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The Americas

Why Guatemala Needs Its Sidewalk Dollar Exchange

By Manuel F. Ayau

GUATEMALA CITY—Latin American nations have not yet collapsed completely due to the incompetency of their governments in their efforts to suppress freedom. These countries struggle along thanks to black markets, the underground economy and the corruption that facilitates law breaking.

One of the most pervasive economic policies of Latin American governments is the expropriation of the foreign exchange (dollars) earned by exporters. The justification for this policy (exchange control) is that the limited dollars available must be rationed according to quotas, licenses and lists of priorities.

When the governments expropriate dollars, they pay less than the market price for them. If they paid the market price, obviously there would be no need for black markets. This policy of expropriation at less than market price amounts to a tax levied exclusively on those who earn dollars. Incredibly, this tax is used to subsidize the spenders of dollars. Is it any wonder that there is a shortage of dollars?

Invariably, this practice will divert resources from dollar-earning to dollar-spending activities, encourage the diversion of dollar earnings from the official to the black (free) market, increase controls, favoritism and corruption, and cause unemployment.

If Latin American countries were limited to the diminished official supply of dollars it would be impossible for normal economic activity to continue. It is the illegal free market that allows those in business, from manufacturers to medical-supply stores, to obtain their scant supplies. However, the governments cannot get their hands on all dollars earned. Thus there is a supply of dollars for the black market, without which some would literally die for lack of timely medical care.

As contradictory as it may sound, it is quite a good thing that Latin Americans have put a good part of their savings out of the reach of their governments. The yield from nonregistered foreign investments (labeled “flight of capital”) is an important source of black-market dollars. Without them, the economic situation would be even worse.

Savings will only return to their country of origin when conditions for capital investment become competitive in terms of yield and security. Meanwhile, if the savings were returned now, the system would simply consume them. Although, through taxes and discriminatory regulations, governments can confiscate land, factories or their output, they have yet to figure out a way to confiscate offshore assets.

The rationale for exchange control is always the same old story: that government intervention is necessary because the free market works only in theory, not in practice.

And yet we can see, in practice, in front of Guatemala's main post office, a thriving black (free) foreign-exchange market. Agents from nearby exchange houses assail the outgoing people with the chant, "Sell me your dollars." Why? Because millions of dollars in money orders or checks are sent to Guatemala from relatives working in the U.S. (In neighboring El Salvador it is estimated that more than $1 million a day enters the country in this manner, making it one of that country's most important sources of foreign exchange.)

This sidewalk exchange in front of the post office has become the hub of Guatemala's dollar black market. A Guatemalan banker recently replied, when I asked him the current free-market price of the U.S. dollar, "Please call me later. I just sent a fellow down to the post office."

In front of the post office several policemen stand watching the viva voce competitive bidding. When one agent was asked if the police ever interfered or bothered them, the reply was that the police were there to protect them. After all, many hundreds of thousands of dollars are being exchanged at the curb.

Some time ago, the Central Bank authorities set up magnetic devices to detect checks in the mail. They would then intimidate the recipient of a check to surrender the foreign exchange at the official devalued price. That went on until it threatened to become a scandal. Now the authorities simply watch and keep the peace in front of the post office, where the price of dollars has commanded a premium of 25% to 50% over the legal price.

Unofficially, the government acknowledges that this free market is a very important source of dollars and other foreign currencies. In an implicit recognition that dollars are worth more than the official rate, the tax authorities went so far as to pass a ruling that allows a 20% increase in costs of imported goods as a deductible expense in those cases where foreign exchange is not bought officially at the Central Bank. Although the ruling does not specify what the 20% is for, it is a means of allowing importers a legal tax-deductible way to disburse the premium paid for the dollars. A receipt for this premium would, of course, be an acknowledgement of having committed a crime. Therefore, for this 20% legal deduction, the government does not require documentation.

Unfortunately, dollars cost more than the 20% allowed as an expense, creating additional problems for managers and especially for publicly held corporations that cannot justify these illegal expenditures to their stockholders. Yet to stay in business, the dollars must be bought.

The efficiency of the free (black) market that “does not work” was dramatically revealed when the Guatemalan government got a bailout from the International Monetary Fund in August 1983. The going premium for dollars above the official rate had reached 50%.

One of the IMF “conditionalities” consisted of requiring all those applying for dollars at the official price to back up their requests with a cash deposit. This reduced bank liquidity by some $280 million, about 25% of the country’s money supply.

The demand for dollars in the free market was considerably reduced overnight. And instantly, the fellows in front of the post office, who probably haven’t the slightest idea what the initials IMF stand for, adjusted the rate to reflect the consequences of the IMF “conditionalities.”

It is ever more obvious that the attempts to abolish freedom are not without cost. Freedom, by whatever name—black market, underground economy, floating exchange, parallel economy, etc.—tends to surface to alleviate social ills precisely because it does work in practice, in spite of attempts to suppress it.

The residual degree of freedom that has escaped suppression, or is illegally practiced, helps keep Latin America going. Ironically, it is this very same freedom that is blamed for our lack of success.

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