Financing economic development in Latin America: the Banco del Sur

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Financing economic development in Latin America: the Banco del Sur

Abstract: In this paper, the authors lay 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.

Key words: development, financial architecture, Latin America.

In the current historical context of the global financial crisis, South America finds itself in a uniquely advantageous position on the global stage. From the late 1970s to the early 2000s, Latin America experienced the most widespread and deepest penetration of neoliberal economic policies of any region in the world. After several episodes of unmitigated economic, social, and political disasters, most South American countries have made the transition, in one form or another, and in varying degrees, to a post-neoliberal political and economic order. In recent decades, the shift from finance-led (or finance-dominated) “free market” capitalism to state-backed production-led capitalism has been a painful one in Latin America, and is proving to be similarly painful in the developed world.

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1 The member states of the Banco del Sur are all South American. However, even as Latin American countries outside South America have not joined the project, they will be included in this paper, as they may join in the future, and as they share the same historical conditions that in large part led to the creation of the Banco del Sur.
Such sea changes, however, are absolutely necessary if national economies are to meet the growing demands of their citizenry for basic social services and gainful employment. Yet while this transformation has already begun in earnest in most of South America, it is still on the horizon in much of the developed world. But South America is not only unique in enjoying widespread political support for state-supported production-based capitalism, it is also perhaps the most socially cohesive region in the world, sharing common cultural, historical, and linguistic ties. In addition, it is possibly the only region in the world that is self-sufficient in both food and energy production.

Even though the region’s material abundance and common history are nothing new, the political will to take advantage of these circumstances to promote economic development at a regional level is a more recent development. One of the mechanisms most capable of transforming this political will into sustainable economic growth, we believe, is the creation of a new pan-state bank—the Banco del Sur. As will be shown in the following pages, the principal function of the Banco del Sur must be to assure that the region’s resources are retained in the region and are channeled toward productive endeavors by modifying the region’s historical tendency toward capital flight.

In this paper, we argue that the Banco del Sur can effectively promote regional economic unity and development at a relatively minimal political cost to member countries.

The need to promote local capital for national development

Upon the introduction of broad-based structural reforms in Latin America during the 1980s, many argued that the opening of financial markets would create a win-win situation in which financial capital from the developed world, abundant but with limited opportunities for investment, would flow to the developing world, where capital was scarce but investment opportunities abounded (McKinnon, 1973). However, at least in the case of Latin America, this premise was based on false assumptions. As a region, Latin America has for centuries been a net exporter of capital, and the region’s relative poverty is explained not by a lack of capital but rather by a chronic unwillingness of the region’s dominant classes and their foreign sponsors to invest locally and to create and ensure adequate conditions for domestic investment (Furtado, 1961; Rodriguez, 2006).

This situation has been further exacerbated by the commercial and financial opening of recent decades. As can be seen in Figure 1, after a
brief period of capital inflows that corresponded to the privatization of the largest state-owned companies of the region, the outflows of capital, due in large part to the repatriation of profits to the headquarters of multinational corporations (MNCs) that benefited from privatizations in the region, have accelerated (Vidal, 2007). At the same time, financial opening and deregulation have also allowed for the widespread penetration of foreign banks into domestic banking sectors, the unfettered flow of capital out of the region, and a dramatic increase in the episodes of financial crises in the region (Correa, 1999).

The increased presence of foreign banks and MNCs has greatly displaced locally owned banks and businesses (Gnos and Rochon, 2004–5). Although the natural alliances between foreign banks and MNCs can greatly increase financial instability in moments of crisis, during moments of financial calm, their mere presence implies a constant outflow of capital, greatly reducing domestic investment in the region. As such, the Banco del Sur’s overarching institutional goal should be to simultaneously promote investment and production within South America and to minimize capital flight from the region.
The goals of the Banco del Sur

The Banco del Sur was officially founded in December 2007. However, basic issues involving the institution’s structure, its functions, and the contributions of member countries are still being actively discussed. As registered in the Quito Declaration of May 2007, there is a clear will among many member countries to expand the Banco del Sur’s operations in the future, both as a development bank and as a monetary fund that would eventually support a regional currency (CADTM, 2007).

The Banco del Sur must be able to retain local capital and to channel it toward productive investment in the region. Several specific goals have been outlined in accordance with this premise. Listed in Table 1, and synthesized in some cases, four goals pertain to the movement of principally financial capital and two correspond to the allocation of mainly productive capital. These objectives are still being negotiated, but there is growing agreement as to which specific goals should be pursued, what basic structure the Banco del Sur should follow, and under what terms member states will participate.

An expanded proposal

This paper proposes a vision of the Banco del Sur that in general terms coincides with the parameters established in the Quito Declaration, but which specifically envisions the evolution of the Banco del Sur into two separate entities: a regional central bank to deal with matters that are principally financial in nature and a development bank to promote endeavors that are primarily in the sphere of production. In addition, the paper explores several issues regarding the bank’s possibilities of success that have been absent in public documentation relating to the entity’s future structure and operations.

Under this proposal, the regional development bank and the regional central bank would both operate under the basic premise of coordinating and balancing regional interests, both productive and financial, but under a very flexible regime in which national governments would sacrifice a minimum of economic sovereignty. In order to balance regional and national interests, a key aspect of this plan is the reliance on national public banks, including central banks, state-owned commercial banks, and development banks.

In this respect, the Banco del Sur would serve as a regulator and coordinator of regional and national financial activities, but would not replace any national public banks. As such, member countries could take
advantage of existing institutions, as all countries already have operational central banks and development banks, or state-owned commercial banks that can fulfill the objectives of a development bank. Moreover, individual countries will in large part be able to determine the economic policies that most benefit them. Even though subscription to the Banco del Sur will certainly imply a certain loss of economic sovereignty, member countries would still retain a great deal of flexibility in their pursuit of individual monetary, fiscal, and credit policies. This fundamental feature of our proposed structure for the Banco del Sur is highlighted throughout the paper.

Table 1
Proposed objectives of the Banco del Sur

<table>
<thead>
<tr>
<th>Financial</th>
<th>Productive</th>
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<tr>
<td>1. To act as an anticyclical agent.</td>
<td>1. To promote intraregional infrastructure projects.</td>
</tr>
<tr>
<td>2. To protect against speculative attacks and external crises; to</td>
<td>2. To diminish regional inequalities.</td>
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<tr>
<td>safeguard monetary sovereignty.</td>
<td></td>
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<tr>
<td>3. To restrict capital flight.</td>
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<tr>
<td>4. To administer intraregional transactions and eventually act as</td>
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<td>a central bank that issues a regional currency.</td>
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The Banco del Sur as a regional development bank

Under the proposed scheme, the regional development bank would have the less complicated operational structure and would act solely as a center for the distribution of pooled regional funds and as a regulator for national development banks that receive the funds. Member countries would agree on specific criteria for which regional funds could be used, as well as the contributions that each member would commit, and the amount of funding that each country would receive. One of the advantages of this scheme is that regional inequalities could be addressed through this mechanism, as poorer countries, such as Paraguay, for example, would be allotted a greater amount of funds than it contributes. Intraregional infrastructure projects would also be funded in this fashion, with each national development or state-owned commercial bank carrying out the portion of the project that corresponds to their country. The Brazilian National Development Bank (Banco Nacional de Desenvolvimento Economico e Social), and the Argentine state-owned commercial bank,
Banco de la Nacion, already finance infrastructure projects between the two countries in this fashion.

The other task of the regional development bank would be to regulate and supervise national development banks. The Achilles’ heel of the public bank has always been corruption, as governments that seek personal gain at the cost of a country’s economic health can easily steal from the coffers of the banks they control or divert their funds to politically motivated projects of little utility to the national economy. The regional development bank would therefore receive a clear mandate to regulate banks that receive its funds, and to establish that only a certain, although ample, range of productive endeavors would be eligible for funding. In addition, the regional development bank would be charged with the task of supervising national banks, ensuring that received funds are used for their stated purposes in an efficient manner.

Under this framework, national governments will have wide discretion over which projects are implemented in their countries, and safeguards will be established so that regional funds are not squandered and so that the Banco del Sur’s reputation will not be tarnished.

The Banco del Sur as a regional central bank

Whereas the channeling and distribution of regional funds is in theory a relatively simple task for the Banco del Sur, its other function as a monetary fund is more complex. As stated, one of the bank’s fundamental functions must be to diminish capital flight. This overarching objective accommodates more specific objectives of increasing local investment, local savings, preserving the sovereignty of local currencies, and insulating the region from speculative attacks and external financial shocks. These goals would be best achieved through a framework in which the Banco del Sur would act as a central bank that issues a regional currency, which would be fully exchangeable with all world currencies, while national currencies of member states could only be exchanged with the regional currency. In this sense, trade and finance with countries outside of the region would be done in this new, supranational currency. Therefore, we see the need for a regional currency as paramount to the goals and objectives of the Banco del Sur. Under this framework, the only two currencies that would be permitted to operate in the region would be national currencies and the regional currency. The Banco del Sur’s central bank function, much like its development bank function, would not replace member countries’ central banks (Castaingts, 1990). Rather, it would act as a central agency that secures, coordinates, and
supervises regional monetary operations. These three functions will be examined separately.

The supervision of monetary operations would entail capital controls both at the national and regional levels. At the national level, central banks would have to ensure that only the national and regional currencies exist in circulation, allowing for small and strictly regulated exceptions as necessary. All international exchanges outside of the region would have to pass through the Banco del Sur, meaning that international capital flows between South American countries and countries outside of the region would have to be strictly controlled by the national central bank, and that all exiting or entering capital would have to be registered by these banks and converted into the regional currency through the Banco del Sur. Capital controls will not work perfectly, but as global financial conditions change, and as local capital expands its presence in domestic economies, the possibilities of a successful regime of capital controls become greater. This point is examined further below.

Under this scheme, the Banco del Sur would operate as a monetary circuit breaker between regional economies and the often turbulent global financial markets. Because of the sheer size of the economic area covered by the regional currency, speculative runs against it would be less likely. The financial standing of member countries would also be greatly strengthened, as individual currencies would not be exposed to the often dramatic ebbs and flows of financial capital. Yet the role of the Banco del Sur in terms of the security of national financial systems would not be limited to insulating against external shocks. As financial deregulation in the region has led to a number of endogenous domestic bank-led banking crises, the Banco del Sur should also act as a regulatory and supervisory agent for national banking systems. Once again, the regional bank would work in close cooperation with national banking regulatory agencies, creating a harmonized regulatory and supervisory regime within the region, based on criteria agreed upon by regional leaders. In exchange for the imposition of certain regulatory standards and guidelines, the monetary fund of the Banco del Sur would act as a lender of last resort in the case of domestically generated financial crises.

The supervision of the region’s financial institutions, both in terms of bank regulation and supervision and capital controls, in addition to the security that the Banco del Sur would offer to local financial markets by offering its services as a lender of last resort and as an insulator against foreign capital flows, will require constant coordination between member states. The most awkward political issues among member countries
may well arise between the management of exchange rates within the region. In this regard, the Banco del Sur will have to walk a fine line between ensuring that regional trade imbalances do not flourish while at the same time giving national central banks leeway to determine the value of national currencies in relation to the regional currency. It is worth emphasizing that we are not advocating a single currency such as the European Monetary Union, but rather a double monetary circuit in which both the national currencies and the regional currency would circulate within each member country. This scheme would offer the benefits of a single currency in regard to its financial and trade relations with the rest of the world while at the same time avoiding the rigidities imposed by the adoption of a single currency by countries whose economic structures vary greatly.

Another crucial issue will be the determination of the value of the regional currency in relation to other international currencies. Although the various exchange rate schemes that could be employed by the regional central bank are beyond the reach of this paper and should be determined in accordance to future conditions of the international monetary system, if national central banks have considerable flexibility in the exchange rates that they set for their national currencies in relation to the regional currency, the value of the regional currency may be a secondary issue.

**Historical precedents of the Banco del Sur:**

**Keynes’s Bretton Woods proposal**

The proposal for a comprehensive reconstruction of the financial system of a region as large as South America begs for comparison to the negotiation of the Bretton Woods agreements, which set several historical precedents of great importance to the present debate over the Banco del Sur. On one hand, Keynes’s proposal for a new global financial architecture to date remains a viable structural guide for proposals such as the Banco del Sur. On the other hand, the evolution of the institutions that the Bretton Woods negotiations brought into existence has created the same conditions that the Banco del Sur must counter if it is to meet its stated goals. At the same time, the very process of negotiating the agreement in 1944 offers useful lessons for the negotiation of the expansion of the Banco del Sur.

During the Bretton Woods debates, the famous negotiations between Keynes and Harry Dexter White were decided largely out of geopolitical considerations. The resulting Bretton Woods agreement, which gave birth to the International Monetary Fund and the World Bank, was based
on the logic of maintaining the dominant position of the United States and not on an economic logic that would favor economic stability for all countries involved. As Keynes correctly predicted, a system that followed this structure would likely

be influenced by extraneous, political reasons and put specific countries into a position of particular obligation towards others; and also that the distribution of the assistance between different countries may not correspond to need and to the actual requirements as they will ultimately develop. (1980, p. 45)

Although the Bretton Woods system was far from perfect and relatively short-lived, it nonetheless created a global financial architecture that offered decades of stable financial conditions in which there was relatively little interest rate and exchange rate volatility. Within this financial environment, many countries were able to expand their economies and employment through state-sponsored productive endeavors. In the case of Latin America, these decades produced the greatest investments in productive infrastructure, and also represented the first time in the region’s history in which basic public services were offered to a large part of society. Networks of state-provided social services such as health care and education were created, and a national industrial platform, although limited, was developed in many countries.

However, the fundamental birth defect of such a system, the reliance on a single country to maintain the international system, came to light in two distinct moments: the first with the unilateral decision of the United States to break the gold standard in the early 1970s, and the second with the financial collapse of the United States beginning in earnest in 2007. In the first instance, the renewed chaos in international prices, particularly interest and exchange rates, was an important early condition of the growing financialization of the global economy, while in Latin America, global imbalances of credit flows led to the regional debt crisis of 1982, which ushered in decades of Washington Consensus policies. After decades of draconian cuts in fiscal expenditures, widespread privatizations, and frequent financial crises, most economic gains achieved during the full operation of the Bretton Woods system were effectively rolled back.

As the U.S.-dominated Bretton Woods system gave way to a similarly U.S.-dominated global financial system, many of the world’s economies have become highly dollarized. In Latin America, the high degree of dollarization of national economies has for decades entailed a double monetary circuit in which savings are not recycled into investments, but rather sent overseas where they can be used to finance the economic projects.
of other countries, principally the United States. Yet the dollarization of many economies leaves the entire world at risk from disruptions in the U.S. economy, as is currently taking place (Liu, 2008). Yet it is indeed still possible in the current global environment to establish conditions for stable financing that can once again promote sustainable economic development. Keynes’s Bretton Wood’s position offers a useful blueprint in this respect. The goal of reaching full employment through the maintenance of stable commercial balances, under a common international currency that would leave in place local currencies with a high degree of flexibility between the two, is indeed what the Banco del Sur’s regional central bank should strive for under a common regional currency.

However, Keynes’s proposal of a creation of an International Clearing Union (ICU), with the bancor serving as the common currency, is not fully compatible with the proposed structure of the Banco del Sur for the simple reason that Keynes’s proposal was international in scope, whereas the Banco del Sur would only have jurisdiction over the region. As envisioned, the creation of the Banco del Sur would signify the establishment of an enclosed and independent financial system, capable of funding the needs of the region and protecting it from external financial upheavals that dependency on external financing entails. However, the regional central bank would interact with the rest of the world. As such, the functions of the regional central bank would therefore have to be divided into internal and external operations.

In terms of the relationship between South America and the rest of the world, the principal function of the region central bank would be to insulate and shelter the collective of South American countries from the financial uncertainty stemming from the volatility of international markets. Therefore, the regional central bank will have to be active in the foreign exchange market, and will need to possess all of the tools available to modern central banks, including the ability to make open market purchases and to issue bonds.

Yet while the regional central bank will have to operate much like other institutions of its type on the international stage, within the regional boundaries, the regional central bank should indeed act principally as a clearinghouse between national central banks. As proposed by Keynes, the goal of an ICU operating under a common currency would be to minimize regional imbalances, imposing corrective measures, principally through the adjustment of the prices of national currency in relation to the common currency, both for countries with surpluses and with deficits in relation to other member countries. As emphasized by Keynes, the regional central bank, acting as an ICU within the region, would have
as its main goal the pursuit of full employment, and would operate in a context of rigorous capital controls and flexible determination of the prices of national currencies against the regional currency.

Under such a scheme, the Banco del Sur would establish the necessary framework for member countries to pursue a strategy of sustainable growth based on monetary sovereignty and sovereign credit policies. However, the Banco del Sur would merely provide the framework for the de-dollarization of the region and the recuperation of national banking systems. The ability to fulfill these goals exceeds the capacities of the Banco del Sur in itself. This is not to minimize the fundamental role of an integrated and fully operational regional development bank and the regional central bank, but rather to stress the importance of complementary measures in reaching these goals. As discussed at length in Marshall (2010), the dramatic increase of MNCs in Latin America, and in particular the systemic positions held by foreign banks in all large economies of the region, have been of crucial importance in the gradual loss of countries’ abilities to establish and to pursue credit policies that could allow for more equitable and sustainable growth.

In order for the full potential of the Banco del Sur to be met, individual countries must strengthen the domestic ownership of financial and nonfinancial firms. Due to the historical and current inadequacy of local private capital to establish and maintain profitable ventures that can offer the employment and services demanded by local populations, the state must provide these opportunities. In the few instances in which Latin American countries have been able to industrialize their economies based on domestically provided credit, both the banks and the majority of firms in the productive structure have been state owned. Latin American economies have never been able to achieve sustainable growth and employment through foreign credit under regimes dominated by international companies. All evidence once again points to the need for a greater presence of the state in financial and productive sectors if the region is to be able to offer greater levels and quality of work to its citizenry.

The need for greater regional economic integration, the generation of sovereign credit, and the strengthening of domestically owned firms, including those controlled by the state, are concepts that enjoy widespread political support in South America. However, negotiations over the expansion of the Banco del Sur and a regional currency have reached a stalemate. Much like the United States represented the dominant world power in the Bretton Woods negotiations, Brazil is the dominant regional power in South America. As happened in the past, it is likely
that concessions will have to be made to the dominant power for an agreement to be reached.

Any collective effort requires individual sacrifice to benefit the group as a whole, yet as we have emphasized throughout the paper, the region’s monetary union and common credit strategies would allow for the maximum flexibility possible for member countries allowed under a scheme where common goals are pursued. In terms of monetary policy, member countries would retain their own currencies and would be able to adjust their value against the regional currency up to certain limits. No restrictions would be placed on fiscal balances, and member countries would have full discretion in their overall expenditures. Obviously, projects approved by the regional development bank would have to be carried out as agreed to, but all other decisions as to how a member country directs its credit and the contribution of fiscal costs to these ends would be completely sovereign.

Conclusions

As stated at the beginning of this paper, South America finds itself in an enviable and unique position in the world as a self-sufficient and socially cohesive region that has already lived through the type of financial crisis that is currently engulfing the developed world. Yet the progressive governments that have emerged still represent nations that maintain longstanding rivalries, and the willingness for compromise and the aligning of national interests toward comprehensive regional policies have been tortuous processes. On one hand, this can be seen as a healthy sign. Hastily agreed-upon regional policies always run the risk of failure and doing more harm than good. The one-size-fits-all monetary policy of the euro region is a good example of this. Constructed upon the economic framework of neoliberal ideology, the European Monetary Union never took into account the possibility of financial crisis and now must rely on ad hoc measures to compensate for its rigidity in fiscal and monetary policy and the lack of regional mechanisms to deal with moments of financial instability.

As with any cooperative effort, individual sacrifice is necessary to achieve common good. However, in the scheme presented for the Banco del Sur, the preservation of member states’ economic sovereignty is given a premium, and common goals, at least in theory, could be fulfilled at a minimal cost to individual countries. At the same time, a strong argument can be made that South America must act quickly to benefit from the current state of extreme volatility in the world’s economic and geopolitical order.
During the great depression of the 1930s, Latin America was forced into radical changes in economic policy. The reliance on the exportation of primary goods and the large-scale and growing presence of foreign companies through the first decades of the twentieth century left the region exposed to the worldwide economic collapse of the era. In response, many countries of the region, led by Mexico, turned to domestic production, driven by state-owned banks in many cases, to lead themselves out of the depression.

The present situation holds many similarities. The unwinding of the highly speculative structure of modern financial capitalism will surely usher in a more traditional form of banking in much of the world. With this change, the possibilities of successfully imposing capital controls greatly increase. In addition, a possible transformation in the political landscape of the United States may permit a more cooperation-based relationship in the Western hemisphere, as happened during the great depression. Both national and international political and economic circumstances favor a timely implementation of the Banco del Sur. If the project proceeds successfully, and is coordinated with other changes in national economies, South America may be able to break with its historical tendencies of capital flight and retain and employ domestic capital in a way that can foster sustainable economic development.

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