

## REGIONAL FINANCIAL COOPERATION Issues in South America

Oscar Ugarteche  
Instituto de Investigaciones Economicas UNAM  
[Ugarteche@iiec.unam.mx](mailto:Ugarteche@iiec.unam.mx)

*There is an emergence of regional financial cooperation in South America as a result of the insufficiency shown by IFIs in crisis periods. In this paper we want to argue that regional financial cooperation serves to cover any or all of the external, fiscal and, savings and investment gaps, in a new regionalism context where the actors are no longer the States only but also the private sector, The requirement for monetary cooperation is financial stability which exists amongst certain subsets of countries but not amongst all. Equally, Latin America has turned into South America and as such is organised around UNASUR due to the political perception that Mexico and the Central American Community countries were shifting towards a US led dominance while the Mercosur countries centred around Brazil. This country launched local currency payment mechanisms and have not in been used widely due to the lack of monetary policy coordination.but equally they would require a a change in the IMF definition of what is a reserve currency. A regional payment system(SUCRE) was also launched and is not used widely for the same reason. Finally there are new research areas found after the Euro crisis that must be studied in order to ensure greater regional financial stability*

JEL Monetary policy, Central Banks and their policies, International monetary arrangements and institutions, Financial aspects of economic integration,

### **Some concepts and general considerations**

The issue of the shift i What we want to suggest is that in addition to the above definitions, regional financial cooperation serves to cover any or all of the external, fiscal and, savings and investment gaps, in a new regionalism context where the actors are no longer the States only but also the private sector,n the existing international regime created after WWII has been centred around the idea that emerging regional cooperation could/should replace the faltering IFIs in order to provide more economic stability and certainty. This argument lies behind work done by the German Development Institute and especially behind Ocampo (2006),

Voltz (2011), Caliari & Voltz (2011), Fritz & Metzger (2007), Fritz & Müllich (2012), Kawai (2008, 2012), Ito (2006), Jung (2008), Ugarteche (2012), Ortiz and Ugarteche, 2008).

The question however is if the change of international regime is in effect going in the sense of a systemic transformation into a new deglobalised regional plurilateral breakup or if there is a transformation from the multilateral public order to a new unilateral US supported market led Governance and the existing multilateral regime then is becoming unilateralised and privatised.

We want to argue that in Greece (2010-2012) and Argentina (2001.2003) what can be observed is that IFIs do not have the political power to enforce the policies required by the financial private sector hence leading to the reinforcement of regional political institutions as “policemen”, with the presence of bondholders in the negotiations represented by the Institute of International Finance with the backstage support of the International Centre for the Settlement of Investment Disputes (ICSID).

In the case of Argentina, where the 2003 repurchase of the bonds was done unilaterally and without IFI conditionality, the private sector sought interdiction through lawsuits made in creditor country courts. This bondholder’s intervention then led to legal interventions to recover the unpaid funds. In the 2011 Greek case, the repurchase of bonds was done with the agreement of the IMF, which put the macroeconomic conditions, the EU, that is the police needed to ensure conditions imposed are complied with, and the Institute of International Finance, who act as the creditors in the name of all the bondholders and who set the rules of the economic game. As a counterfactual example, Ecuador did a unilateral repurchase of bonds at 75% discount with the help of Lazard Frères investment bank without neither the IMF nor the IIF. The lack of a BIT or an FTA with the United States appears to have protected them from bondholders lawsuits at the ISDC.

### **Some definitions of Integration**

Van Langenhove y Costea (2004) argue that *regions* are human constructions built on perceptions influenced by geographic, historical, economic, political and cultural factors. They suggest that we are undergoing a change from the westphalian world order based on territory, sovereignty, autonomy and legality to a new one where regions and nation states play a leading role and where regional integration processes increasingly determine international relations. In this sense, globalisation understood as a process of relationships that defies

territoriality in the relationship amongst nations has affected the system of the world order and is paving way to a new order where attributes that before belonged to the relationships between nations is being slowly pushed into the regional sphere. Neumann (2006) considers that given that regions are not an empirical reality but an “imagined” one, it would be appropriate to study its process of transformation through the main instrument political actors have: the discourse.

Hettne (2005) defines *region* as “a limited number of states linked together by a geographical relationship and a degree of mutual interdependence”. Taking from Hurrell (1995) he adds that a more comprehensive view would have that a region consists of ‘states which have some common ethnic, linguistic, cultural, social, and historical bonds’. Even more comprehensively, regions can be differentiated in terms of social cohesiveness (ethnicity, race, language, religion, culture, history, consciousness of a common heritage), economic cohesiveness (trade patterns, economic complementarity), political cohesiveness (regime type, ideology) and organisational cohesiveness (existence of formal regional institutions)’. He then goes on to suggest that “there are no ‘natural’ regions: definitions of a ‘region’ vary according to the particular problem or question under investigation. Moreover, it is widely accepted that it is how political actors perceive and interpret the idea of a region and notions of ‘regionness’ that is critical: all regions are socially constructed and hence politically contested” (2005:544)

Haas defines *regional integration* as a shifting of certain national activities toward a new centre (1958). Lindberg (1970) suggests it is an “evolution over time of a collective decision making system among nations”. Guerra Borges (2009) states that nations now pursue regionalisation policies, in order to gain political influence and not only markets. Genna (2007) suggests that regional integration is the establishment of regular collective decision making among states for the intention of establishing and regulating market flows. The degree of integration refers to the degree of collective decision making. At one end is an intergovernmental arrangement in which states make common decisions but are autonomous in regulating those decisions. If a regional authority does exist, it services at the pleasure of the individual states. On the opposite end is the supranational arrangement, in which regional institutions do exist and make decisions alongside intergovernmental arrangements or supersede the member-states’ authority.

What we want to suggest is that in addition to the above definitions, *regional financial cooperation* serves to cover any or all of the external, fiscal and, savings and investment gaps, in a new regionalism context where the actors are no longer the States only but also the private sector, Multinational firms and local ones,

NGOs and social movements. It is a mechanism that serves to keep domestic saving within a given and agreed region, where region is defined as Neumann (2006) as an 'imagined space' that in the political discourse, ensures the autonomy of economic policy design from unwanted extra regional political interventions and thus contributes to the dynamics of economic integration as in Hettne, Haas and Guerra Borges. Finally, it should facilitate the convergence of all member economies towards the highest standard of living country within the region

However, in practical terms, the neofunctionalist concept of integration still lingers on in many analysts' minds in Latin America, with the underlying idea that economic processes will lead to political ones. This 'old integration' concept is based on formal processes and official actors following the European integration process and Jean Monnet's idea as theorised by Haas (1958). In this sense, for example, Venezuela's withdrawal from the ANDEAN Community was meant to symbolise something and lead to something else at the State level. This of course did not happen as the 'new regionalism' is more complex and involves more actors. In actual fact, for example, what it did mean is that it was no longer willing to work in a supranational context of shared sovereignty (*Comunidad Andina*) and was more willing to withdraw into a regional context of national sovereignty while at the same time creating its own "region" of ALBA member nations. This in turn is a reminder that the neofunctionalist view remains but in the reverse, where the political processes of ALBA that should lead to economic integration.

In a 'new regionalism' approach, Hettne suggest that "regions must at the same time be understood as endogenous processes, emerging from within the geographical area in question. They are not simply geographical or administrative objects, but subjects in the making (or un-making); their boundaries are shifting, and so are their capacities as actors, which can be referred to as their level of 'regionness'. *Regionness* defines the position of a particular region in terms of regional cohesion, which can be seen as a long-term historical process, changing over time from coercion, the building of empires and nations, to voluntary cooperation. In general terms one can speak of five levels of regionness: a regional space, a translocal social system, an international society, a regional community and a regionally institutionalised polity." (548)

In this sense some examples are the Asian region expressed in the Asean+3, the Gulf Cooperation Council, the UNASUR, CELAC, and the Southern Africa Development Cooperation Council with its two offspring: East African Community (EAC) and the Common Market of Eastern and Southern Africa (COMESA). They have shifting boundaries, are endogenous processes, and are subjects in the making with civil society pressure in different levels. The EU has

some un-making tendencies and is a counter example of the same dynamics, that are beyond interstate relations and agreements from a social demand angle, i.e. the *indignados* movement, the Occupy movement, etc. The common denominator is the post westphalian concept of the transnational, where there is a voluntary pooling of national sovereignties.

The scenario for these regions as political actors is the globalised world where they play jointly to counterbalance hegemonic tendencies of the larger State actors that play alone globally. An example would be the Community of Latin American and Caribbean States (CELAC) decision at the VI Summit of the Americas in Cartagena in 2012, not to invite the United States to the next Summit if Cuba is not invited as well. The decision is that Cuba must assist the next one but it does not matter if the United States does not. This process has made CELAC more cohesive in spite that within it there are different world views, economic policies and alliances. The Arch of the Pacific member countries and the MERCOSUR member countries allied against what is perceived as an imperialist imposition. At the same time, within CELAC there is a balance of power game to offset the weight of Brazil though the presence of Mexico. CELAC includes, in turn, all UNASUR, CARICOM and Central American Integration member countries.

## **1. Regional financial cooperation in South America**

Hettne (2005) suggests that *monetary regionalism* may have many objectives, the most important of which is likely to be financial stability. "The exit of international investors from one particular 'emerging market' transforms a national public 'bad' into a regional and eventually global public 'bad'." (Griffith Jones, 2003)<sup>i</sup> The point of regional financial cooperation then, is maintaining the financial stability of the region and the system while easing commercial flows. In this sense, it could be argued that the trade collapse of 2009 as a result of the credit crunch in US dollars was the result of a lack of sufficient regional financial cooperation in the world. Says Hettne, "Financial stability is a global issue, but the global instruments show a bias against the weak, which has raised the issue of building regional institutions for protection against excess volatility." (548) he suggest this has to do with the Asian Financial Crisis (1997) and its impact both at the ASEAN level and the APEC level with foreign intervention on conditionalities that led to the introduction of neoliberal policies in Asia. However, it must be remembered that the European monetary union process started when the Bretton Woods agreement ended and fixed exchange rates disappeared, introducing high volatility in the exchange rate markets after 1971. This later proved Friedman wrong but brought forward the 1961 Mundell idea of Optimal Currency Areas in order to reduce

transaction costs given the existing very high level of intraregional trade. It would appear then that monetary regionalism becomes strengthened every time there is a major shock in the international monetary system.

The example of the EFTA and later the EEC with heavy intraregional trade under heavy pressure from foreign exchange volatility starting in 1971 led to a series of agreements that paved the way for the European Monetary Unit (EMU), the snake and much later (1992) to a European Monetary Union. This all belongs to what is now called "old integration". The idea then (Balassa, 1961) was that a free trade area would lead to a customs union and further to a common market, economic union and political union and the monetary side of that is what was mentioned assisted by Mundell's (1961) optimal currency area concept.

The difference between the ECU and the Euro is the capacity of each country to have autonomous foreign exchange and monetary policies given a regional monetary unit, is a common unit of account created through a basket of currencies, while trade is settled in local currencies. "New regionalism" theories would argue that this is a dimension of the changing international political economy and world order and Hettne (2005) suggests that regionalism might actually shape world order. This means to say that from an international political economy standpoint, the dynamics of regional currency baskets gives way to a new world economic order. It must be kept in mind that the object of having a regional currency unit is to provide for a more stable exchange rate reference and allow for bilateral currency settlements within the region in a context of increasing exchange rate volatility of the four reserve currencies used in international trade and finance

In the Western hemisphere, there are two large regions: North America and Latin America. However, the last one has been transformed from Latin America into South America and as such first constituted the *Comunidad Sudamericana de Naciones* in 2003 and then into UNASUR following Giacalone (2006). What made this change possible was the political perception that Mexico and the central American Community countries were shifting towards a US led dominance while the Mercosur countries centred around Brazil. The initial step was the configuration of a *Comunidad Sudamericana de Naciones* (CSN) promoted by Cardoso since the 1990's to counterweigh Mexico's influence in the region through what was then the possibility of an FTAA where Mexico was playing its usual role as a bridge between North and South America. Brazil was not interested in the FTAA as it saw (and sees) itself as a global player and in that sense its markets went beyond the hemisphere. (Giacalone, 13-16) in that measure first the CSN was promoted but then this was turned in 2008 into a South American Union UNASUR following the spirit of the European Union under Brazilian leadership.

The reference to regional cooperation then must be seen not as a Latin American mechanism but a South American mechanism vis a vis the North American FTA. North American regional financial cooperation consists of creating a US Dollar monetary union, with a single central bank and currency. This has been agreed upon and operated with El Salvador (2001), Panama (1904) and Ecuador (2000) with no capacity to issue local money, nor define neither an independent exchange rate nor credit policies. Equally, for larger countries there exists a de facto North American regional financial cooperation scheme through the US FED which in times of crisis launches swap credit lines to the central banks of Mexico and Brazil mainly.(Fleming & Klagge, 2010)

*Regional financial cooperation* refers to a mechanism that helps maintain systemic stability more than specific national benefits. Amyx (2004) states that “The 1997–98 financial crisis spurred two shifts in trends in regional cooperation. First, financial cooperation replaced trade cooperation as the priority item. In particular, the establishment of cooperative mechanisms to prevent the recurrence of financial crisis became a key imperative. Second, the primary forum for such efforts became one comprised exclusively of East Asian countries. A new informal regional grouping, dubbed ‘ASEAN+3’, brought together the ASEAN member countries plus Japan, South Korea and China.” (1) It must be kept in mind that in 1971, equally, the exchange rate liberalisation led to fora of European countries where ideas that had been debated earlier around the foreign exchange markets were applied in defence of a more stable Europe without the support of Great Britain. It must also be added that the efforts to stabilise the currencies through the Snake agreement failed and had to be taken on later in the decade again. The point is that monetary crises give way to monetary regionalisms but in turn they have different stages depending on the willingness of its actors to abide by the agreements made in the fora.

In a monetary union, a central bank is created and a single monetary policy applied to all member countries regardless of inflation, growth, or productivity. This implies at least fiscal and inflation coordination as well as balance of payments performance criteria. The productivity differentials however cannot be covered through these mechanisms. The fixed exchange rate mechanism applied in Argentina was a sort of a monetary union with the United States dollar. In time it created a massive crisis as imports became cheaper and substituted local production given productivity increases in Argentina were smaller than in the United States. A catastrophic balance of payments crisis emerged leading to the 2001 cease payments. Something similar occurs in Greece with the Euro where a

major balance of payments deficit has grown over the past decade due to productivity differentials bursting in the 2010 crisis.

### *GDP growth*

The reality of export led growth in Latin America, from Mexico to Argentina, is varied, with different Export to GDP elasticity rates and dynamics. Export led policies in Peru and Chile for example, show high export elasticity on GDP growth over the 1990-2010 period. For every 1% export growth, GDP grows at about ½%. These are economies where inflation targeting policies work efficiently leaving inflation rates in the low one digit range and exchange rates seem to have appreciated exactly together since October 2002 to December 2011. Income distribution has deteriorated and the general wage level is irrelevant given they are mineral exporting countries. While in Chile it is high (40% of GDP) in Peru it is low (22% of GDP).

A second group of economies includes Argentina, Brazil and Colombia. In these, the elasticity is low. For every 1% of export growth, GDP is pulled 0.10% on average. To be exact, in the Argentine case the relationship is negative which implies it is consumer led growth. The other two are consumer led with some export support. In the three cases, the export growth serves to give oxygen to required imports for domestic production/consumption. The three countries observe an improved income distribution and wages on GDP ratio over time.

Finally we have the case of Mexico which could be labelled import led stagnation financed through workers remittances. In this case the export growth elasticity is very low (0.08%), income distribution has worsened and wages deteriorated over the 20 year period observed. The balance of payments gap is mainly covered through workers remittances.

### *Monetary policies*

There appear to be four monetary policies being applied in South America.

- An inflation targeting policy in Colombia, Chile and Peru, that makes their exchange rates stable amongst themselves since 2002. (See graph 1 below).
- An inflationary policy in Venezuela and Argentina, to feed economic growth, that makes these currencies devalue vis a vis the first ones

- An inflation targeting policy affected by massive foreign exchange flows in Brazil (and Uruguay?)
- The monetary union of Ecuador, el Salvador and Panama to the United States that leaves in the hands of the FED interest and exchange rates leading to a depreciation of their exchange rates vis a vis their Latin American neighbours.

The outcome is that there is some financial cooperation between the Pacific basin countries in the form of a common stock market (*Mercado Integrado Latino Americano- MILA*) for the benefit mainly of larger firms that need to raise capital. The MILA has connected the bourses of Santiago, Lima and Bogotá and more recently of Mexico City. This last one opens the New York Stock Exchange to them simplifying both issuing and buying, given they all operate as one. In political terms this coincides with the 'Arch of the Pacific' concept launched by Peruvian President García in 2009, which is now an actor in the Trans Pacific Partnership negotiations. Measured by market capitalisation MILA is one of the largest stock exchanges in the world. There has been no overture of MILA to the Sao Paulo bourse. They, the stock exchanges of Santiago, Lima and Bogotá, preferred Mexico and New York to Sao Paulo thus splitting the financial integration concept into two clear financial arenas.

According to central bankers from these three countries<sup>1</sup>, they do not coordinate their exchange rates and are unaware of the stability of their intra exchange rates over the 2002 to 2012 period and do not trade in local currencies.

There seems to be little financial cooperation within MERCOSUR in spite that Brazil in the late 1990's began to study the idea of becoming the central banker for South America (Giambiagi, 1998; Arestis & de Paula, 2008). In 2012 Marcos Cintra is working again on the issue for Itamaraty. What impeded it was the Argentine crisis of 2002. The vast productivity differences between for example the economies of Brazil and Paraguay or Argentina and Ecuador prevents the use of a common currency. Worse, the existence of four different monetary policies in South America.

As one country devalues as an industrial policy, the other has for example, an inflation targeting policy and revalues, and there are no foundations for a common currency which requires at a minimum coordination of GDP growth, inflation and exchange rate and credit policies. For this reason, for example, although Brazil approved in October 2008 a local currency payment mechanism to be used inside

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<sup>1</sup> Conversations held at the SELA conference on regional integration, Caracas, February 2012

MERCOSUR, it has not worked. This has also been offered to Colombia and to China and finally has led to an intra UNASUR and intra BRIC trade payment mechanism. This concept has not been taken up by the Argentines for the reason mentioned. There is no monetary policy coordination and Brazilians do not want to hold Argentine *pesos* as it is rendered to be a “weak currency” of an inflation ridden country in spite of its GDP growth rate.

On the other hand, there is little cooperation between the Pacific Arch countries and MERCOSUR in this field, save the local currency trade agreement between Colombia and Brazil. However, the possible use of the *Real* in Brazilian trade is very expensive if unconfirmed term letters of credit are used. The *Real* is used only with confirmed letters of credit operations, synonymous to spot currency trading, given Brazilian interest rates are unusually high making foreign trade operations cheaper in USD or even Euros than in *Reales*.

## **2. The existing regional cooperation schemes**

The idea that local currencies should be used has been launched at various times by different presidents. In the first decade of the XXI century at least three presidents took to the idea: Garcia from Peru, Chavez from Venezuela and Evo Morales from Bolivia. Lula from Brazil toyed with the idea of the *real* being such a currency but in this direction nothing beyond the above mentioned local currency agreements occurred.

- Ecuador launched a newly designed payment compensation system for bilateral industrial trade, in the spirit of the regional compensation chamber of the Central America integration scheme of 1961. The *Sistema Unificado de Compensacion Regional* (SUCRE) is a system with a currency unit designed for payment of industrial goods amongst the partners of the ALBA region during a six months period. At the end of the semester, the settlement of accounts is done in US dollars.
- This clever mechanism has two drawbacks: the first one is that the members of ALBA that sold in SUCRES can only use them for buying industrial goods inside the subregion. But the ALBA member countries do not have an industrial base properly speaking except Cuba. Since the settlement is done after a semester, Cuba, for example, would not have foreign currency to trade with anyone else, which could be regarded as a high opportunity cost. The second element is that if the object of regional financial cooperation is

to use more local currencies and reduce extra regional currencies, this mechanism does not respond to that need as it settles in US dollars.

- Other regional compensation schemes exist in ALADI, the Latin American Integration mechanism based in Montevideo, which has a settling of accounts in local currencies if wanted.

### 3. The issue of international reserves and reforms at the IMF

A side problem that appears with the emergence of intraregional financial cooperation is that of the definition of international reserves. According to the IMF most recent handbook on the Balance of Payments:

Reserve assets consist of those external assets that are readily available to and controlled by monetary authorities for direct financing of payments imbalances, for indirectly regulating the magnitude of such imbalances through intervention in exchange markets to affect the currency exchange rate, and/or for other purposes. (See paragraphs 425 and 432.) The category of reserve assets, as defined in this Manual, comprises monetary gold, SDRs, reserve position in the Fund, foreign exchange assets (consisting of currency and deposits and securities), and other claims. (See paragraph 443.) Securities that do not satisfy the requirements of reserve assets are included in direct investment and portfolio investment. (IMF, 1993; p.97, P 424)

The definition of the Special Drawings Right has returned to a gold standard at one special drawing right per 0.888 671 gram of fine gold while reserve currencies according to the articles of agreement are still the Yen, the Euro, the Pound Sterling and the US Dollar, those that have a liquid market. This leaves out of the discussion the need for new reserve currencies although there have been major questions posed by Ocampo (2008) and Xiaochuan (2009) about the inadequacy of the US dollar as the reserve currency given the Triffin paradox.<sup>2</sup> Most international reserves are still kept in US dollar Treasury Bills.

The composition of the SDR remains by the four reserve currencies as defined in the IMF articles of agreement with the drawback that they all belong to highly indebted rich countries, underfunded, and with very low or nil growth prospects in the next decade. The new strong currencies that belong to the major emerging countries are not yet internationally taken into consideration as reserve currencies properly or as references for the construction of a new basket currency.

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<sup>2</sup> The Triffin Paradox was defined by Robert Triffin in his 1961 work *Gold and the Dollar Crisis: The Future of Convertibility*, Yale Paperbound; as the situation where the country that wants to make its currency used worldwide must hold massive external deficits which in turn weakens the currency leading to a liquidity crisis as dollar holders will seek gold at the fixed rate of 35 USD an ounce..

A measurement of the SDR with BRIC country currencies might give trade references more price stability, for example. The depreciation of the US dollar has had an impact of around 40% on international price increases over the first decade of the XXIst century which reflects the weakening of the leading economy's currency.

#### **4. The question of trade**

Intraregional trade in UNASUR is only 22% of total UNASUR trade. With this argument some countries do not view in good light the efforts done to promote intraregional trade. The case is that while the Pacific Basin countries have very little trade within South America, the Atlantic coast countries have very large intraregional trade. The difference between ones and others is the industrial component of exports. The more primary exporting countries have less intra regional trade while the more industrialised countries have more. The rate of intraregional growth is faster than extraregional growth. With the onset of the crisis, the consequence has been some protectionist measures in the industrial countries of South America.

When the issue is broadened beyond the UNASUR region and Mexico and Central America are included, the patterns change slightly. There is more intraregional trade within North America than with the rest of the world, but Mexico's fastest growing market is in South America. Central America, did not suffer a massive shock with the credit crunch of 2009 because one third of its trade is intraregional. It still does not trade much with South America but it has signed a regional FTA with Peru, among other South American countries. For Peru, for example, the service industry of Guatemala has turned out to be an interesting client.

#### **5. UNASUR and the Politics of Regional Financial Cooperation**

There are different approaches to regional financial cooperation within the newly created UNASUR related to the monetary policies of those countries involved. The meaning of *financial integration* then must be taken with a pinch of salt. In actual fact UNASUR refers to it by name but the content of the concept is *reserves management and regional liquidity arrangements*. Properly speaking there is no discussion on either regional financial cooperation in the sense of Kawai (2012) or de Grauwe (1992), nor even less of financial integration in the sense of building a regional currency unit as in the ECU or AMU or a monetary union. Financial integration in the sense of a coordination of macroeconomic and

monetary policies is not in discussion given there are the above mentioned four policies, and one country has entered a monetary union with the United States leaving the FED as its central banker.

There is a Working Group in Financial Integration (WGFI) that was created at UNASUR in August of 2011 composed of the Finance Ministries of all member countries coordinated by the Governments of Ecuador and Colombia. Given its official status, it convenes UN ECLAC as a secretariat of sorts providing general background information on the international economy and the regional prospects for the year.

The WGFI objective is the handling and management of international reserves. It wishes to expand the Latin American Reserve Fund (FLAR) and if necessary create an additional one. FLAR is made up of Bolivia, Colombia, Costa Rica, Ecuador, Perú, Uruguay y Venezuela. I.e. the Andean Community countries, plus Costa Rica and Uruguay. It is still not a South American Fund. The size of FLAR is currently small with total equity of 2 bn USD and total liabilities of a further 2.3 bn USD.<sup>3</sup> The size of a reserve fund that would serve as a bailout fund would need to be over 100 bn in the minimum. In no case could the Brazilian banks or balance of payments be covered by a mechanism of this sort given their size.

A specific objective of the WGFI is to study other reserve management initiatives in the world that can help face external shocks. It must be emphasized that South America faces the same problems of asymmetry that exist in Asia and Africa.

A second WG was established to study reciprocal credit and payment agreements as in ALADI, SUCRE and SML. The object of this group is to foster local currency transactions in intraregional trade, to bolster the use of ALADI and compensated trade settled in local currencies and to study the SUCRE mechanism and a regional unit of account to be used as reference in intraregional transactions.

The object is to reduce time and transaction costs in the foreign exchange market related to intraregional trade. This mechanism, says the, *Acta de la Reunión Plenaria del Grupo de Integración Financiera*, 17 de febrero, 2012;<sup>4</sup> should help the process of political, economic and social integration.

A third WG was established coordinated by Brazil and Chile with the aim of studying mechanisms to promote intraregional trade. The object is to replace

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<sup>3</sup> [https://www.flar.net/documentos/3418\\_memoriaFLAR2010.pdf](https://www.flar.net/documentos/3418_memoriaFLAR2010.pdf)

<sup>4</sup> [http://www.unasur.org/index.php?option=com\\_content&view=article&id=537:acta-de-la-reunion-plenaria-del-grupo-de-integracion-financiera&catid=84:consejo-suramericano-de-economia-y-finanzas](http://www.unasur.org/index.php?option=com_content&view=article&id=537:acta-de-la-reunion-plenaria-del-grupo-de-integracion-financiera&catid=84:consejo-suramericano-de-economia-y-finanzas)

stagnant extra regional markets for dynamic intraregional ones in light of the global crisis and thus strengthen the productive capacities of those countries in the region.

The UNASUR political will is behind the concept of a stronger region and in this way a process of regional financial cooperation appears to be slowly beginning.

## **6. The Banco del Sur initiative**

Sponsored initially by the Governments of Venezuela and Argentina as a sort of international reserves fund and development bank, it was taken on by the Government of Ecuador who launched a more carefully studied concept of a Development bank that would not be centred in infrastructure, like CAF and IDB, but have the potential of becoming a major actor in the region differently. This new generation development bank was meant to centre its activities around production and more so around food and medicine production as well as finance cross border productive projects, in the poorest parts of the continent. Its aim is to eliminate poverty in the region. The idea was that there are severe poverty ridden areas in border areas that can only be dealt with through cross border productive projects.

Its main features are 1) that its voting process follows the one country one vote concept. 2) That contributions into paid in capital be differentiated between very large, medium and small countries, 3) that total bank capital available for lending have a maximum leverage of three times subscribed capital. The size of the bank was meant to be of 63 billion dollars, placing it at over three times larger than the Andean Financial Corporation (CAF) at 18 bn USD.<sup>5</sup>

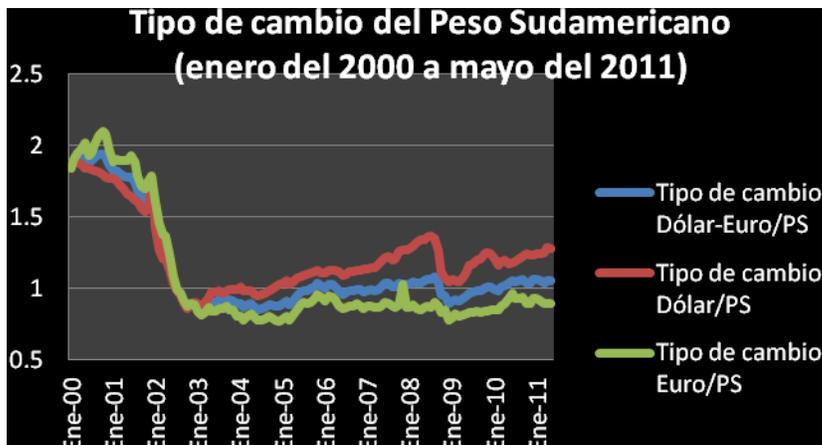
The Banco del Sur has progressed in some ways as some parliaments have approved its operation and except for the three Pacific Basin countries that did not join from the beginning, the bank seems to be going forward. There is no evidence that the size of the bank, designed to have 21 bn USD of subscribed capital and that should begin work with a third of that in paid in capital, has been reduced. At the August 2011 meeting of the WGFI it was mentioned that instruments needed to be developed in order to have more long term funds available for lending.

In this sense, the space is open for the design of a regional currency unit, The South American Monetary Unit (SAMU) such as shown below with the object of issuing bonds for the Banco del Sur to be sold to the central banks of the region.

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<sup>5</sup> <http://publicaciones.caf.com/media/15141/factsheet2010esp.pdf>

Given it is a value reference; the actual long term bonds would be issued in the local currencies of the countries in the region but denominated in SAMUS.



Source: [www.obela.org/http://www.wix.com/pesosudamericano/peso-sudamericano#!](http://www.obela.org/http://www.wix.com/pesosudamericano/peso-sudamericano#!)

A conference was held at SELA in Caracas in January 2012 where this was discussed and the need for a common currency unit was brought forward. The possibility of creating a South American peso as a unit of accounts is present. The conference document reviews all regional cooperation schemes in the world and presents their problems and ways forward in Latin America.<sup>6</sup>

In this field the Euro crisis has brought forward the need for

1. A bailout fund related to bank runs and balance of payments problems. This is the now multilateral swap agreement of the Chiang Mai Initiative and the extended FLAR idea in UNASUR but needs to be promoted in the regions around the world at the same time as consolidating the existing ones. The EU created the European Financial Stabilization fund in May 2010 with too few resources to be of much help. For the larger G20 nations the swap line facility at the FED serves this purpose

2. A lender of last resort related to critical fiscal problems. The EU institution is the ECB since 2011, when it became clear that it either helped

<sup>6</sup> “La situación reciente de la reforma de la arquitectura monetaria y financiera internacional y de los avances hacia una arquitectura monetaria y financiera regional para América Latina y el Caribe.” En [http://www.sela.org/attach/258/default/DT-2\\_Reforma\\_de\\_la\\_Arquitectura\\_Financiera\\_%28esp%29.pdf](http://www.sela.org/attach/258/default/DT-2_Reforma_de_la_Arquitectura_Financiera_%28esp%29.pdf)

the debtor nations of the EU, buying their sovereign bonds, or they would have had an even deeper crisis in its hands. The question is if they should have intervened the bond market when spreads began to grow between the low risk and the high risk countries. It should have started earlier in 2008 and did not do so for fears of inflation. The regions do not have this designed nor quantified.

3. Regional bonds denominated in a regional currency basket paid in local currency and purchased by the central banks into a common reserve fund that could serve as the basis for the LOL

4. Regional currency baskets as common references for international trade intra and extra regional.

5. Exchange of experiences amongst financial regional bodies to see how they have managed since 2007.

6. Research needs to be done into stigma and its implications in the use of regional bodies of either type.

**In brief,**

There is a shift in the existing international regime created after WWII. There is an idea that regionalisation will replace previous multilateral institutions in a process of power transfer from the multilateral public arena to the regional plurilateral public arena. What we have argued in this paper is that there are several shifts occurring at the same time. One is from the Public multilateral regime to a private regional one and another is the shift from public multilateral to public plurilateral.

There is a dynamics of regional integration in South America that is extending to Latin America. This is more related to the need to use its influence in the global agenda than in the strengthening of intra regional trade, following the 'new regionalism' concept.

The UNASUR dynamic has replaced both the Mercosur and the Andean Community as the centres for regional decision making although it is not a supranational entity and does not have policy enforcement capacities. It is essentially a coordination body without any substantial infrastructure of its own which is leading it to a collective decision making process in the political and security arena, but not in the economic one.

A process of regional financial integration is defined in the political field of UNASUR but remains distant in reality as there are four monetary policies making it impossible to create a common inflation space, a la Grauwe (1992). There remains the underlying idea that political integration will lead to economic integration to use the neofunctionalist school paradigm. This is very unlikely as both coasts have different trade and integration dynamics. One coast is industrialised, the other is essentially primary exporter. But both are affected by the unusually high prices of commodities that distort their trade pattern.

The UNSUR dynamic has been broadened to the Central American, Caribbean and Mexico and CELAC has been created in order to gain political space from the United States. There is a discussion on financial cooperation being held at UNASUR and SELA – the CELAC secretariat of sorts – with the aim of maintaining financial stability. This has been pushed forward by the crisis that began in 2007 and is in that way reminiscent of the European monetary dynamic started in 1972 after the end of Bretton Woods. The difference is that while in Europe intraregional trade was very important, in South America it is not, although there is a difference between the Mercosur countries and the Andean Community ones. There is also a difference between these two and Mexico and the Caribbean, as Mexico's region is essentially North America if we take the definition of Haas (1958) but in the sense of Hettne belongs to Latin America, 'spiritually'.

There has been a transformation of Latin America into South America as the growing perception has been that the bridge country (Mexico) had taken sides with North America. However, as it is now perceived to as the victim of the North American Free Trade Agreement, the process is being reversed to include Mexico and Central America again in a pendulum that went from UNASUR to CELAC. The United States is being left out of the hemispheric agreements as it is perceived as not playing with a level field.

The discussion on regional financial cooperation has two limits, one is the existing asymmetry between Mexico and Brazil and the rest. The other is the difference in monetary policies within South America. The real institutional solution for the larger nations seems to be an agreement with the US FED for very large bilateral swap lines as in the 2009 credit crunch between the FED and the Mexican and Brazilian Central Banks. The other countries then, are subject to the new regional institutions being designed and their conditionality while the asymmetric ones are not. Nevertheless in UNASUR there are no new institutions possible without Brazil, and in CELAC without Mexico also. Much like in Asia there are no

institutions possible without China, Japan and Korea and in Europe without France and Germany.

The existing regional cooperation schemes have at least two if not three different blocs. There is the ALBA scheme with the SUCRE, the Pacific Arch countries with the MILA and regional stock market integration – they also have stable currencies with nearly fixed exchange rates amongst them. Finally there is the Brazilian initiative of payments in local currencies now made policy through a UNSUR agreement. There is an umbrella UNASUR that uses UNECLAC as its secretariat, with a set of schemes ranging from common reserves management; reciprocal credit and payment agreements; and the third one for mechanisms to promote intraregional trade.

The Banco del Sur initiative is stagnant as Parliaments are slowly approving the granting of public funds to the new institution. The three countries that did not join initially, still have not one so, These are members of the Arch of the Pacific. Finally, the discussion for a regional currency unit has not been established yet. There is no perceived need yet to have a regional currency unit in order to issue common regional bonds paid for in local currencies and with international reserves as a manner of retaining savings regionally instead of exporting them to the highly indebted countries of the North.

The lessons of the Euro crisis have not been learned yet. As the crisis continues, there is a growing need for:

1. A bailout fund against bank runs and balance of payments problems derived.
2. A lender of last resort for fiscal crisis
3. Regional common currency unit denominated bonds.
4. Regional currency baskets as common references for international trade.
5. Exchange of experiences amongst regional financial institutions to see how they have managed since 2007.
6. There is need to study the stigma involved in the use of regional institutions. The existing institutions in Asia have never been used yet.

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