

Why There Isn't a Widely Used "Afrodollar" and What Would Be Needed for One to Exist?

Prof. Pierre A. Bultez^{1,2},

¹Pan-African Centre for Trade, Industry and Innovation (PACTII)

²Global Humanistic University

Understanding the Concept of the "Afrodollar":

The term "Afrodollar" refers to U.S. dollar deposits held in banks located within Africa that are not governed by U.S. banking regulations. This is conceptually similar to the well-established Eurodollar market, where U.S. dollar deposits are held outside the United States, typically in European banks. Despite this parallel, the term "Afrodollar" is seldom used in practice, mainly because the market for offshore U.S. dollar deposits in Africa remains significantly smaller and less developed than its Eurodollar counterpart.

If realised, an Afrodollar market or a regional currency within Africa could offer several advantages:

- **Reduced transaction costs:** Utilising local currencies would help African countries avoid exchange rate fluctuations and transaction fees tied to the U.S. dollar.
- **Increased economic sovereignty:** A regional currency would grant African nations greater control over their own monetary policy, reducing dependence on external markets and influences.
- **Boost to regional trade:** The adoption of a common currency would simplify trade between African countries, encouraging economic integration and growth across the continent.
- **Enhanced financial resilience:** A regional currency could serve as a more stable alternative to the U.S. dollar, helping insulate African economies from external economic shocks.

Several initiatives are underway to promote these goals. For example, the Pan-African Payment and Settlement System (PAPSS) seeks to facilitate trade using local currencies, thereby decreasing reliance on the U.S. dollar. Likewise, the New Development Bank (NDB) provides loans in local currencies to encourage financial autonomy.

Main Reasons an Afrodollar Market Has Not Developed

Reason	Explanation
Limited USD liquidity in Africa	Most African economies are net importers of U.S. dollars. As a result, corporations and banks do not hold large, stable pools of excess dollars to deposit offshore. The constant flow of U.S. dollars that sustains the Eurodollar market is absent in Africa.
Shallow inter-bank market	The Eurodollar market relies on a dense network of banks that lend to each other in U.S. dollars on a short-term basis. African banking systems, on the other hand, are less interconnected and depend more on correspondent banks in Europe or the U.S., rather than engaging in direct U.S. dollar transactions with each other.
Regulatory and legal environment	African central banks and regional regulators often lack the capacity to supervise large offshore U.S. dollar pools. The absence of a clear and stable legal framework further discourages foreign investors from placing substantial U.S. dollar deposits in African jurisdictions.
Currency-risk perception	Although deposits may be denominated in U.S.

	dollars, the African bank serving as the counterparty is perceived to carry greater credit risk. Many African banks have lower credit ratings and less diversified asset bases compared to their European peers, resulting in higher credit-risk premiums.
Access to the global USD market	African banks already obtain U.S. dollar funding through established channels such as correspondent banking relationships, syndicated loans, and the Eurodollar market itself. This reduces the incentive to create a separate Africa-based pool for U.S. dollars.
Political and macroeconomic volatility	Fluctuations in exchange rates, sovereign-risk events, and capital-control regimes increase the risk for foreign investors holding U.S. dollars in African institutions. By contrast, the Eurodollar market benefits from the relative political stability of its host countries, such as the UK and Switzerland.
Infrastructure and settlement	Efficient U.S. dollar settlement systems like CHIPS or SWIFT are already accessible through European and U.S. financial hubs. Replicating such infrastructure within Africa would require significant investment, with limited added benefits.

Requirements for Establishing a Meaningful Afrodollar Market

- A large, stable source of USD liquidity: For example, a coalition of African commodity exporters—such as those involved in oil, gas, or minerals—would need to consistently generate U.S. dollar surpluses and be willing to retain these funds within African banks.
- Strong, credible regulatory oversight: The creation of a regional supervisory body with the authority and technical expertise to enforce prudential standards on par with major financial centres like London or Zurich would be necessary.
- Improved banking infrastructure: The implementation of real-time gross settlement (RTGS) systems capable of efficiently clearing U.S. dollar transactions within Africa would help reduce settlement risk.
- Higher credit ratings for African banks: This could be achieved through sovereign guarantees, robust collateralisation, or the participation of multinational banks as “anchor” depositors.
- Political commitment to financial-market integration: Initiatives such as the African Continental Free Trade Area (AfCFTA) and the African Union could provide frameworks for the harmonisation of legal and tax treatments of U.S. dollar deposits.
- Demand from non-African investors: If foreign corporations or funds identify a secure and low-risk mechanism for depositing U.S. dollars in Africa—such as through an “African-Eurodollar” fund—they might allocate a portion of their short-term cash-management portfolios to the region.

Existing Alternatives That Fulfill Similar Roles

Instrument	Where It Is Used	Relation to “Afrodollar”
Correspondent banking USD accounts	African banks hold U.S. dollar accounts at major European or U.S. banks	This provides U.S. dollar liquidity, but the deposits themselves remain outside Africa.
Offshore USD bonds issued by African sovereigns	International capital markets (such as the Eurobond market)	This approach raises U.S. dollar funds for African governments, with investors receiving a U.S. dollar claim on the sovereign

		rather than on a bank deposit.
Regional USD-denominated money-market funds	Countries such as Kenya, Nigeria, and South Africa	These funds pool short-term U.S. dollar cash from regional investors, but the funds are typically managed through offshore custodians.
Local-currency “USD-linked” deposits	Some banks offer deposits indexed to the U.S. dollar but settled in local currency	This provides exposure to the U.S. dollar without actually holding U.S. dollars offshore.

These instruments enable African banks and businesses to access U.S. dollar liquidity and short-term investment yields, serving many of the same functions as an Afrodollar market, even though a distinct Africa-based pool of offshore U.S. dollars has not been established.

Conclusion

Empirical data highlights the significant disparity in USD liquidity between global markets and Africa. According to the Bank for International Settlements (BIS, 2023), offshore USD deposits are estimated at approximately \$13 trillion worldwide. In comparison, the total assets of African banks are around \$1.5 trillion, which underscores the region's limited capacity to handle large-scale USD transactions (AfDB, 2022). Furthermore, Asia accounts for about \$4 trillion in offshore deposits, while Africa's offshore deposits are estimated at \$100 billion, although data for Africa remains limited.

This section draws on literature by Eichengreen (2017), who examines the influence of offshore markets in global finance. Krogstrup & Tille (2018) analyse aspects of financial integration and the process of currency internationalization. Masson & Pattillo (2005) provide insights into regional monetary cooperation in Africa.

The analysis utilises a combination of qualitative methods, including literature and policy review, alongside quantitative evaluation of USD liquidity and banking sector data.

Relevant economic theories referenced include currency internationalization (Cohen, 2012) and financial globalization (Obstfeld & Taylor, 2004). The concept of optimal currency areas (Mundell, 1961) is also used to contextualise African regional integration efforts.

It is important to distinguish between the Afrodollar and proposals for a regional African currency. The Afrodollar emphasises the use of USD in Africa for trade and financial activities, while a regional African currency, such as the proposed "Afro," seeks to enhance regional integration and is distinct from the Afrodollar.

The absence of a widely used Afrodollar market can be attributed to a lack of essential economic and institutional prerequisites in Africa. These include the absence of large, stable U.S. dollar deposits, limited inter-bank trading infrastructure, weak regulatory oversight, and insufficient political stability. Until these foundational conditions improve, African financial participants are likely to continue relying on the established Eurodollar market and other offshore channels to meet their U.S. dollar funding needs, rather than developing a dedicated African-based pool of U.S. dollar deposits.

Step-by-Step Roadmap for Establishing an Afrodollar Market

1. **Build Sizable and Stable USD Deposits:** Encourage the accumulation of large, stable pools of U.S. dollar deposits within African financial institutions by promoting cross-border trade in U.S. dollars and incentivising savings in U.S. dollar-denominated accounts.
2. **Develop Robust Inter-Bank Trading Infrastructure:** Establish efficient and transparent inter-bank U.S. dollar markets across African countries to foster trust among participants and improve liquidity.
3. **Strengthen Regulatory Frameworks:** Implement effective regulation and supervision for U.S. dollar transactions, including clear guidelines for risk management, anti-money laundering, and prudential standards tailored to cross-border U.S. dollar flows.
4. **Enhance Political and Macroeconomic Stability:** Promote stable governance, sound macroeconomic policies, and regional cooperation to build investor confidence and reduce risks in both local and offshore U.S. dollar markets.

5. Foster Regional Collaboration: Encourage partnerships between central banks, financial regulators, and market participants across Africa to harmonise rules and share best practices for the management of offshore U.S. dollars.
6. Launch Pilot Afrodollar Instruments: Introduce pilot projects for Africa-based offshore U.S. dollar pools, such as regional U.S. dollar-denominated bonds or deposits, to test demand and operational frameworks before scaling up.
7. Promote Transparency and Market Access: Ensure open access to the Afrodollar market for a wide range of participants, and provide clear, timely data on market activities to build credibility and attract international investors.

By following these steps, African markets could lay the foundation for a sustainable and widely used Afrodollar market, ultimately reducing reliance on external offshore channels and supporting regional economic growth.

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