Argentina: Driven Black

MEREDITH HOFFMAN

 ELIS SPERRY

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BUENOS AIRES—When the peso hit rock bottom in January, Ande Wanderer rang up her money dealer—a former official in Argentina's national government. She'd sold off her stocks, cashed in her American savings, and wired him the money. Now she rushed to his office, a ninth floor room in downtown Buenos Aires. The official exchange rate was 8 pesos to the dollar. But her dealer gave her 11—the black market rate at the time—and kept a small fee for himself. That meant she got some 40 percent more pesos for her U.S. money.

"When I see tourists take money out of the cash machine, I want to tackle them," says Wanderer, 40, a Georgia-born journalist who's lived in Argentina the past 10 years. "Yes [the black market] is illegal, but you realize once you've lived here for a while that you have to do illegal things to get by."

Wanderer—who says her money dealer works mainly with high-power businessmen and picked up the trade as a "new avenue to make money after leaving the government"—has, like other financially savvy expats and Argentines, been using the currency black market here the past two years. Foreigners can get far more pesos for their dollars. Locals often have no other option to get dollars.

Argentina's currency black market has almost always existed, but once every 15 or so years it booms, its fluctuations a major indicator of the health of the nation's economy. Since 2011, the Dolar—actually "Dolar Blue"—the country's term, attenuated by one letter for the dollar black market—has once again come alive, with an increased visibility through Twitter, online exchange companies, and its own website. Today, most individuals who choose to buy dollars are using Dolar Blue instead of official channels. Between $5 million and $40 million is changed on this black market every day, analysts estimate—but since it's illegal, there's really no way to know.

Black market vendors advertise *cambio* (change) for dollars boldly up and down Buenos Aires' downtown pedestrian strip, and more discreet *arbolitos* (money changers, or literally "little trees"), like Wanderer's supplier, offer pesos at black market rates through online bank transfers or PayPal payments in dollars. Then there are the *cuevas* (caves), the largest Dolar Blue exchange houses. For many here the black market has become a giant, unpredictable game—its strength stemming from the government's efforts to tighten regulations on Argentines obtaining dollars or other foreign currency, economist Gaston Rossi says.

"The black market was marginal before. The difference in values was only 3 or 4 percent in 2010," says Rossi, who served as secretary to the economic minister for

Meredith Hoffman, a journalist currently working in South America, previously reported for The New York Times *and DNAinfo.com.*

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President Cristina Fernandez de Kirchner in 2007-2008 and now runs a consulting company with his former ministerial colleague. "But when you put on exchange controls, it creates a natural demand" for dollars.

To some economists, the Dolar Blue network is more valid than the official exchange system. "Ultimately the most realistic value of the peso is in the black market," says economist Ivan Cachanosky, a professor at the University of Buenos Aires and analyst for the non-profit Freedom and Progress Foundation. "The black market price is determined by supply and demand, but in the official rate the government intervenes...and the official rate here seems to ignore the reality of the actual value of the peso."

MAKING CITIZENS PAY

Argentina is currently in a financial bind. Its fiscal deficit has been surging each year, while the government's reserves have been plummeting. A typical developed nation would resort to borrowing money from other countries to balance its spending, but Argentina has had a bad global reputation since it defaulted on its debt in 2002 and passed through any number of economic crises, explains Juan Luis Bour, chief economist of the Foundation of Latin American Economic Research. So if Argentina wants to borrow money, it has to pay a hefty price.

Instead, over the past few years the government has taken another route. It started printing ever larger quantities of pesos to finance its deficit, says Bour, whose foundation independently measures inflation and other fiscal data. "The government has been financing itself by printing more pesos, but the more pesos it prints the higher inflation," Bour continues, explaining the plummeting value of the peso. "And when it obligates citizens to use the peso, it's issuing that debt to the people. It's like forcing you to pay more taxes, since the peso is worth less and less."

Argentines have two options to escape this fiscal conundrum, Bour says. "You leave the country, or you turn to the black market."

Over the past 50 years, Argentina's currency has been devalued and replaced by a different form of money several times—all because the currency lost its value through inflation. Argentina is infamous for its series of economic crises (once every 10 years or so), the most recent being in 2001, when banks completely shut their doors and refused to give even depositors their own money. Some economic analysts blame government overspending and its focus on short-term benefits. Meanwhile, chronic instability has fostered a lack of faith in the country's currency. "There's a culture of 'I want dollars,'" says Cachanosky of the long-standing practice of people saving money in U.S. bills, as Argentine currency quickly plummets in value. "In Argentina, the exchange rate is like the thermometer of the economy," Rossi says. "In Brazil, for instance, no one cares about the exchange rate, but in Argentina everyone knows" what it is, from moment to moment.

Meanwhile, the government's heavy fiscal hand—with regulations and typically high taxes—has helped prompt an informal economy where a third of all workers are paid under the table, according to a 1993 estimate, a number that has changed little since then. This means a black market for dollars always exists at some level. Since individuals and businesses must disclose their incomes when they ask for dollars from banks and the government, even before the 2011 exchange controls, they go to the black market when they want the currency. "There is no way to avoid the black market

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here," says economic analyst Fausto Spotorno, director of research for the consulting firm Orlando Ferreres and Associates.

SPENDING BONANZA

In 2010 and 2011, Argentines' economic spirits soared as salaries increased 30 percent each year, and the peso dropped just 5 percent relative to the dollar annually—which meant Argentines could afford to buy more abroad. The government had also pumped money into the public sector and printed more pesos as a strategy to recover from the 2001 economic crisis.

At that point, President Cristina Fernandez de Kirchner and her advisors had no restrictions on access to the dollar, and people could change pesos for dollars at their will. But this apparent success was doomed. Argentina's domestic inflation was increasing about 25 percent a year, so it took ever more pesos to buy products in the country. If a person saved pesos in the bank and earned the average interest rate of 12 percent, the depositor would still be left with a loss, since his pesos could buy less and less. Meanwhile Argentina was becoming less competitive exporting goods and providing labor to international companies, since the peso was increasingly expensive compared to the dollar.

"Consumption exploded, but it started growing against savings...there's no way to save pesos with inflation," says Spotorno. "Inflation is like a drug, and like a drug you have to maintain inflation to keep feeling everything is good. But at some point you no longer have investment in the country because you have no savings." Fiscally savvy Argentines took note—and braced for a decline. "Once you start seeing the dollar become cheap here, it's foreshadowing some economic problem," says Rossi. To ensure their stability, individuals began buying dollars feverishly in early 2011, at the same time Argentina's foreign reserves started to decline. In December 2010, the reserves were at $52 billion, but one year later they had shrunk to $46 billion, he says.

Still the Fernandez administration continued to allow open dollar access, and when Fernandez ran for reelection in October 2011, her campaign slogan was "*La Mejor es Porvenir*" (the best is yet to come). She won—but less than one week after her victory the government announced its first currency exchange controls. At that point, Rossi says, the government could have devalued the peso, admitting it was worthless. Instead, the government hoarded its dollars.

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The government's first exchange controls simply limited access to dollars, according to fuzzy rules that were like "playing the lotto," Rossi says, describing their unpredictability. By May 2012, even limited access was closed. The government implemented complete exchange controls, and simply wouldn't change an individual's pesos to dollars. The only exceptions were for businesses importing goods that required dollars and for individuals who proved they needed dollars for a trip abroad—all in the interest of the government avoiding devaluation of the peso and maintaining its image as a strong, reliable currency. Conversely, these measures led to an explosion of the dollar black market.

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Meanwhile, the government continued to deny inflation was rising, even fining Orlando Ferreres and Associates for providing what it called elevated estimates of inflation. Not long after, Argentina became the first country in the world to be censured by the IMF for under-reporting its inflation. The National Institute of Statistics and Censuses (INDEC) reported about 10 percent inflation in 2012 and 2013, while inflation was actually at nearly 25 percent, according to estimates by the Foundation of Latin American Economic Investigators.

MAKING A MARKET

About six or seven big wholesale Dolar Blue dealers—those that circulate the most black market money—are the "market makers." These most powerful players examine supply and demand to determine the exchange rate.

"Here you can be a wholesale trader if you have enough money. It's a very liquid market. You can start as a small firm and become a wholesale trader in months," says Spotorno. "And the incentives are very big. If the gap between the black market and official rate is 10 percent, and you operate $1 million in a day, you make about 1 million pesos," or $125,000 at the official exchange rate.

Those wholesale dealers hide in obscurity, and meanwhile countless (literally countless, Spotorno has no estimate for the number of people working in the field) individuals who either work for those wholesalers or operate their own small *arbolitos* offer the service. There is an official Dolar Blue price to sell dollars, and another to buy dollars, and the difference in costs ensures a margin of profit each time a dealer buys or sells dollars from a client.

Arbolito owners like Carlito Bondi are part of a small community of vendors who all know one another. For each of them, the black market is a legitimate livelihood that happens to offer a necessary service for tourists and locals. "I sold sandwiches before, and then I began selling *cambio* on the street when the government started its exchange controls," says Bondi, 40, who soon opened a kiosk on Buenos Aires' Florida Street (the main black market hub) to have a base for his burgeoning operations. He stays at the kiosk and sells candy and magazines—and his five employees stand nearby, announcing *cambio* in low but strong voices with the tones of auctioneers.

"You just have to have a vision," Bondi boasts of his enterprise, which changes about $9,000 a day, mainly from passing tourists, then selling the money to *cuevas*—larger black market exchange houses. He says he earns about 3,000 pesos ($375) a day from the trades. "I don't think what we do is illegal. If so, why aren't official exchange houses illegal?" Bondi challenges. "They make money from exchanges too. Who are the owners of money?"

Occasionally the government agency AFIP (which controls currency exchanges) has cracked down on *arbolitos*, issuing fines and temporarily shutting them down. But those efforts can do little to break down the system, since other *arbolitos* just appear, economist Jorge Heilpern says.

WAVES WASH OVER NEIGHBORS

All five neighboring South American countries—Chile, Bolivia, Paraguay, Brazil, and Uruguay—have felt waves from Argentina's powerful informal market. For residents near its borders, coming to Argentina has become an easy way to make money. Since all the surrounding countries have open access to dollars, locals bring their dollars into Argentina, sell them on the black market, and often use those pesos to

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buy goods in Argentina, far more cheaply than in their own countries. Paraguay has taken the largest hit from this.

"Paraguayans are coming, even from the capital, to cross the border to sell their dollars and to buy things. This means there's less activity in the market in Paraguay, and prices have gone down," says Bour, referring to data compiled by the Bank of Paraguay.

Along with Argentina's currency regulations came new trade restrictions requiring every import to be registered—prompting a steep drop in trade, Rossi notes, and singling out Brazil's electro-domestic and textile industries that have suffered a particularly notable blow. Currency restrictions have also made it more difficult for Argentines to travel abroad. Neighboring Uruguay's tourist industry has taken a significant hit, with a 6.5 percent drop in foreign visitors in 2013, according to research company Fitz Ratings. And since the government's recent restrictions have made it nearly impossible to take dollars out of Argentina, foreign companies already in the country struggle to extract their profits, and new foreign companies simply won't enter, Bour says.

"The companies here are hostages," says Bour, noting that about 70 percent of foreign direct investment in Argentina comes from companies already in the country reinvesting their money, since they can't take it out of Argentina. "You're not going to see a large new company entering here."

QUICK FIXES

Twice in the past year, the spread between the Dolar Blue and official rate has soared so high that the government has rushed to tame the black market with new policies. Last May, the black market rate jumped to double the official exchange. Dolar Blue was around 10 pesos to the dollar, the official rate around 5 pesos to the dollar. Within days, the government announced a tax incentive for people to put their black market-earned dollars in the bank or to use buying real estate.

Then, this past January, Dolar Blue leapt to a record high, at 13 pesos to the dollar. There was a sense of frenzy in Buenos Aires, as residents watched the fluctuations of the market hour-by-hour on television screens around the city. Immediately afterwards, the government devalued the peso, admitting the currency's official worth was lower than previously claimed (but still worth more than the black market rate). They also allowed limited access to dollars again, for upper- and middle-income citizens to put in their savings accounts each month. The first week of the new access was rocky, with lines snaking down blocks outside banks and many clients turned away because of "system malfunctions." But in the past few months about one million people have been able to purchase some dollars for their accounts, the government told national newspaper *La Nacion* in April.

THE ONLY WAY TO CALM THE BLACK MARKET IS TO COMBAT INFLATION. THAT WOULD REQUIRE A COMPREHENSIVE STABILIZATION PROGRAM TO READJUST THE NATION'S FISCAL AND ECONOMIC POLICIES.

The government's long overdue accountability for the inflation that its economic practices produce and the eventual devaluation of the peso have helped lower

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the official Dolar Blue gap. But Bour predicts the spread will increase again until another devaluation of the peso is necessary. That's because inflation is continuing to rise, while the government has fixed the official peso-dollar exchange at a ceiling of around 8 pesos to the dollar.

"This year inflation is going to be about 40 percent, and if you have inflation it's hard to keep the peso fixed at 8 to the dollar," Bour says. "They're going to have to devalue again. This problem doesn't have a short-term solution."

Bour says the only way to calm the black market is to combat inflation. That would require a comprehensive stabilization program to readjust the nation's fiscal and economic policies. But inflation, Spotorno says, has "gotten the worst of the economy," so the government has no option but to take measures to contract the economy, or decrease its spending. Other economists agree that Argentina's economic dilemma is far from a solution, but some emphasize a handful of measures the administration has taken just this year that could produce results. The government gave citizens more incentives to deposit money in the bank through increased interest rates, and those deposited pesos would likely go straight to the black market.

Meanwhile, officials have finally become more sincere about holding the line on prices. In February, Argentina's official statistics agency INDEC gave an estimate of 3.7 percent inflation for the final quarter of 2013 (an annual rate in excess of 15 percent)—a drastic leap from the agency's previous calculations, which had caused IMF to censure Argentina in 2013 for inaccurate data. The new estimate still has flaws, Bour notes, because the methodology is unclear and lacks transparency, but he still believes it's a step in the right direction.

Argentine officials have also told local news outlets that they are in talks with international banks to take out loans. Early this past spring, the government announced a loan from Goldman Sachs—a sign the country is moving in the right direction and trying to restore credibility. In addition, officials unveiled an impressive agreement to repay $9.7 billion in longstanding debt to the Paris Club—a group of 19 donor countries, including the United States, Russia, and the United Kingdom—at the end of May, helping further restore Argentina's credibility. Argentina now has five years to repay the debt, after the Paris Club announced it was satisfied by the country's progress "towards the normalization of its relations with creditors, the international financial community and institutions."

The plan paves the way for Argentina to borrow from international markets at lower interest rates, analysts say, and it surprisingly excludes any requirements that the nation strike an agreement with the IMF. Local economists have asserted that the IMF held the key to restoring a rational economic system for Argentina, since Argentina would have to present a new fiscal plan with lower expenses, a lower exchange rate (closer to the Dolar Blue rate), and agreements with each province in the country. Such reforms would open the door to a free market, Spotorno explains.

"This is an exchange rate problem… To me if the price is the same [in the black and official markets] you're in conditions to liberate the dollar," says Sportorno, adding that would be the best route to creating a free market and annihilating the Dolar Blue.

Another way to take down the black market would be to open access to the dol-

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lar immediately, Spotorno says of the more abrupt approach—cautioning that inflation would skyrocket even further overnight (as supposed to the other option, which would gradually increase inflation). Ultimately, he says, the key is to have a free market for dollars—and that is only possible if the actual value of pesos is recognized by the government.

Rossi agrees that a free market is the key to dismantling the black market, but argues it's not the Paris Club's job to mandate such reforms. The changes must come from the inside—and while they are possible, Rossi firmly believes the current government will not make such dramatic moves. First, the country would have to reduce public expenditures, which are the highest in the Western Hemisphere at 43.5 percent of GDP this year, according to the latest IMF data. The government must also slash the printing of money, dismantle exchange controls, and admit the lower value of the peso. But to do all this successfully, the government would also have to issue large amounts of debt.

"In terms of the economy, it could be easy, but this government seems unwilling," Rossi says. And Bour agrees that an entire restructuring of the economy is necessary, but that must wait until the next administration enters at the end of 2015, at the very earliest. "Argentina will bear a curse for a number of years," Bour says, "and that's high inflation and a record spread between the Dolar Blue and official market."

CALIBRATING HARSHNESS

An agreement with the IMF may be critical to helping Argentina get on economic track, but the country has long had a rocky relationship with the powerful monitor. Politicians and citizens here blamed the IMF for the 2001 economic crisis, since the fund had encouraged Argentina to make draconian reforms that many believe led to the country's downfall. The IMF agreed to lend Argentina money if it adjusted its fiscal expenditures, opened trade, and pegged the peso to the dollar in the 1990s, but after those reforms the economy collapsed. "Society was looking for an enemy," and blamed the IMF, Rossi says, arguing that the problem was actually Argentina's government, not the international agency. The government stopped allowing the fund to do economic analyses of the country beginning in 2006, and the IMF's 2013 censure of Argentina prompted outcries from government leaders, who claimed the IMF was unfairly targeting the country. The censure also further soiled Argentina's international economic reputation.

> THE IMF HAS MAINTAINED THAT IT IS COMMITTED TO WORKING WITH ARGENTINA TO IMPROVE ITS FISCAL POLICY.

As part of the censure, the IMF threatened to impose sanctions on Argentina if it did not reform its consumer price index (CPI) to reflect true inflation rates. Early this year, the government made the necessary adjustment. "The pressure from the IMF helped restore confidence in our statistics," Rossi says, maintaining that the controversial censure was actually the IMF's best option to help Argentina in the long run. Meanwhile, some analysts assert the IMF should be even harsher with Argentina to spur real change.

"They asked Argentina to revise its statistics but haven't been very strict," Bour says. "You could say that by not putting enough pressure on Argentina to improve

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its macroeconomic policy or statistics they have caused damage by omission."

But the IMF has maintained that it is committed to working with Argentina to improve its fiscal policy. The IMF "stands ready to continue the relationship between Argentina and the Fund," it declared in late 2013 when announcing it would not place sanctions on the country.

DANGERS AHEAD

What if Bour and Rossi are correct, and the government simply refuses to liberate the market? The economy will continue to spiral downward, analysts warn. Imports, exports, and investments will all reach such lows that industries here will shrink, and Argentina will slip ever deeper into economic decline. Real wages will keep dropping (they dropped an average of 5 percent last year), and unemployment will rise. The black market will remain the lifeline for many residents. But the black market is more a symptom of the economy's sickness than the sickness itself.

"The black market leaves the country better off than not having it," says Spotorno of the current situation that has left foreign trade severely restricted. Using the black market, small businesses can import necessary goods for their operations while official rules block the trade.

But a strong black market will also prompt further domestic price increases, since many business owners gauge the value of the peso based on the Dolar Blue instead of the official rate. And with the large gap between official and unofficial exchange rates, companies anticipate the inevitable rise in the official rate, waiting to export their goods until the official exchange is closer to the black market value. All this further slows the economy, which has already largely stopped growing since 2012, its growth rate plunging from 21 percent in 2011 to 6.5 percent in 2012 to under 3 percent last year.

Meanwhile there is a further underlying risk—that the black market will accumulate too much power. As the spread between official and unofficial rates widens again, legislators may reach a point when they have no other option but to devalue the peso to the Dolar Blue rate, perhaps even changing the form of currency again, as the government did in earlier economic crises.

Ultimately, the black market remains the inevitable result of grave mismanagement. "If the black market continues to grow, it is not because of the malevolence or perversity of Argentines," Bour insists. "It's because of the government's inability to limit its expansion and to function like other countries at its equal level of development." ●

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