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Regional Monetary Fund: the Case for Latin America

Abstract: This article deals with the perspectives of the new regional financial architecture in South America. The topic is the Bank of the South, which is the main pillar of the present integration processes in the region. Lastly, presenting an analysis of its goals and purposes, and the problems of its functioning.

Key words: The Bank of the South, South America, regional financial architecture, financial institution, regional monetary fund, economic integration.

In the beginning of 2007 the President of Venezuela Hugo Chavez proposed to establish the Bank of the South (el Banco del Sur). This initiative gave a momentum to the economic integration process in the region.

The Foundation Act of the Bank of the South was signed on September 9, 2007. This document reflects the necessity to create a new regional financial architecture that would then strengthen the role of the South American continent in the globalized world and favor greater stability in socio-economic development of the region.¹

The Constituent Treaty of the Bank of the South was signed by Argentina, Brazil and Venezuela at the Second Africa-South America Summit in 2009. Bolivia, Paraguay, Uruguay and Ecuador joined the Treaty later. The Treaty will come into affect only after its ratification by all the countries. Presently, however, the agreement was ratified only by Venezuela and Ecuador.

It is necessary to point out that the initiative to create a regional financial institution is not completely new for the South American region. There are several organizations that are similar, e.g. the Fund for Basin of Plata River (FONPLATA), Andean Development Corporation (CAF), Latin American Reserve Fund (FLAR).

Nevertheless, it should be noted that the Bank of the South fundamentally differs from the mentioned organizations above. The main purpose of the newly organized financial institution is to create an effective financing mechanism, to coordinate separate efforts of different countries and

¹ Acta Fundacional del Banco del Sur. 2007. Diciembre.
<http://www.integracionsur.com/sudamerica/ActaFundacionBancoSur2007.pdf>

their blocks into the sphere of regional collaboration and economic development and integration in the South American region.

In this connection what also should be emphasized is that the members of the Union of South American Nations (UNASUR) established the Bank of the South. This organization was founded in 2008 with the purpose of merging the Southern Common Market (Mercosur) and Community of Andean Nations (CAN) into a single integrated space. It will strengthen the economic and political collaboration and also promote the creation of independent space for all the members with equal rights to cooperate.

The following Table shows the South American countries that take part in the indicated integration processes.

Table 1

Latin American countries in the integration processes

	MERCOSUR	CAN	UNASUR	Bank of the South
<i>Argentina</i>	+	*	+	+
<i>Bolivia</i>	*	+	+	+
<i>Brasil</i>	+	*	+	+
<i>Chile</i>	*	*	+	
<i>Columbia</i>	*	+	+	
<i>Ecuador</i>	+	+	+	+
<i>Guyana</i>			+	
<i>Paraguay</i>	+	*	+	+
<i>Peru</i>	*	+	+	
<i>Suriname</i>			+	
<i>Uruguay</i>	+	+	+	+
<i>Venezuela</i>			+	+

“+” – members

“*” – associated members

The UNASUR Constituent Treaty points out that the creation of the Union characterizes “the aspiration for integration unity and the building of the common future,” and among the priority tasks of the organization it is worth to mention “the creation of free trade zone for member countries during the next fifteen years”.²

To mention this in other words, the Bank of the South should give a new impact to the South American integration processes.

Let us now turn to a more detailed examination of the aspirations and purposes of the Bank of the South.

Firstly, it is a priority that financial support of state and private companies should modernize and develop the regional infrastructure. In this respect, the Bank of the South should give a wide

² Tratado constitutivo de la Unión de naciones suramericanas.
http://www.comunidadandina.org/unasur/tratado_constitutivo.htm

spread realization to the programs and projects which specifically administer development of South American countries.³

Secondly, the Bank of the South should overcome promissory dependence of the region, starting from the international financial institutions.

The following Table contains the data on the public debt from the Bank of the South's members.

Table 2

Public debt (in % of GDP)

	2000	2001	2002	2003	2004	2005	2006	2007	2008
<i>Argentina</i>	45,0	53,7	145,9	138,2	126,4	72,8	63,6	55,7	48,3
<i>Bolivia</i>	60,7	72,7	77,5	86,8	81,1	75,6	49,8	37,1	33,8
<i>Brasil</i>	29,9	31,6	37,9	34,0	31,0	30,9	31,0	31,4	25,2
<i>Ecuador</i>	73,3	56,9	50,3	45,8	40,8	35,9	29,4	27,5	23,7
<i>Paraguay</i>	32,6	41,1	59,2	44,4	38,0	31,4	23,8	16,9	15,3
<i>Uruguay</i>	30,6	40,1	94,4	90,2	71,4	64,2	57,2	48,2	46,2
<i>Venezuela</i>	26,8	30,4	42,4	46,3	38,1	32,8	23,9	19,3	14,0

Source: Estudio económico de América Latina y el Caribe 2008-2009. Comisión Económica para América Latina y el Caribe (CEPAL). P. 365.

Undoubtedly, surplus external debt is the negative factor, which to some extent restrains economic development of the Latin American countries. Moreover it frequently appears as the mechanism of manipulation from the side of the developed countries and international financial institutions. The greater part of the financial resources of South America belongs to the European countries, USA and China.

Thus, the mission of the Bank of the South consists in renewal of financial independence of Latin American countries, which is now limited by the terms, imposed by the international financial institutions.

Speaking of the process of creating a new regional financial architecture in South America, I would like to make some comments on other initiatives that take place in the region.

First of all, two special financial institutions are going to be established. The Common Reserve Fund (el Fondo Común de Reservas) will specialize on short-term lending, and Regional Stabilizing Fund (el Fondo de Estabilización Regional) will render assistance in any case of balance

³ Convenio Constitutivo del Banco del Sur. 2009. 27 Diciembre.
http://www.mre.gob.ve/union/index.php?option=com_content&view=article&id=2078:-convenio-constitutivo-del-banco-del-sur&catid=106:banco-del-sur&Itemid=71

deficits, by granting short and mid-term credit lines. The Funds will also secure the regional economy from the possible negative consequences of crises.

The other thing that should be noted is the extension of the usage of national currencies for intra-regional payment settlements. This initiative is mainly related to the process of financial dollarization of the region in the last decades. The US dollar gradually begins to execute the functions of national currency.

The following Table contains the data on the deposits in foreign currencies of the members of the Bank of the South.

Table 3

Deposits in foreign currencies (in % of GDP)

	2000	2001	2002	2003	2004	2005	2006	2007	2008
<i>Argentina</i>	16,8	16,5	0,7	1,4	1,7	2	2,3	2,6	2,7
<i>Bolivia</i>	...	45	41,7	39,4	33,1	30,9	26,7	23,9	20,3
<i>Brasil</i>	...	...	...	...	...	...	...	...	...
<i>Ecuador</i>	...	...	...	...	...	...	...	...	...
<i>Paraguay</i>	16,2	19,9	18,4	14,8	13,1	11,7	10,6	10,7	12,8
<i>Uruguay</i>	60,2	80	77,4	70,3	56	47,6	45,3	36,4	42,2
<i>Venezuela</i>	...	...	...	...	...	...	...	...	...

Source: Estudio económico de América Latina y el Caribe 2008-2009. Comisión Económica para América Latina y el Caribe (CEPAL). P. 358.

The Agreement between Argentina and Brazil was signed on December 2006, which then led to the first step on the way to overcoming the financial dollarization in the region. Countries agreed about the conduction of mutual settlements of payments in national currencies (Brazilian real and Argentine peso). Thus, the regional payment system between Argentina and Brazil (Sistema de Pagos en Monedas Locales [SML] entre Argentina y Brasil) was launched. However, this system is not obligated for the participants in the foreign currency payment settlements. The purpose of this system consists in facilitation of payment settlements between the countries and reduction of the amount of foreign currency transactions between them.

In the first months of functioning (October, 2008 – April, 2009) 160 companies took advantage of the possibility to make payments in this system. The general volume of operations for this period made 122.8 mln dollars (214 operations were conducted). It is necessary to add that the sums of the transfers did not exceed 500 thousand dollars in 90% transactions and 10 thousand dollars in 57%.

The coordinated usage of free resources for infrastructural projects will be under subzero interest rates and on the reasonable terms.

Finally, the question about the creation of the Special Social Fund (el Fondo Especial de Solidaridad Social) and the Special Stabilizing Fund is under consideration. These institutions are going to finance social projects and programs of the region, e.g. the reduction of poverty and the fight against unemployment. Let me direct your attention to the following Table of unemployment rates in the South American countries, might I add that they are relatively high.

Table 4

Unemployment rates (%)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
<i>Argentina</i>	15,1	17,4	19,7	17,3	13,6	11,6	10,2	8,5	7,9	8,8
<i>Bolivia</i>	7,5	8,5	8,7	9,2	6,2	8,1	8,0	7,7	6,7	6,8
<i>Brazil</i>	7,1	6,2	11,7	12,3	11,5	9,8	10,0	9,3	7,9	8,1
<i>Ecuador</i>	14,1	10,4	8,6	9,8	9,7	8,5	8,1	7,4	6,9	8,6
<i>Paraguay</i>	10,0	10,8	14,7	11,2	10,0	7,6	8,9	7,2	7,4	...
<i>Uruguay</i>	13,6	15,3	17,0	16,9	13,1	12,2	11,4	9,6	7,9	7,7
<i>Venezuela</i>	13,9	13,3	15,8	18,0	15,3	12,4	10,0	8,4	7,4	8,0

Source: Balance preliminar de las economías de de América Latina y el Caribe 2009. Comisión Económica para América Latina y el Caribe (CEPAL). P. 172.

Therefore, the creation of the Bank of the South is very important in the launching of new mechanisms in crediting and financing of socio-economic development in Latin American countries and in the creation of new regional financial architecture, which is the key element that has been previously mentioned.

In accordance with the agreements, signed in 2007 between Argentina, Brazil and Venezuela, the owned capital of the Bank of the South had to make 7 bln USD. It was planned that each of three countries would deposit 2 bln USD.

However after the signing of the Constituent Treaty in 2009 participants agreed to increase the Bank's capital to 20 bln USD. The sum of the subscribed capital will make 7 bln USD. It is planned that during the following ten years, member countries will make deposits in equal stakes to the capital.

All of this goes back to the distinctive organizational feature of the Bank of the South, which values greatly the principle of equality in the voices of all the participant countries. Thus, each country will possess a unique voice.

Speaking about the prospects of the new regional financial institution, it is a priority to administer the positive and negative trends. As the core institute of integration processes in Latin America, the Bank of the South has multiple duties to tend to. The key task of the Bank is to accumulate resources needed for the modernization and development purposes. Also, the Bank is

called to set the new trend of development for the overall international economic relations and international financial relations in particular.

Now let us look more specifically at the problems arising in the establishment of the Bank of the South. The participating countries are rather indecisive on when to open the Bank. In a short-term perspective, there is the real threat to miss an opportunity because of the realization process these countries must take.

In this respect it is important to use reserves that were formed by the South American countries under the favorable conditions, e.g. high prices on raw materials (Table 5).

Table 5

International reserves (bln USD)

	2000	2001	2002	2003	2004	2005	2006	2007	2008
<i>Argentina</i>	32,5	15,3	10,4	13,8	19,3	27,3	31,2	45,7	46,2
<i>Bolivia</i>	1,2	1,2	0,9	1,1	1,3	1,8	3,2	5,3	7,7
<i>Brazil</i>	33,0	35,9	37,8	49,3	52,9	53,8	85,8	180,3	193,8
<i>Ecuador</i>	1,2	1,1	1,0	1,2	1,4	2,1	2,0	3,5	4,5
<i>Paraguay</i>	0,7	0,7	0,6	0,9	1,2	1,3	1,6	2,2	2,7
<i>Uruguay</i>	2,8	3,1	0,8	2,1	2,5	3,1	3,1	4,1	6,4
<i>Venezuela</i>	20,5	18,5	14,9	21,4	24,2	30,4	37,4	34,3	43,1
Total:	91,9	75,8	66,4	89,8	102,8	119,8	164,3	275,4	304,4

Source: Estudio económico de América Latina y el Caribe 2008-2009. Comisión Económica para América Latina y el Caribe (CEPAL). P. 350.

There are also the immanent contradictions that are common to the socio-economic development of the region. To some extent they can also influence the Bank of the South.

No need to forget that the economic development of the South American countries is not homogeneous. The figures in the following Table speak eloquently of the GDP growth and inflation rates in the participating countries of the Bank of the South.

Table 6

GDP Growth and Inflation (%)

	GDP Growth (%)									
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
<i>Argentina</i>	-0,8	-4,4	-10,9	8,8	9	9,2	8,5	8,7	6,8	0,7
<i>Bolivia</i>	2,5	1,7	2,5	2,7	4,2	4,4	4,8	4,6	6,1	3,5
<i>Brazil</i>	4,3	1,3	2,7	1,1	5,7	3,2	4	5,7	5,1	0,3
<i>Ecuador</i>	2,8	5,3	4,2	3,6	8	6	3,9	2,5	6,5	-0,4
<i>Venezuela</i>	3,7	3,4	-8,9	-7,8	18,3	10,3	9,9	8,2	4,8	-2,3

<i>Paraguay</i>	-3,3	2,1	0	3,8	4,1	2,9	4,3	6,8	5,8	-3,5
<i>Uruguay</i>	-1,4	-3,4	-11	2,2	11,8	6,6	7	7,6	8,9	1,2
<i>Venezuela</i>	3,7	3,4	-8,9	-7,8	18,3	10,3	9,9	8,2	4,8	-2,3
	Inflation (%)									
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
<i>Argentina</i>	-0,7	-1,5	41	3,7	6,1	12,3	9,8	8,5	7,2	6,5
<i>Bolivia</i>	3,4	0,9	2,5	3,9	4,6	4,9	4,9	11,7	11,8	0,8
<i>Brazil</i>	6	7,7	12,5	9,3	7,6	5,7	3,1	4,5	5,9	4,2
<i>Ecuador</i>	91	22,4	9,4	6,1	1,9	3,1	2,9	3,3	8,8	3,5
<i>Paraguay</i>	8,6	8,4	14,6	9,3	2,8	9,9	12,5	6	7,5	2,8
<i>Uruguay</i>	5,1	3,6	25,9	10,2	7,6	4,9	6,4	8,5	9,2	6,5
<i>Venezuela</i>	13,4	12,3	31,2	27,1	19,2	14,4	17	22,5	31,9	28,9

Source: Balance preliminar de las economías de de América Latina y el Caribe 2009. Comisión Económica para América Latina y el Caribe (CEPAL). P. 158, 177.

Take notice that the cyclic character of economic crises in the region's development. The treatment of current historical questions shows that this is one of the most important destabilizing factors.

Table 7 contains data on the timing of financial crises in Latin America in 1970-2007.

Table 7

Timing of Financial Crises in Latin America, 1970-2007

<i>Country</i>	Systemic Banking Crisis (starting year)	Currency Crisis (year)	Debt Crisis (default date)
Argentina	1980, 1989, 1995, 2001	1975, 1981, 1987, 2002	1982, 2001
Bolivia	1986, 1994	1973, 1981	1980
Brazil	1990, 1994	1976, 1982, 1987, 1992, 1999	1983
Chile	1976, 1981	1972, 1982	1983
Columbia	1982, 1998	1985	
Costa Rica	1987, 1994	1981, 1991	1981
Dominica			2002
Dominican Republic	2003	1985, 1990, 2003	1982, 2003
Ecuador	1982, 1998	1982, 1999	1982, 1999
El Salvador	1989	1986	
Grenada			2004
Guyana	1993	1987	1982
Guayemala		1986	
Haiti	1994	1992, 2003	
Honduras		1990	1981
Jamaica	1996	1978, 1983, 1991	1978
Mexico	1981, 1994	1977, 1982, 1995	1982
Nicaragua	1990, 2000	1979, 1985, 1990	1980

Panama	1988		1983
Paraguay	1995	1984, 1989, 2002	1982
Peru	1983	1976, 1981, 1988	1978
Suriname		1990, 1995, 2001	
Trinidad and Tobago		1986	1989
Uruguay	1981, 2002	1972, 1983, 1990, 2002	1983, 2002

Source: Laeven L., Valencia F. Systemic Banking Crisis: A New Database. IMF Working Paper. 2008. November. P. 50-55.

Finally we have arrived to the following conclusion. One of the main tasks of the Bank of the South consists in development of effective mechanisms in overcoming the crises and its negative consequences. Otherwise the countries would undertake uncoordinated measures, which will cause damage to the regional interests.

A survey of the new regional financial architecture leads to the conclusion that presently the Bank of the South is the main pillar of the integration processes in the South American region. The establishment of this financial institution is the prerequisite in emerging the common economic space. The aspiration of the Bank is to direct the economic activity toward the real sector, to develop industrial capacities and transport infrastructure, that will allow to co-ordinate the economic growth with the social development.

Indeed, the success in the realization of this project depends on the political will that would be embodied in the actions and accelerate the beginning of the Bank of the South.