



Dollarize Argentina; Abolish the BCRA

By John Greenwood,
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Introduction and Overview

- There are times when a country needs drastic reforms to escape from its current malaise. Argentina has reached this point after years of high inflation and despite numerous failed IMF rescues.
- The essence of the Argentine problem is the tendency of successive governments to use the powers of the central bank, Banco Central de la República Argentina, or BCRA, to create money to fund politically ambitious programmes – whether for populist purposes such as public welfare or infrastructure projects or other expenditures designed to provide benefits to one segment of the electorate or another.
- The result has been prolonged periods of excessive broad money growth that have fuelled inflation, robbed the citizens of real purchasing power and debased wages and living standards in the process.
- In this Newsletter I set out some basic principles for switching from a peso-based economy to a US dollar-based economy, a path previously adopted with significant success by Panama in 1904 and Ecuador in 2000.
- The principles are very straightforward. With the exception of peso banknotes issued by the BCRA, the value of all other assets and liabilities on the balance sheets of Argentine individuals, firms, banks and the government can be switched to US dollars after a brief interim period during which the exchange rate floats freely to find a proper market level and the monetary base is frozen.
- The peso banknotes will be withdrawn and replaced with US dollar banknotes at the chosen exchange rate. This is the only “real” cost of the operation associated with the switch to the US dollar and can be easily funded from Argentina’s current stockpile of gold and foreign exchange reserves.
- Having dollarized the economy in this way, what will the future bring? Lower inflation and lower interest rates for sure, and probably big capital inflows.
- However, there can be no guarantee that future Argentine governments do not abuse their borrowing powers, ending up with excessive US dollar or other foreign currency debt. Only the Argentine people can ensure adequate institutional reforms to guard against such abuses in future.

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1. The Overall Justification for Dollarization

The stability and value of the Argentine peso has been repeatedly undermined by successive governments in Buenos Aires relying on the monetary powers of the BCRA to create money to make up for revenue shortfalls of high-spending administrations. Since January 2018 alone, the value of the Argentine peso has plunged from an official rate of ARS19.6 per USD to 350 per USD in November 2023. But the official rate is not a market rate. The “blue” rate for the Argentine peso, a parallel or more realistic exchange rate has recently been trading at 910 for buying and 960 for selling. Probably a free-market rate would be somewhere between the official and the “blue” rate. In either case, the peso has depreciated drastically. As Keynes wrote, “By a continuing process of inflation, government can confiscate, secretly and unobserved, an important part of the wealth of their citizens”. The process of inflation transfers purchasing power directly from private sector holders of money to the government. It is, in effect, outright robbery.

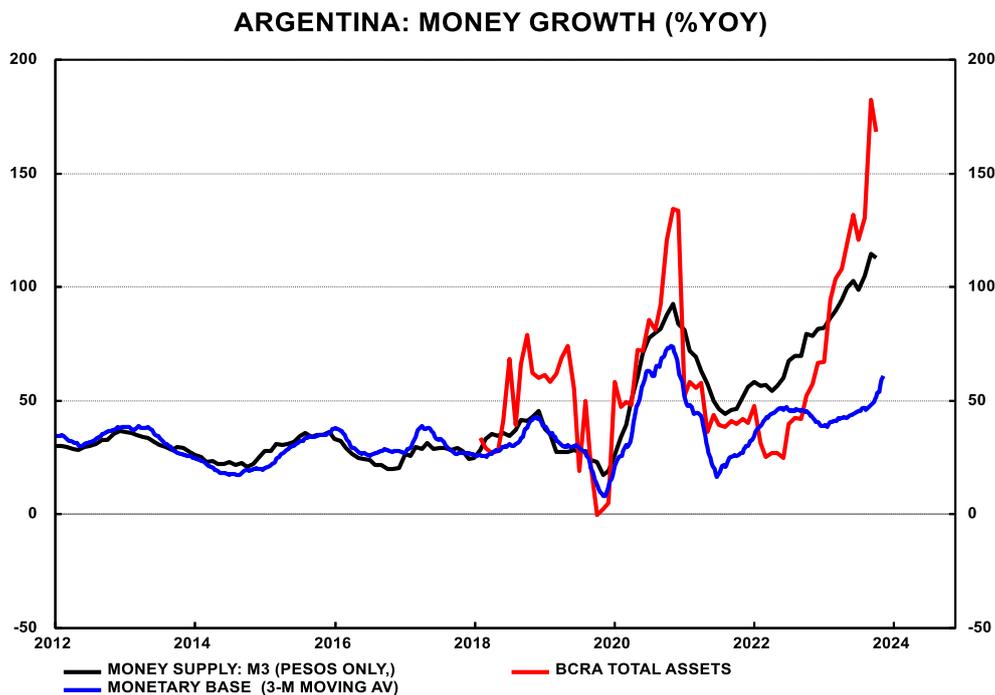
Figure 1. The Depreciation of the Argentine Peso.

Source: Calafia Beach Pundit <https://scottgrannis.blogspot.com/>

The presidential election of November 19 creates an opportunity for the Argentine people to end the persistent abuse of their currency once and for all. The people of Argentina must never again allow their government to abuse the central bank at their expense. The best way to do this would be to move to a monetary system where the government or fiscal authorities have no access to a central bank. In Argentina’s case, this means abolishing the Banco Central de la República Argentina (BCRA) and dollarizing the economy.

In the future the government would maintain its accounts at various commercial banks, which would act as paying agent for the government, as they do for any other customer (as happens in Hong Kong and Panama). Such a move would strengthen fiscal discipline, imposing a hard budget constraint on the government. In future, government finances will be sourced solely from (1) tax revenues and earnings of public sector corporations, (2) drawing down on accumulated past surpluses or (3) issuing USD-denominated debt to finance deficits. The government would no longer be able to rely on the central bank as a clandestine, hidden source of funding.

Figure 2. Successive governments have engineered excess money growth.

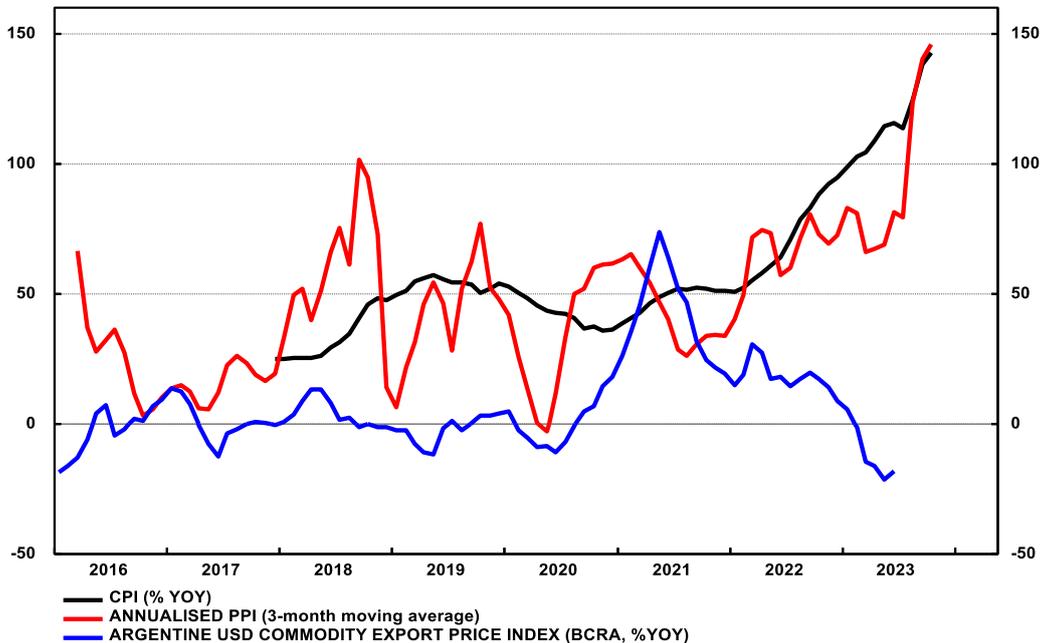


In carrying out these monetary and fiscal reforms, politicians and administrators would be compelled to engage in serious institutional changes – possibly amounting to constitutional amendments. No longer able to print money to fund projects at will, the budgetary oversight process could be strengthened, and a much higher degree of transparency could be introduced. While such reforms are not a cast-iron guarantee against abuse or corruption in future, they would eliminate monetary tampering. Excess fiscal spending is still possible (as has occurred in Ecuador and Panama), but only by running up large debts and persuading foreign governments and foreign investors to part with their funds. However, the solution to this kind of abuse would not imply repeating the past cycles of growth, debt, and devaluation because the nation's currency would no longer be Argentine pesos, only US dollars whose value is beyond the control of Argentine politicians, and the BCRA would no longer exist.

At this stage it should be mentioned that if dollarization is not carried out in the next year or so, there is a non-negligible chance that dollarization may be forced even on an unwilling government by circumstances. For example, the Argentine people already hold substantial quantities of US dollars (said to be worth between \$200 and \$260 billion) in physical cash or deposits, and despite all the government restrictions on use of the US unit and multiple, discriminatory exchange rates, they are still able to conduct many transactions in US dollars. The authorities are fighting a losing battle to keep the peso.

Figure 3. Excess money growth has generated high inflation.

**ARGENTINA: CPI & PPI INFLATION FROM 2015
COMMODITY EXPORT PRICE INDEX SHOWN IN US\$**



Source: LSEG Datastream

2. Dismantling the BCRA

2.1 Basic Principles

Over past decades the BCRA has acquired many functions in addition to its narrow monetary functions. We now propose to dismantle the central bank, eliminating its money-creating powers and shifting its other activities to alternate agencies. Table 1 shows the balance sheet of the BCRA as published for October 23, 2023, while Table 2 shows its assets and liabilities grouped according to function, as indicated in the coloured panels A-F on the right, helping to clarify what needs to be done as outlined in Section 2.2.

The process of dollarization requires the recognition and adoption of two basic principles. **First**, an announcement should be made that all contracts currently in pesos will be converted by decree to USD contracts at a fixed exchange rate at a future date (Dollarization-day or D-Day) and time to be specified. **Second**, after a period of (say) 30 days from the date of this announcement, the prevailing exchange rate will be adopted as “the” exchange rate which will be used to convert all existing peso contracts into USD contracts from that day forwards.¹ This is exactly what was

Table 1. Balance Sheet of BCRA

¹ Where peso interest rates are specified in existing contracts, they should also be revised to USD terms but in a way that does not constitute “novation” to ensure legal continuity.



Balance Sheet of BCRA on 23 October 2023 (Units: Pesos billion, with FX translated at 350 ARS per USD)			
Reservas Internacionales <i>Gold and FX Assets</i>	8,593	Base Monetaria <i>Monetary base</i>	7,054
<i>Of which Gold</i>	1,372	Billetes y Monedas <i>Banknotes and coin</i>	5,900
<i>And Foreign Exchange</i>	7,221	Cuentas Corrientes <i>Banks' reserve accounts</i>	1,154
Titulos Publicos <i>Government Securities</i>	39,432	Medios de pago en otros monedas <i>Means of Payment in FX</i>	8
Of which Letras Intransferibles/ <i>Non- transferable Bills</i>	23,542	Cuentas Corrientes en Otras Monedas <i>FX Deposits</i>	3261
Adelantos transitorios <i>Temporary advances to the national Govt</i>	4,091	Depositos del Gobierno Nacional <i>Govt Deposits</i>	1,905
Creditos al Sistema Financiero del Pais <i>Credits to the Domestic Financial System</i>	2	Otros Depositos Varios <i>Various other deposits</i>	7
Aportes a Organismos Internacionales <i>Contributions to International Orgs</i>	1,880	Asignaciones de DEG (=SDRs) <i>SDR Allocations</i>	146
Financieros Derivados <i>Financial Derivatives</i>	173	Obligaciones con Organismos Internacionales <i>Obligations to International Orgs</i>	1,108
Operaciones de Pase <i>Repo Operations</i>	11,187	Titulos Emitidos por el B.C.R.A. <i>Securities Issued by the B.C.R.A. (LELIQs)</i>	24,092
Otros Activos <i>Other Assets</i>	1,367	Contrapartida de Aportes del Gobierno Nacional a Organismos Internacionales/ <i>Counterpart of Contributions from the National Govt to International Organizations</i>	1,433
		Obligaciones Provenientes de Otros Instrumentos <i>Other derivatives</i>	12
		Obligaciones por Operaciones de Pase <i>Obligations for Repo Op'ns</i>	10,115
		Deudas por Convenios Multilaterales de Credito/ <i>Debts for Multilateral Credit Agreements</i>	4
		<i>Other liabilities & provisions (=8,498+23)</i>	8,521
		Total Liabilities	57,667
		Capital	9,060
Total Assets	66,726	Liabilities & Capital	66,726

Table 2. The BCRA's Balance Sheet Classified by Function

Total Balance Sheet of BCRA (Units: Pesos bn with FX translated at 350)				
FX Assets allocated to covering monetary base	7,054	Monetary base	7,054	A. Monetary Assets and Liabilities
		A.1 Cash Currency	5,900	
		A.2 Banks' reserves	1,154	
"Non-Monetary" Activities of BCRA				
Credit to financial system	1,903	Government deposits	1,905	B. BCRA as banker and provider of credit
Adelantos transitorios (Temporary advances to the national govt)	4,091	Other deposits	7	
		DEG (=SDRs)	146	
Residual FX assets after matching monetary base (=8,593*-7,054)	1,539	Means of payment in FX	8	C. BCRA as FX agent of Govt
		FX deposits	3,261	
		Other FX liabilities	1,108	
		Other FX (1,433+4)	1.437	
Government debt	39,432	LELIQs	24,092	D. BCRA as operator of LELIQ, derivatives & repo markets
		Other derivatives	12	
		Repos	10,115	
Other assets	12,707	Other liabilities & provisions (=8,498+23)	8,521	E. Other items
		Total Liabilities	57,667	F. Summations
		Capital	9,060	
Total Assets	66,726	Liabilities & Capital	66,726	

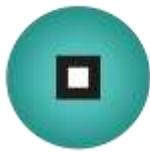
*This is the total amount of gold and foreign exchange assets listed on the BCRA's balance sheet on 23 October 2023, converted to pesos at 350 per USD. All figures in Table 2 correspond to data in Table 1.

done in the case of Bulgaria in 1997, on Steve Hanke's advice, to determine the new, fixed exchange rate.² The outcome was a very rapid fall of consumer price inflation from over 2000% in 1997 to 22% by March 1998, 4% by August 1998, and an average of 2.5% for the year 1999 as a whole.

During the one-month period of floating, the monetary base should also be frozen, again as was done in Bulgaria, effectively mothballing the BCRA immediately.

In essence this means that all peso obligations of the BCRA (and the government) will be converted to USD obligations. However, there is one exception: the outstanding peso banknotes which are liabilities of the BCRA will need to be paid out as rapidly as feasible in USD banknotes. All other items on the balance sheet of the

² See <https://www.nytimes.com/1998/03/20/business/worldbusiness/IHT-q-a-steve-hanke-voice-of-suhartos-guru.html>



BCRA – or on the balance sheets of commercial banks or companies or individuals – constitute “claims” or IOUs for Pesos (or ARS) and can therefore readily be translated at the selected D-Day exchange rate to USD-denominated claims or IOUs. This applies to all contracts, public and private, whether for deposits, loans, rents, wages, interest, and dividends, or complex instruments such as futures contracts or derivative contracts. It also includes the entire market for LELIQs, or Letras de Liquidez, Liquid Bills and Notes issued mainly in Peso currency by the BCRA (see pp. 8-10 below). Instead of being Peso-denominated, these contracts and their associated interest rates or yields will all become USD-denominated claims and obligations on or after Dollarization-day, or D-Day.

2.2 Treatment of individual items on BCRA’s balance sheet

(In this section, each item (e.g., A.1, A.2 etc) corresponds to a colored section of the BCRA’s balance sheet in Table 2.)

A.1. Cash Currency or Banknotes and Coins.

Currently (using data for Oct 23, 2023) the BCRA has outstanding banknote issues and coin amounting to ARS 5,900 bn. In Table 1, gold and foreign exchange reserves amount to ARS 8,593 bn, divided into gold (ARS 1,372, or 16%) and foreign currency reserves (ARS 7,221 bn, or 84%). However, these values are translated at the highly unrealistic, official exchange rate of ARS 350 per USD. According to the BCRA’s website, the central bank’s international reserves amounted to US\$ 20,977 million on November 13, 2023. If a more realistic exchange rate closer to the “blue” rate of 900 per US dollar was used, the value of Argentina’s gold and foreign exchange reserves is closer to ARS 18,879 billion, over three times what is needed to redeem all outstanding peso banknotes at a market exchange rate.

The **banknotes** could be called in for redemption from D-Day at the chosen, fixed exchange rate. The period allowed for redemptions by the public can be generous – say with a deadline of up to twelve months from D-Day. This will reduce any sense of panic and allow people to continue to use Peso banknotes in place of coin alongside US dollar banknotes at the (now) fixed exchange rate. The redemptions of peso notes will take place mainly at commercial bank branches; there should be an option, but no requirement, for the redemptions to occur at the BCRA. Argentineans should be told the source of the USD they will receive, namely the country’s gold and foreign exchange reserves – which are ultimately the property of the citizens of Argentina anyway. Also, the underlying figures for outstanding peso banknotes and new USD banknotes estimated to be put into circulation could be published on a daily basis to avoid any panic conversions.

Supplies of US dollar banknotes could be ordered and obtained from the Federal Reserve System (normally from the Miami branch of the Federal Reserve Bank of Atlanta) by the BCRA before its dissolution, or by individual commercial banks from their US affiliates or counterparts. It would be courteous, in this context, to notify the US Treasury and the Federal Reserve System in advance of the increased demand for US dollar cash currency.



The peso **coins** currently in circulation need not be exchanged and could continue to circulate until reversal of the necessary provisions of the *Ley de Convertibilidad* which established the current Peso in January 1992. In practice, Peso coins are now worth so little due to the massive depreciation of the peso that they are seldom used. Going forward, the Argentine Treasury (**not** the BCRA) should mint new US\$-denominated coins in the same denominations as US coinage but bearing Argentine symbols. The banks would purchase these new coins for their customers, paying US dollars, and the Argentine Treasury or Ministry of Economy would be required to hold a 100% US dollar reserve against the coins issued (like a miniature Currency Board). In this way, soundly backed new coins would enter circulation alongside US dollar bank notes, and the old peso coins would gradually disappear.

A.2. Bank Reserves. Currently, banks hold reserve deposit accounts at BCRA (amounting to ARS 1,154 bn on October 23) to meet legal reserve requirements and/or to make settlements with other banks and/or to make tax payments to the government on behalf of customers. After dollarization, these reserves would be translated into/expressed in USD at the chosen exchange rate. There is no need for conversion in the foreign exchange market. The reserve requirements at BCRA could be eliminated and/or replaced with other balance sheet ratios enforced by a new agency for financial supervision which is not part of the central bank. (This is done in many countries, notably in Canada.)

Following dissolution of BCRA, commercial banks could operate the two clearing systems currently operated and supervised by the BCRA: (1) SML or Sistema de Pagos en Moneda Local – a Real Time Gross Settlement system that operates in Pesos and USD – and (2) CCE, or *Camara Compensadora Electronica*, an automated clearing house (ACH) which operates as an interbank clearing house, settling transactions on a net basis at the end of the day. Ideally, reserve balances at the BCRA will be transferred to these clearing houses.

B. BCRA as banker and provider of credit to the government.

Eliminating the ability of the BCRA to provide credit to the government is central to the task of ending Argentina's inflation. The provision of deposit accounts to the government would also be eliminated. The government accounts could be moved to one or more private, commercial banks.

C. BCRA as foreign currency agent for the government.

This function could also be transferred to an international or supra-national agency (such as the IADB or BIS) or, after a bidding process, to a private sector bank – domestic or foreign.

D. BCRA as operator of the LELIQ market.



The elimination of BCRA as operator of the short-term LELIQ market and the conversion of LELIQ securities to US dollars is perhaps the most controversial proposal here. (Several commentators have expressed the need either for LELIQ bills to be paid out to creditors as quickly as possible and treated as secured debt second only to Base Money, or for a Special Purpose Vehicle (SPV) to be created so that the market can be continued in some form.)

To understand the true position, consider the market for EFBN in Hong Kong. This market was set up in the 1990s because the Hong Kong Monetary Authority wanted to create a local currency yield curve, but due to annual budget surpluses, there was no government debt available in Hong Kong on which to build such a yield curve. The HKMA therefore issued paperless, electronic debt instruments itself, known as Exchange Fund Bills and Notes, using the old name for the Currency Board, the Exchange Fund. Initially these short-term debt securities were auctioned on a frequent basis, with the proceeds held by the HKMA in its portfolio. Currently the amount outstanding is approximately HK\$1,228 billion (or US\$ 157.5 billion). Because the EFBN are liabilities of the HKMA, they can readily be discounted or sold to top up banks' clearing balances. Since it is a rule of the clearing house in Hong Kong that banks must maintain positive settlement balances (they cannot become overdrawn), the main buyers of EFBN have been banks which use the EFBN to manage their short-term liquidity positions.

In many respects the Argentine LELIQ market is analogous to the EFBN market, except that the disposition of the proceeds by the BCRA (into Non-transferable Bills of the National Treasury) is considerably more opaque, and the reliability of ultimate repayment is much more doubtful. The LELIQ market (literally, Letras de Liquidez, or Liquid Bills and Notes issued mainly in Peso currency) is a segment of the Argentine money market where the central bank of Argentina (BCRA) auctions short-term liquidity bills (LELIQs) to local banks in order to manage the amount of money in circulation and influence the interest rate. LELIQs are mostly denominated in pesos and have different maturities, ranging from 7 to 28 days. The BCRA has typically set the floor rate for LELIQs, which serves as the benchmark rate for monetary policy and lending in the economy.

Proceeds of the LELIQ auctions are invested in "*Letras Intransferibles del Tesoro Nacional*" (Non-transferable Bills of the National Treasury). As shown in Table 1, on October 23, 2023, the outstanding amount of LELIQs had reached ARS 23,542 billion (US\$25 billion at a "blue" mid-market exchange rate of 935, or \$67.3 billion at the official 350 exchange rate). The non-transferable assets corresponding to the LELIQs were the largest component of the ARS 39,432 billion of Government Debt held by BCRA. In reality, this is a scam, comparable to the scheme in Lebanon³ where the central bank of Lebanon issued high-yielding debt to attract funds from the banks but has never repaid any of it.

³ Under the technique adopted in Lebanon, the central bank offered higher-than-market interest rates on US\$ funds of banks (actually, their customers' foreign currency deposits) to borrow on behalf of the government. Restrictions were then imposed on the withdrawal of foreign-denominated deposits from banks, effectively freezing a large portion of the foreign currency deposits held by the non-bank public in the

The LELIQ market was created in August 2018 as part of a new monetary policy framework that allegedly aimed to curb inflation and stabilize the peso, which had been depreciating sharply due to a loss of confidence in the government's ability to repay its debt. The BCRA adopted a zero-growth target for the monetary base (sic!) and committed to sell LELIQs at rates necessary to absorb any excess liquidity in the market. The floor rate was initially set at 60%, but it has fluctuated over time depending on the inflation outlook and the exchange rate pressures.

Irrespective of these announcements and the introduction of LELIQs – however well-intentioned – M3 growth and monetary base growth have soared (see Figure 2, p. 3), and inflation has sky-rocketed (see Figure 3, p. 4). These developments have naturally increased both the nominal and the real cost of credit for the private sector and the government.

For present purposes – dollarizing the Argentine economy – we need to decide how to treat the LELIQs. There seems to be no reason why the two principles set out on p. 4, should not apply. LELIQs are IOUs to be treated like any other IOU. They should therefore be subject to the same decree, converted at the chosen fixed rate to US dollar obligations from D-Day. The outstanding total amount could be transferred from the balance sheet of the BCRA to the balance sheet of the government. Insofar as the BCRA was a government entity, the debt was and is ultimately payable by the Argentine government anyway.

Going forward, maturing issues could be redeemed in US dollars (at the D-Day exchange rate), and new issues could be auctioned by a new department set up within or outside the Treasury or Ministry of Economy. This would parallel the role of the Debt Management Office (DMO) in the UK, which is an Executive Agency of HM Treasury, established by the UK government in April 1998 with responsibility for government wholesale sterling debt issuance (popularly known as gilts), and transferred from the Bank of England. (<https://www.dmo.gov.uk/>)

Banks could continue to use the new USD-denominated LELIQs for managing their short-term liquidity if they chose to do so or sell them for USD cash in the market (after D-Day) or redeem them with the Argentine government (in USD after D-Day). Interest rates on LELIQs are likely to fall abruptly as D-Day approaches, and thereafter they would trade at a spread over equivalent US rates. The spread would be determined by the creditworthiness of the Argentine government, as viewed by market participants.

In the past, the LELIQ market has naturally been affected by political and economic developments in Argentina, such as IMF bailout agreements, the COVID-19 pandemic, and the presidential elections, and no doubt it would continue to be affected by such factors in future. Going forward, there might be a

Lebanese banking system. The IMF called this scam “financial engineering”. Some of us would call it outright robbery.



demand for the maturity of USD-denominated LELIQs to be extended beyond the current 28-day term of Peso-denominated LELIQs, and the new Debt Management Office would clearly need to decide whether to increase supply in this way. There would be no need, however, for any government agency to be setting any floor rate for USD-LELIQs as the BCRA did with Peso-denominated LELIQs. The auctions and the free market would set the yields for LELIQs.

Argentina would no longer have a monetary policy; it would only need to concentrate on ensuring the solvency of the government in USD terms. The supervision of banks and other financial institutions could be transferred to an independent financial sector regulatory agency (similar to Canada's OSFI, the Office of the Superintendent of Financial Institutions).

The role of the BCRA in conducting repos (repurchase agreements) and derivatives would disappear. If banks needed a tri-party repo market in future where a third entity acts as an intermediary between the two parties to the repo, it could be provided through individual clearing banks (just as JP Morgan Chase and Bank of New York Mellon do in the US)⁴ or through a centralized clearing system or exchange operated by a central counterparty (CCP) such as operates in the US and in Europe and the UK.

E. Other liabilities.

The balance of Other Liabilities is composed mostly of either inter-government or bi-lateral agreements with foreign countries and international organizations, and there is little or no exposure to the private sector. Many of these liabilities are offset with corresponding asset entries such as SDR facilities. These could all be assumed by the Argentine government on an interim basis until a decision is made about how to participate in supra-national organizations such as the IMF and BIS.

3. Concluding Remarks

The plans set out here to dollarize the currency of Argentina broadly follow the templates used in Montenegro, which successfully adopted the Deutschmark in place of the hyperinflating Serbian-Montenegrin dinar in 1999 (and now uses the euro in place of the German mark), and in Ecuador, which dollarized the sucre in 2000. In addition, lessons learned in setting the exchange rates of the currencies of Hong Kong in 1983 (when a currency board was re-introduced to stop a collapse of the Hong Kong dollar) and Bulgaria in 1997 (when a currency board replaced a hyperinflating domestic currency) have also been applied.

⁴ The "third party" typically facilitates services such as collateral assessment, payment and settlement, custody, and management during the life of the transaction. In the US and Europe these services are predominantly provided by private sector operators. There was no need for the BCRA to provide such services in the past, and under the dollarization proposal it will not be there in future to do so.



There is nothing especially complicated or unique about the Argentine case provided the two principles explained at the start of this plan are followed. Within a matter of weeks, the Argentine people could be benefitting from a stable, global currency, sharply lower interest rates and a dramatically falling inflation rate. However, the success of the plan will depend – in the long-term – on the willingness of the Argentine government to play its part and not to engage in unsustainable borrowing to finance ambitious and extravagant welfare or infrastructure programs financed by debt. Nobody on earth can guarantee the good behaviour of the country's rulers except the citizens of Argentina. Reforming the currency should therefore be viewed as just part of a series of deep and far-reaching institutional reforms that set the country on a path to a better future.

Ideally those reforms will include strict limits on government budget deficits, the level of government debt, or any increase in taxation. The National Congress must have authority to monitor government expenditures so that a breach of any pre-set limit on the deficit or an increase in taxes or an expansion of the national debt should require super-majorities in the Congress. Whatever the mechanism, it is essential that, having ended the ability of Argentine politicians and governments to abuse the currency by excess money-creation through a central bank, they are not permitted to attempt the same kind of abusive property theft through fiscal means.

Summary and Investment Implications

- This Newsletter has explained how Argentina has reached a point where, after years of high inflation and despite a series of incompetent IMF rescues, drastic reforms are necessary.
- The essence of the Argentine problem has been the tendency of successive governments to use the powers of the central bank, Banco Central de la República Argentina, or BCRA, to facilitate or supplement its fiscal expenditures.
- The result has been prolonged periods of excessive broad money growth that have fuelled inflation, robbed the citizens of real purchasing power and debased wages and living standards in the process.
- The basic principles for switching from a peso-based economy to a US dollar-based (or euro-based) economy, are simple. All claims and obligations currently in pesos should be converted, by decree, to US dollars at a fixed exchange rate which will be set after a period of one month during which the currency will be freely floating. During that month, the size of monetary base should be frozen to prevent any further erosion of the value of the currency.
- The only item that requires special treatment is the redemption of all peso-denominated banknotes and their conversion to US dollars during a period that can extend beyond the period of the floating exchange rate.
- The peso banknotes will be withdrawn and replaced with US dollar banknotes at the chosen exchange rate. This is the only “real” cost of the operation⁵

⁵ Some commentators argue that the loss of seignorage is a significant loss that would arise from giving up an independent currency, but in my judgement the gains from abolishing the BCRA would far outweigh the alleged benefits of maintaining a persistently mismanaged, albeit independent, currency with seignorage.



associated with the switch from the peso to the US dollar and can be easily funded from Argentina's current stockpile of gold and foreign exchange reserves.

- This set of actions is by no means unprecedented. Broadly similar procedures were followed with significant success by Panama in 1904, by Montenegro in 1999 and by Ecuador in 2000.
- Moreover, the experiences of Hong Kong in 1983 and Ecuador in 2000 in setting the new, fixed exchange rate show what needs to be done and what should **not** be done.
- Having dollarized the economy is this way, what will the future bring? Lower inflation and lower interest rates for sure, and probably big capital inflows.
- On this platform, economic growth, investment and employment should all improve dramatically – as they did in the early years of the Convertibility plan.
- However, there can be no guarantee that future Argentine governments do not abuse their borrowing powers, ending up with excessive US dollar or foreign currency debt. Only the Argentine people can ensure adequate institutional reforms to guard against such abuses in future. Deep and meaningful reforms to control fiscal expenditures should therefore accompany or follow the replacement of the peso currency with the US dollar.
- The investment implications are potentially huge. When Argentina adopted the Convertibility plan in April 1991 the performance of the stock market and the economy improved dramatically for several years. Only after several years when failures to implement the plan in a manner consistent with exchange rate stability became apparent and the country's overseas debt started to soar did economic and stock market performance start to unravel.
- As indicated in the text, steep falls in interest rates and sharply lower inflation can be expected to follow dollarization. Such changes would benefit both local equities and bonds, as well as general sentiment, driving up multiples.
- The only question is whether the new Argentine President has the intellectual perception, the strength of character, and the political authority to do the right thing.

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