Sistema Económico
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Latin American and Caribbean
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Latino-Americano e do Caribe

Système Economique
Latinoaméricain et Caribéen

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Regional Meeting: Reform of the International Financial Architecture and Monetary and Financial Cooperation in Latin America and the Caribbean

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Permanent Secretary of SELA;

Mr. Chairman;

Colleagues.

First I want to thank all of you for the privilege of participating in this conference in discussion of a topic that is very exciting and very timely.

Introduction

The background document for the meeting is entitled Experiences in Monetary and Financial Cooperation in Latin America and the Caribbean: Critical Balance and Regional Proposals for Action. The report gives very useful information on the various financial/monetary institutions and initiatives in Latin America and the Caribbean. It reviews the work of institutions such as the Inter-American Development Bank; Andean Development Corporation (CAF); Central American Bank for Economic Integration (BCIE); Financial Fund for the Development of the Plata Basin (FONPLATA); the Caribbean Development Bank; the Andean Development Bank; and the recent initiative driven largely by Venezuela, to establish yet another development bank in the Region. In fact, several Latin American countries are already on board with respect to this new initiative – Venezuela; Nicaragua; Bolivia and Cuba.

Also reported are Latin American initiatives to address external economic shocks; debt restructuring; balance of payments short-term liquidity; through institutions such as FLAR (Latin American Reserves Fund) established since 1978 to support the Andean countries and which provides short-term contingency financing to affected countries, based on provision of a series of satisfactory policy initiatives to address the crisis and also to ensure repayment. Also noteworthy are several initiatives to address the constraints to intraregional trade through the use of local currencies (Agreement with respect to Payments and Reciprocal Credit of ALADI; Payment System in Local Currency between Argentina and Brazil), initiatives which the region sees as critical to circumventing the constraints to trade imposed by the use of international convertible currencies, notably the US dollar. One of the intentions is to expand the use of these initiatives throughout the region.

Also very much under discussion is the idea of a single regional currency of which the most notable initiative currently so far is that to the SUCRE, an initiative championed by Venezuela.

After a fairly exhaustive overview of regional and financial institutions, the document concludes with essentially three recommendations: (i) the establishment of a Regional Development Bank; (ii) the establishment of a Regional Contingency Fund; and (iii) the creation of a single regional monetary space. The document concludes by recognizing that the pursuit of these initiatives clearly has to have strong political support not only at the level of the political directorate but also at the level of the society as a whole.

The foregoing review and the new proposals for monetary and financial cooperation resulted from the difficulties posed by the current global economic crisis to developing countries in the Latin American and Caribbean region and a desire to insulate the region from such events in the future by the development of a strengthened monetary and financial architecture which would help to insulate the region.

A. Establishment of a Regional Development Bank

The establishment of a regional bank for the entire Latin American and Caribbean region while it would bring with it, among others, advantages of scale economies and the spreading of risks across the Latin American and Caribbean Region, and hence, a reduction in borrowing costs, would also clearly have implications for all of the development banks which currently exist. The massive restructuring required of existing development banks would be a substantial issue that would have to be addressed and would excite very strong political challenges from existing institutions and their supporters. For example, as noted in the background document for the conference, the Caribbean already has its own development bank. In addition, the Caribbean region is served by the IDB and the World Bank. Unless, therefore, the political challenges presented by the current institutional development banking infrastructure are resolved, a Development Bank encompassing the entire Latin American Region would be very difficult. Hence, apart from the strong technical and economic arguments that would be presented for the establishment of a regional development bank, there would be formidable political constraints which would need to be overcome. Note that before the crisis, it was being argued in some quarters that development banks were not needed. Note also the failed Asian attempt to establish an IMF after Asian crisis.

From the Caribbean perspective, however, the establishment of such a bank would facilitate the provision of additional investible resources the lack of which continues to be if realized, a constraint to the development of the Caribbean region, particularly in the context of trade liberalization and globalization which are forcing costly adjustments and even closure of key industries and are underscoring the need to establish new industries. In the absence of adequate funding, both of these very necessary initiatives are being delayed to the detriment of the performance of the regional economy. But then this is true of LAC region as a whole as it faces globalization and trade liberalization. Caribbean membership in such a Bank would help to supplement the limited resources available to the Caribbean region in this very important transition period.

Additionally, the recent experience of the Caribbean with commercial debt has not been a good one. With the withdrawal of concessionary bilateral aid to the Region in the nineties, several countries very quickly increased their external commercial borrowings to their own detriment. Many are now saddled with debt stock of more than 100% of GDP or close to 100% of GDP, with very high debt repayments and are continuously forced to borrow large sums in order to meet debt repayments. In other words, they are caught in a debt trap. Hence the recent call for debt relief by the Caribbean Heads of Governments. It needs to be noted also that Caribbean economies are for the most part very small. Some may term them micro economies. Hence they can be easily overwhelmed with debt. The need for caution therefore in borrowing is clear. So also is the need for greater access to non-commercial debt. In this regard, the establishment of a regional bank encompassing the Latin American and Caribbean region and providing loans below commercial rates would be very advantageous and welcome.

The foregoing points also to a major gap in the discussions on the new regional and international financial and monetary architecture, that is, the need for more automatic mechanisms for debt relief.

In the private sector, especially in MDCs, such mechanisms exist and are readily accessed to facilitate the restructuring of individual and company balance sheets overburdened with debt. As regards country debt, however, access to debt restructuring is much more difficult, the access to relief much more prolonged to the detriment of the economy and social welfare of citizens. The social and economic opportunity costs of high debt are in some cases astronomical. In many cases, the cost of such debt falls disproportionately on the poor, even in wealthy countries such as the US.

It is also very clear that this economic crisis is not over and may be far from over, as the huge debt incurred in the attempts to stimulate economies in the face of precipitous declines in economic activity becomes due. The second stage of this crisis may very well be a debt crisis, a matter of deep concern, not only to LDCs but to MDCs as well, as the current experience of Greece, Portugal and even the US makes clear.

In light of all of the foregoing discussion, the need for more automatic mechanisms for debt restructuring and debt relief is clear. Several years ago, the IMF had embarked on an initiative to establish such a mechanism. This was spearheaded by Dr. Anne Krueger, the Vice President of the IMF. It was called the SDRM (Special Debt Restructuring Mechanism).

. Indications are that the threat of such a mechanism in the public domain forced international financial markets to restructure their own contracts to permit greater chance of flexibility in the restructuring of loans, if at least 75% of investors agreed. Such clauses have helped several countries to restructure their debt in a more timely fashion, for example, Argentina. However, as the case of the Caribbean has shown, there may yet be need for additional mechanisms in the public realm to accelerate access to debt restructuring. Indications are that with the increasing debt as a result of the current crisis, such an additional mechanism(s) must be an integral part of a reformed international monetary and financial architecture and is long overdue. This may be a HIPC-like mechanism for middle- income countries and/or some other mechanism like the SDRM. The current ad hoc approaches to debt restructuring of some countries with their populations caught in a debt trap within an unreformed and unaccommodating international architecture must be a thing of the past. The IMF approach of insisting exclusively for years on reduced public expenditure and/or increased taxes on poor and overburdened populations, throwing weak economies into recession in order to meet huge debt repayments, must be a thing of the past. The current extreme difficulty of Greece is a cautionary tale, with implications clearly not only for Greece itself, but potentially for the world economy and underscores the need for much greater access to restructuring mechanisms.

It is likely that membership by Caribbean countries in a Latin American and Caribbean bank can lead to much greater familiarization of the Caribbean with Latin America, the exploration and the establishment of new and dynamic trading links to the benefit of both the Caribbean and Latin America. Speaking more broadly, the establishment of such a bank would tend to further support the integration of the Caribbean into the Latin American region, a process which so far has been very slow.

B. Regional Contingency Fund

The establishment of a Regional Contingency Fund would also be of tremendous benefit to the Caribbean region, and conceivably has a greater chance of acceptance within the region, given the general absence of such institutions, the absolute need for such an institution, the small size of the Caribbean economies and their vulnerability to various shocks. It has been established empirically that Caribbean economies are among the most vulnerable economies internationally. Hence the usefulness of a contingency fund. There are vulnerabilities not only to external economic shocks but also to various natural disasters notably hurricanes and earthquakes. The recent experience of Haiti, battered by four storms in 2008 and devastated in 2010 by earthquake, is a case in point. The recent experience of Chile also needs to be noted here. The availability of funds for risk mitigation and for facilitation of a quick rebound after natural disasters would be a major boost to those Caribbean economies that are so often affected. In addition, the difficulties of the Caribbean region in the current economic crisis also underscore their vulnerability to external economic shocks as several economies are currently under severe fiscal stress, for example, Barbados, and the Bahamas with the decline in performance of their main industry, tourism, in 2009. Currently, very little in terms of contingency funds are available to these economies which very often are left to their own devices or traditional funding.

While current institutions provide support for traditional financing requirements, the availability of funding for major crises or even small crisis is often lacking. An institution, therefore, that recognizes the various vulnerabilities of regional economies and outfits itself to respond readily and adequately to the types of shocks characteristic of regional economies, should be an integral part of the regional financial architecture and should be given priority, given the relatively greater need regionally for such an institution.

The region clearly has some ambitious goals in terms of the restructuring of the regional architecture. However, everything cannot be achieved simultaneously simply because some things are more difficult than others. Prioritization of initiatives is therefore critical to success. This has to be an integral part of the discussion going forward.

C. Creation of a Single Regional Monetary Space

Essentially, the proposal is the establishment of a monetary union encompassing the Latin American and Caribbean Region. It is a very ambitious project and one fraught with difficulties as shown by the experience of even smaller country groupings which are currently seeking to establish monetary unions – Gulf Cooperation Council (GCC) comprising Saudi Arabia; Kuwait; United Arab Emirates; Bahrain; Qatar and Oman; CARICOM. Also, the recent and current difficulties of the EU itself which is the best known and most advanced of monetary unions should indicate that this no easy task. However, this does not mean that it should not be attempted, given the need to restructure the international and regional monetary and financial architecture to one more suited to the development needs of the Latin American and Caribbean region.

From the Caribbean perspective, an immediate concern would be possible conflict with its own initiatives in this area. However, the Caribbean initiative most likely, given arguably its lesser complexity because of the lesser number of players and also the presence already in their midst of a monetary union in the OECS, (Organization of Eastern Caribbean States) would suggest that it would likely be completed before the initiative for the Latin American and Caribbean initiative and may even, because of its early completion, facilitate consideration of and integration into the wider regional project.

Conclusion

From a general perspective, there is clearly much to recommend in the proposals of the consultant and also in the vision of Latin American and Caribbean monetary and financial reform. Arguably, however, as in such undertakings, the likely success of these initiatives would be as much a result of the cogency of the objectives being pursued as well as the effectiveness of the strategies that are being employed. In my opinion, it seems best to coalesce early efforts around those initiatives, that have the largest political support because they respond to greater needs. Such an approach would permit the prioritization of initiatives and minimize the loss of efforts in initiatives which though worthy, are likely to be much more difficult.

Thank you.