

# **Black-Markets for Currency, Hoarding Activity and Policy Reforms**

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## Abstract

In the former Soviet Union and throughout Eastern Europe, black-market exchange rates and second-economy prices often are interpreted by policy-makers as indicative of post-reform levels. However, these exchange rates and prices can provide highly-biased signals for policy setting. These biases are especially important when exchange rates fixed on the basis of these signals are expected to play a nominal anchor role during stabilizations. This paper traces the paths and biases in black-market exchange rates, second-economy prices, hoarding stocks, and privately-held dollars balances after policy-initiatives or other changes in the economic environment are implemented. The stimuli studied are official exchange-rate adjustments, price reforms, foreign-aid packages, altered risks of monetary confiscation or currency reforms, and goods-supply related initiatives. We provide the conditions under which announcements of reform lead short-run prices or exchange rates to overshoot or to undershoot their long-run equilibrium levels.

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