Steve Hanke: “You’d Have to Be Insane to Introduce Bitcoin into an Environment that’s Already Corrupt”

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When the Salvadoran Legislative Assembly passed the Bitcoin Law, in the early hours of June 9, few analysts were as skeptical as Steve Hanke, professor of applied economics at Johns Hopkins University and former economic advisor to Ronald Reagan. “President Nayib Bukele and his 62 accomplices have just had their names entered into Hanke’s Encyclopedia of Economic Stupidity”, the economist wrote on Twitter.

“As someone who’s been involved in numerous successful currency reforms in Europe and Latin America, I have a pretty good appreciation for what works and doesn’t work“, he told El Faro in this interview. His resume certainly vouches for him.

He not only served in the eighties as a senior economist on Reagan's Council of Economic Advisers. He was later the architect of numerous currency reforms in Europe and Latin America, and dubbed the “father of dollarization” in Ecuador, which adopted the currency in 2000, one year before El Salvador followed the same path. Hanke served as an advisor to 7 other heads of state (Argentina, Venezuela in the 90s, Estonia, Bulgaria, Bosnia) and also held cabinet positions in Lithuania and Montenegro.

He now works at the Cato Institute, a libertarian think-tank that advocates for “individual liberty, limited government, free markets, and peace.” His scathing criticism makes him a frequent guest in media to comment on economic issues.

Conservative economist Steve Hanke has been one of the most vocal critics of El Salvador's new Bitcoin Law. Photo: social media of Steve Hanke

Hanke, a promoter of global dollarization, argues that the U.S. Dollar has kept inflation in El Salvador at bay relative to the rest of Latin America. From his experience, he emerges as a critic of the current crypto business model. His solution is an idea that goes against the decentralization and deregulation which crypto enthusiasts so passionately defend: a crypto currency board, a sort of central entity that would set exchange rates.

To argue his points, he sometimes makes extreme comparisons. For instance, he called the Salvadoran Bitcoin Law's requirement that vendors accept bitcoin "a communist staple", similar to forced acceptance of the Soviet ruble or even the tender imposed by the Nazi regime in occupied countries.

With less than a month before the Bitcoin Law enters into effect, Hanke claims it's too late for Salvadoran banks to comply with regulations, therefore making El Salvador an international pariah. As for the government's plan to create a nationally backed stablecoin, Hanke says it does nothing to solve the issues with bitcoin and that, to the contrary, the experiment would embroil the economy in a crisis of inflation.

Less than a month away from the implementation of the Bitcoin Law and the government hasn't made public any document other than the three-page law. No regulation or technical study whatsoever. How much time do you think is required for the financial system to adopt a change like this?

It's clear that amateurs drafted the Bitcoin Law. Now, it's far too late for Salvadoran banks to comply with any new regulations that might be forthcoming. The banks simply don't have enough time. And, if Salvadoran banks cannot comply with any new regulations, there is the risk that foreign correspondent banks will be concerned about compliance and risk, and will cut off business ties with their Salvadoran partners. Unlike the Bitcoin Law, which was hastily passed in the middle of the night of June 8th, the Law of Monetary Integration was only passed after years of painstaking preparation, weeks of congressional deliberation, and a green light behind the scenes by the U.S. Treasury and the International Monetary Fund. Not to mention, there were actually world-class experts involved with drafting the dollarization law, like El Salvador's former Minister of Finance, Manuel Hinds (1994-1999).

If all of this isn't bad enough, there's never been any official document prepared by experts to indicate why the current system in El Salvador should be changed. All this simply indicates that the initiatives being taken with regard to the Bitcoin Law and potential cryptocurrencies are being undertaken by people with absolutely no expertise or experience in currency reform.

The world seems to be on the fence about crypto assets and governments are issuing regulations. There's a Presidential Working Group currently working on cryptocurrency recommendations in the United States, which is relevant for El Salvador since the country runs on U.S. dollars. Do you see the world heading toward Bitcoin and other cryptocurrencies?

As a speculative asset that is highly volatile and risky, cryptos are attracting a great deal of attention, particularly from the bitcoin evangelists. Since cryptos are not currencies, it's not surprising that they're used in very few transactions, with the exception of illegal activities.

After the State Department published the Engel List, which includes several of Bukele's allies, you related it to the Bitcoin Law. What connection do you see?

The main use of bitcoin is in shady criminal activity. The most comprehensive study of this indicates that about 46 percent of bitcoin use is for the facilitation of criminal activity, like money laundering and the finance of terrorism. Some of the Salvadorans named on the Engel List, including President Bukele's current Chief of Cabinet, were accused of money laundering. You'd have to be insane to introduce a vehicle of corruption (read: bitcoin) into an environment that's already corrupt.

You've written about the "regulatory nightmare" that the Bitcoin Law implementation will generate on an international level. Could you elaborate?

The Financial Action Task Force (FATF) is the international "money laundering and terrorist financing watchdog." The FATF mandates that the parties engaging in virtual-asset transactions provide complete and sufficient know-your-customer information. It also requires that senders and recipients of virtual assets obtain accurate knowledge and information about "the transaction, the source of funds, and the relationship with the counterparty." The chances of Salvadoran bitcoin transactions meeting such requirements are slim-to-none. El Salvador's probable violation of FATF regulations under the Bitcoin Law promises an FATF flagging and economic sanctions. El Salvador runs a big risk of being economically and financially cut off from the rest of the world.

On that isolation point, El Salvador has been negotiating an agreement with the IMF since March. It seems stalled, we haven't heard news on how that is going. On the other side, several high executives of the IMF have positioned themselves saying cryptoassets aren't money. How much do you think this bitcoin, Colón- Dollar plan is playing a role in the negotiations?

I haven't spoken to any IMF or Salvadoran officials about the ongoing negotiations. That said, it's clear that the Bitcoin Law, and any other cryptocurrency fantasies that El Salvador might have, will play a decidedly negative role in any negotiations with the IMF, the World Bank, and other international institutions. The reason for that, among other things, is the fact that everyone is aware that the Bitcoin Law will probably destabilize El Salvador and facilitate its evolution into a major money laundering center.

When El Faro broke the news about the government plan to issue a cryptocoin called the Colón-Dollar, you went to Twitter and called it a disaster. Why?

Thanks to the Law of Monetary Integration, El Salvador finally got rid of its third-rate, junk currency, the colón, and replaced it with the U.S. dollar, the world's premier international currency. Now, the government is proposing to reintroduce the colón as a cryptocoin. Bukele claims to have a plan to do so, but I don't think Bukele even knows what the word "plan" means. The colón-dollar cryptocoin proposal is clearly a con-job that will lead to nothing but a river of tears.

What is the scenario you imagine with an idea like this?

At present, El Salvador's dollarized competitive currency regime has worked like a charm. Since 2001, El Salvador's average annual inflation rate of 2.03 percent has been the lowest in Latin America. Twenty-five-year mortgages have been steady at an interest rate of around 7 percent. GDP per capita growth (measured in purchasing power parity) and export growth have both been higher than in most Latin American countries. Now, the government wants to throw a new coin into the system, one being proposed by President Bukele's unelected, unappointed brothers. Why would you want any change, whether it be the Bitcoin Law or the proposed cryptocoin plan?

Isn't the issuing of a coin, as a monetary policy lever, a sound option for a government in a complicated fiscal position such as that of El Salvador, where the national debt amounted to 95 percent of the GDP by mid-2021?

No. Issuing a cryptocoin is exactly what you would not want to do. In El Salvador's current situation, if you introduce a new coin, you will end up with Latin American-type inflation and more ups and downs in the economy. In short, you will destabilize the economy. And while stability might not be everything, everything is nothing without stability.

One of the main issues with Bitcoin is how volatile it is. Does the idea of a national, state-backed stablecoin solve some of those problems?

No. A national, state-backed stablecoin might be even more unstable than bitcoin, particularly one issued by a Latin American country. Indeed, Latin America's landscape is littered with disastrous currency crises that have been ignited by weak, volatile currencies.

You've been very vocal against the Salvadoran plan to adopt Bitcoin as legal tender, even calling it stupid. What drives such passionate commentaries, or what it is that you see at stake at the international level?

As someone who's been involved in numerous successful currency reforms in Europe and Latin America, I have a pretty good appreciation for what works and doesn't work. And, in the crypto world, what would work is a cryptocurrency board. A traditional currency board issues a currency that is freely convertible at an absolutely fixed exchange rate with a foreign anchor currency or gold. Therefore, under a currency-board arrangement, there are no capital controls. The currency issued by a currency board is backed 100 percent with anchor-currency reserves. So, with a currency board, its currency is simply a clone of its anchor currency. Currency boards have existed in about 70 countries, and none have failed.

A private cryptocurrency board would be the ideal institutional arrangement for the crypto world. For example, its home offices and reserves could be located in Switzerland, a safe-haven financial center, and it could be governed under Swiss law. It could be operated with a small staff, as is the case with all traditional currency boards. As for its anchor, it could be a currency issued by a central bank, or gold, which is not issued by a sovereign. Furthermore, given its digital nature, the balance-sheet information of a private cryptocurrency board, including its reserves, could be publicly available and independently audited on a regular basis.

A cryptocurrency board would work because people want actual legal tender, like the U.S. dollar, the swiss franc, or gold. The key with a cryptocurrency board is that people could redeem the cryptocurrency into real legal tender that people actually want. The problem with the current so-called stablecoins that are currently issued is that there’s no right of redemption. So, people who own a stablecoin are stuck with a stablecoin, which are very difficult to use in transactions and can’t be redeemed at a fixed exchange rate with an attractive anchor currency.