are likely to fail.

In our part of the world, we don't pay enough attention to carrots. We are always in a hurry to apply the stick. Our leaders like to govern by decrees (sticks) without fulfilling their side of the social contract. I do not support dollarization. But I also know that dollarization does not emerge out of a vacuum. The reason why most Canadians use the Canadian dollar is not because the state goes around policing the use of other currencies. It is because most Canadians, even without the fear of punishment, have no **incentive** to use other currencies in domestic transactions.

We bemoan the fact that our country is overly dependent on imports. Unfortunately, our governments are (have been) part of the problem. In addition to corruption and mismanagement, our governments have an insatiable need for the good things of life produced in foreign lands (e.g., four wheel drives for officials in the public sector). According to the TUC, the

"... Government itself is most guilty on this (i.e., dollarization). We are in a country where custom duties charged by government are dollar-indexed. State agencies, like the Tema Development Corporation (TDC), sell land at Dollar-indexed prices. The Ghana Institute of Management and Public Administration (GIMPA), along with other public educational institutions, have indexed their fees to the US Dollar. In such an environment, one can only expect rational economic actors to procure dollars ahead of time to shield themselves from exchange rate losses. Yet, Government turns round to blame innocent Ghanaians for dollarizing the economy." First parenthesis mine.

In response to the Bank of Ghana's 2013 directive on dollarization, the the acting General Manager of Novotel hotel, was reported to have asked "Why should the government of Ghana charge non-residents to pay dollars to acquire an Identity Card and turn around to ban hotels from charging their rates in dollars?":
http://www.ghanaweb.com/ GhanaHomePage/NewsArchive/ artikel.php?ID=287684

The state is given the power to print and issue a country's currency. This is one of the unique functions of the state and it is indeed a very important one. No other person or entity in an economy has this power. This power comes with a responsibility to govern in a manner that maintains the value of the currency at a reasonable level; the state cannot impose a high level of inflation tax and thereby erode the value of the people's cedi-denominated wealth for many years and then ban dollarization. The state must do its part (the carrot) and then the people will do theirs (obey the laws of the land). Under this view, the state's ability or moral right to ban dollarization goes beyond economics and the law. It is about politics, governance, and the relationship between the state and its citizens; it goes to the very heart of the legitimacy of the state. In the same vein, Michael Melvin and Bettina Peters argued in a 1996 paper that dollarization is a market-enforced monetary reform where the public, rather than the monetary authorities, introduces a new monetary unit, which imposes a certain level of discipline on the government. According to them:

"Dollarization is the ultimate repudiation of inflationary policies as the private sector avoids the domestic inflation tax ... To restrict dollarization by official means is to restrict the free choice of individuals to protect their purchasing power and wealth ... By raising the cost to the government of ... (inflationary) policies, dollarization may play an important role in bringing monetary and fiscal discipline to developing countries." Parenthesis mine.

This is *not* an endorsement of dollarization but instead a reminder of the grave consequences of economic **mis**management. It is a demand for responsible governance because a legal tender (the stick) must ultimately be an economic tender (the carrot).