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Argentina: dollarise the economy!

By: Jude Webber - May 10, 2013

Dollars in Latin America may be the currency that many people think in, but only Ecuador and Panama have them as legal tender. That said, in some countries, some items are priced, and can be paid for, in greenbacks and you can even draw them out of ATMs.

Dollars are an especially sensitive subject in Argentina, where foreign exchange controls are rigid and the black market rate has soared to twice the official rate.

So here's one provocative idea: ditch the peso in Argentine entirely. Dollarise.

That is the view of Steve Hanke, a senior fellow at right-wing think-tank the Cato Institute, a Johns Hopkins University professor of applied economics and a former senior economic adviser to President Reagan and the U.S. Congress. It's even more provocative as an idea given that Argentina's decade-long experiment in pegging the peso to the dollar at par, starting in 1991, collapsed in chaos and social tragedy in 2001-02.

According to Hanke, who has been pushing the merits of dollarization for Argentina for two decades, the country is "back to where it was in the late 1980s".

How would his idea work? Simple. From Hanke:

In short, the Banco Central de la Republica Argentina (BRCA) would take all of the assets and liabilities on its balance sheet denominated in foreign currency and convert them to U.S. dollars. The Central Bank would then exchange these dollars for all the pesos in circulation (monetary base), at a fixed exchange rate. By my calculation, the BRCA would need at least \$56.36 billion to dollarize at the official exchange rate (as of 23 April 2013).

What rate would apply? Well as Hanke points out, the central bank would fail to cover the monetary base if it used the official rate of some 5.2. But if it used something closer to the unofficial (he euphemistically calls this the "free-market exchange rate") of roughly double that, it could. He lays out his calculations in the table below.

Dollarizing Argentina

At the Official ARD/USD Exchange Rate (in billions of USD)	
Monetary Base	\$56.36
Less BCRA's Net Foreign Assets	\$31.23
Additional Funding Needed	\$25.13

At an ARD/USD Exchange Rate of 9.33 (in billions of USD)	
Monetary Base	\$31.23
Less BCRA's Net Foreign Assets	\$31.23
Additional Funding Needed	\$0

Source: BCRA and calculation by Prof. Steve H. Hanke, The Johns Hopkins University. Note: These calculations were based on the Central Bank's balance sheet as of April 23, 2013.

Of course, this isn't going to happen any time soon under the government of Cristina Fernández. But according to a report by BancTrust, the government's latest bid to tackle the country's currency problems in a proposal this week of a tax amnesty for funds illegally held abroad:

... shows that the government has acknowledge its failure in attempting to "pesofy" the economy, which brought the real estate sector to a virtual standstill after dollar transactions were hindered.

As a proposal, it doesn't look much like a winner to many people. Bright ideas on a postcard to the presidential Pink House then...