South America and a new financial architecture

Jean-François Ponsot & Louis-Philippe Rochon

To cite this article: Jean-François Ponsot & Louis-Philippe Rochon (2009) South America and a new financial architecture, Journal of Post Keynesian Economics, 32:2, 155-162

To link to this article: https://doi.org/10.2753/PKE0160-3477320201

Published online: 08 Dec 2014.

Submit your article to this journal

Article views: 35

View related articles
South America and a new financial architecture

The current financial and economic crisis can be considered a crisis of capitalism, originating in the United States and spreading far beyond its borders. Some Post Keynesians see this as the inevitable result of a long process of financialization or finance-dominated capitalism (Stockhammer, 2004), that is the growing influence of financial actors and financial markets, and the resulting impact on income distribution, consumption, investment, and growth, which may have begun with the inflation-fighting tactics of central banks in the early 1980s and the string of market-friendly policies of deregulation.

This new accumulation regime has been accompanied by a push toward deregulated markets, both domestic and internationally. As a result, financial actors have been able to extend their reach far beyond national borders: financial flows across borders have increased at a voracious pace and banks have been able to develop new banking activities, both domestic and abroad, and innovate to such a degree that the economic system has become increasingly fragile. Moreover, exchange rates are increasingly volatile, all with dire consequences on inflation, production, employment, and growth.

Financial crises are not characteristic of the United States, Canada, and most of Europe and the United Kingdom—or at least not frequent occurrences—but the same cannot be said of many developing countries, many of which have lived through severe crises of their own, resulting from both domestic and international forces. Yet this crisis opens a new door for South and Latin American development: now even developed countries are not immune from financial crises, and this may present many developing countries with an opportunity to make important institutional changes to their financial architecture. In particular, the monetary

Jean-François Ponsot is Maître de Conférences, at the Laboratoire d’Economie de la Production et de l’Integration Internationale, Université de Grenoble. Louis-Philippe Rochon is an associate professor at Laurentian University, Canada.
dimension of the current crisis cannot be ignored. Indeed, this crisis also reveals the weaknesses of an international monetary system based on the hegemony of the U.S. dollar, a topic that was explored at length in a previous symposium in this journal (volume 26, no. 4). Under such a system, consider the following facts:

- Countries most vulnerable are developing and emerging economies, which are subject to wild fluctuations in exchange rates. In turn, this often leads to high inflation, which then force governments (unwisely) to raise interest rates, while also reorienting domestic production toward the export sector, thereby favoring export-led strategies of growth;
- Overall, the current system rests on a deflationary bias, as deficit countries all too often aim for current account surpluses to maintain their exchange rate;
- The hegemony of the U.S. dollar favors the instability of international finance and the creation of global imbalances, the effects of which are particularly evident in the current crisis.

Post Keynesians have often advocated abandoning such a fragile system and replacing it with a new international monetary and financial architecture, in particular since the collapse of the Bretton Woods system, in August 1971, and the beginning of a new financial order anchored on the U.S. dollar. And considering the string of crises since the end of the 1990s, the issue has become more urgent than before.

Within this discussion of a new financial architecture, Post Keynesians in general have advocated the creation of a new supranational, global currency as a settlement unit of account, much inspired by Keynes’s discussion of the bancor and the International Clearing Union (ICU).

Within the profession at large, however, such a solution is not taken seriously, or even barely discussed. Indeed, the creation of the ICU, as proposed by Keynes, would have seen the United States today, with its large trade deficit, devalue its currency, and possibly threaten its hegemonic role. Indeed, how could policymakers convince the United States to voluntarily abandon its privileged position in the international monetary sphere and the benefits that come with it?

Given this policy impossibility, mainstream economists today seem to favor a regional approach to monetary and financial problems. In this sense, regional monetary arrangements have become the cornerstone of a new international architecture. And while not abandoning its support for the bancor, Post Keynesians are able to contribute to this emerging literature.
Notably, the papers assembled for this special symposium of the Journal of Post Keynesian Economics share many points, in particular their attention to the emerging discussion of a new financial architecture in South America. This new architecture rests on two important premises: a financial argument built around the creation of a new development bank, the Banco del Sur, and a monetary argument, founded on the notion of monetary regional integration, independent of the use of the U.S. dollar.

The Banco del Sur, first discussed in 1998 during the presidential campaign of Venezuelan president Hugo Chávez, was further discussed in 2006, although at a meeting in Buenos Aires, in December 2007, the bank was officially created. In November 2008, it was officially expanded and now has the full support of Argentina, Brazil, Bolivia, Ecuador, Paraguay, Uruguay, and Venezuela. It aims at encouraging regional economic development along lines different from those advocated by financial institutions. Indeed, it seeks to finance public and private projects that carry important macro or collective implications. The purpose is to propose a new financial architecture that is based on a new way of financing development, far removed from the philosophy of the Washington Consensus.

The discussion over a new financial architecture, however, is only a partial solution as it also calls for the creation of a new monetary order that is based on the integration of the regional countries and their liberation from the use of the U.S. dollar as the basis of interregional trade. This is precisely the double objective of the “sucre” plan.

There remains nonetheless many details to be discussed with respect to both the creation of the Banco del Sur and the regional monetary integration. We can identify several important issues. The classic literature on monetary integration tends to emphasize two models usually resting on “currency consolidation,” developed by Rogoff (2001) and Kenen and Meade (2008).

The first model consists of two possible solutions, both resting on the optimum currency area literature, first developed by Mundell (1961). The first approach focuses on the replacement of national currencies by a common, supranational currency and a sharing of monetary sovereignty and central bank functions. This is the example of the European experience. The second approach revolves around the adoption of an existing currency to serve as the common currency, such as in examples of dollarization, which creates an “asymmetric monetary union.”

With respect to Latin America, discussion over the creation of a monetary union is not new, as some authors argue in this symposium, but it is
certainly the first time the idea has garnered such support. In fact, it was discussed recently and approved at the last Alba summit (the Bolivarian Alternative for the Peoples of Our Americas), with the participation of Bolivia, Cuba, the Dominican Republic, Honduras, Nicaragua, and Venezuela, with Ecuador, Uruguay, and Haiti observing.

The second model of regional monetary integration, however, is more consistent with Keynes and Post Keynesians. It rests on the creation of a common currency—or a unit of account—that does not supersede the existence of national currencies. This currency would be used solely for settling interregional payments, much like Keynes’s bancor. This solution has more to do with the creation of a regional payment system than the creation of a monetary union.

Structure of the symposium

This issue of the Journal of Post Keynesian Economics is dedicated to the Banco del Sur and the creation of a new financial architecture in South America. Many of the contributors, including the editors, have been involved to various degrees with the discussion surrounding the creation of the Banco del Sur.

In the first paper, by Pedro Páez Pérez, former minister of economic policy coordination in Ecuador and current chairman of the Presidential Commission for the Design of the New Financial Architecture–Banco del Sur, the author argues that the neoliberal experiment in Latin America has consumed more than a generation of enormous resources with very little economic results, resulting in disastrous social and environmental effects and a deterioration in democratic legitimacy that will have to be recovered. A necessary, although insufficient, condition to recover a hopeful horizon on these fronts is the qualitative advancement toward a continental integration process that includes monetary and financial dimensions, even while the classic themes of trade and tariff integration are still far from being resolved. The Ecuadorian plan that was introduced at the multilateral negotiations in relation to Venezuela’s initiative to create the Banco del Sur proposes the simultaneous and coherent promotion of a process to construct a New Regional Financial Architecture (NRFA), in which the Banco del Sur would be the nucleus of one of the three fundamental pillars—that is, the transformation of the development bank. The other two pillars include the enrichment and coordination of the continental tasks of the central bank, connecting stabilization with development, and the convergence toward a common monetary scheme.
In the second paper, Claude Gnos, Virginie Monvoisin, and Jean-François Ponsot argue that reducing transaction costs and the need for international reserves is a primary objective to the establishment of regional payment agreements. Another objective, especially in the case of Latin America where the Ecuadorian promoters of the Bank of the South and the New Architecture are planning the implementation of a regional clearing system, is to reduce member countries’ dependence on the U.S. dollar as an international standard and reserve currency. To help improve the design of such agreements, this paper refers to the plan Keynes designed for the Bretton Woods conference. First, it observes that cases were made against this plan from which useful lessons may still be drawn. Second, it shows that Keynes defined a system for exchanging domestic currencies for each other that can be improved and help design currency unions in accordance with their promoters’ objectives.

The third paper, by Wesley Marshall and Louis-Philippe Rochon, continues the discussion by laying out a proposal for the institutional framework for the Banco del Sur. Considering the recent historical experiences of Latin America and the need to promote economic activity based in domestic currencies and channeled through nationally owned banks, the authors suggest that the Banco del Sur be divided into two parts—a regional development bank and a regional central bank that issues a regional currency. Under such a scheme, the region would benefit from greater financial stability while member countries would be afforded the maximum economic sovereignty possible.

In the next paper, Alcino F. Camara-Neto and Matías Vernengo provide an evaluation of the possibilities for an NRFA in South America within the context of the “original sin.” It is argued that conventional explanations of the “impossible trinity” are limited, and that once the geography of money is properly introduced in the analysis, then the trade-offs faced by peripheral countries in South America are deemed to be considerably harsher than those at the center. The authors present the pros and cons of the NRFA in reducing the severity of the constraints faced by the countries in the region, and provide some preliminary conclusions about the political viability of the NRFA.

The fifth paper, by Luiz Carlos Bresser-Pereira and Marcio Holland, considers the long history of Latin American attempts to achieve regional integration, although they are quick to point out that the success has been modest. The authors argue that this is essentially due not so much to protectionist practices in the various countries, but to the lack of a common currency, or, at least, of a tightly managed exchange rate band. They review the optimum currency area criteria that claim it is prudent
to increase economic integration before attempting to establish exchange rates coordination. It seems fair to say that diminishing exchange rate instability could encourage trade and investment flows across Latin American economies. The authors also perform a very simplified exercise to understand how feasible efforts would be between policymakers in two large economies—Brazil and Argentina—to achieve exchange rate parity stability and step forward toward adopting a common currency.

In the next paper, Fernando J. Cardim de Carvalho argues that Mercosul (Southern Cone Common Market) was created in the mid-1980s with four members—Argentina, Brazil, Paraguay, and Uruguay. Theoretically, it was supposed to be the start of a regional integration initiative that could eventually evolve into a Union, following the example of the European Union. Economic motivation, however, was not the mainspring of Mercosul. The initiative was devised to approximate the two main economies of the region, Argentina and Brazil, both just emerging from long-lasting military regimes, to provide mutual insurance against new military coups. In fact, the author contends that because the economies of Brazil and Argentina are similar in structure, it created important obstacles to the development of regional division of labor. The removal of barriers to trade between the two economies has been stalled by the difficulty in allocating activities between them. On the other hand, the smaller members of the initiative, Paraguay and Uruguay, have not found in Mercosul the support for their development they expected. Thus, Mercosul still survives, more than 20 years later, mostly because of its political virtues rather than its economic potentialities. The author explores recent attempts at enlarging Mercosul that may create new tensions and eventually threaten its survival.

Finally, José Antonio Ocampo and Daniel Titelman review the experience of South America with subregional financial cooperation. They show that this experience has been one of the most successful in the developing world, though uneven in terms of country coverage and services provided. The Andean region has been particularly successful in developing multilateral financial institutions, and development financing has been broader in scope than monetary cooperation. The two most successful institutions, the Andean Development Corporation (CAF) and the Latin American Reserve Fund (FLAR), have shown the capacity to provide services to member countries in a timely way, with countercyclical effects and on a large scale relative to other forms of multilateral financing. The strong sense of ownership of these organizations by member states, preferred creditor status, and professional management, are reflected in very healthy portfolios, even in the face of default by member countries.
The services of these institutions could be broadened to support, among others, the development and integration of the physical infrastructure and macroeconomic policy coordination.

Conclusion

Although there is still much to consider about the specific details of a new financial architecture in Latin or South America, there seem to be clear advantages to such a new architecture. For instance, countries would no longer dependent on the U.S. dollar, which in itself is a huge benefit. Moreover, the creation of the Banco del Sur and a new settlement currency may serve as an important experiment for the rest of the world, and a possible creation of an international currency of settlement, such as a bancor.

As always, we thank Paul and Louise Davidson for their continued support and encouragement.

REFERENCES
