Decentralizing finance: New steps for a new dance

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DISORDER AND GOVERNANCE

Every economic crisis buries some practices and gives rise to new ones. What we see today is a move away from what Robert Wade called the "High Command" of global finance and the rise of less formalized institutions. The G20 may be one of these. So far, the G20 summit agenda has focused heavily on the question of the regulation of international financial markets. In addition, the G20 leaders made a commitment at their first summit in November 2008 to press on with the reform of the Bretton Woods institutions in order to give greater voice and representation to emerging and developing economies.

Two years later, the Toronto summit closed on a dull note. The G20 resolved to have all members halve their deficits by 2013 and stabilize overall debt by 2016. Brazil and Argentina, along with India and China, were strongly against cutting back spending at this early point in the global economic recovery. Brazil's Finance Minister, Guido Mantega, warned the G20 not to balance budgets on the backs of the world's poor. Other agendas remain mostly ignored. As these initiatives creep along, it may be that other mechanisms, particularly those at the regional level, gain momentum.

The first steps of the process were taken more than a decade ago. The sequence of economic crises that hit several corners of the world in the 1990s and 2000s provided valuable lessons on the building of regional protective mechanisms to cushion the impact of an external shock. East Asian countries have pioneered expanding financial cooperation regionally after their crisis in 1997 through the Chiang Mai Initiative. Originally a modest safety net of bilateral swaps, this agreement has evolved into the largest international reserve pooling worldwide. The potential to expand this cooperative mechanism is still promising because the country with the largest amount of international reserves in the world—China—is a key member of this agreement.

MORE REGIONAL PLURALISM

On the opposite side of the globe, the Argentine economic meltdown in the wake of the 2000s became the seed of regional monetary agreements in the second half of the decade. Particularly, regional payments clearing houses are making progress toward decoupling trade operations from the US dollar. In October 2008, Argentina and Brazil agreed on a local currency payments system. In Brazil, exporters may now operate in *real*, while Argentineans may operate in *pesos*. With the elimination of the need to go through a third currency, exporters can set prices in their home currency, thus being insulated from exchange risk. The system still covers a marginal proportion of trade between these countries, although it is growing rapidly from that low base. The good timing of this initiative has swept it beyond South American borders. In their April 2010 summit in Brasilia, Brazil, the BRIC countries (Brazil, Russia, India, and China) took this experience as a precedent and decided to look into regional monetary arrangements, including a local currency trade settlement among member countries.

In a similar vein, in October 2009, the SUCRE (Unitary System for the Regional Compensation of Payments, a virtual currency used by central banks to count trade in the books) was set up among Venezuela, Cuba, and Ecuador. The rest of the member countries of ALBA (Bolivarian Alliance of the Americas)—namely, Antigua and Barbuda, Bolivia, Dominica, Nicaragua, and St. Vincent–Grenadines—are also expected to join SUCRE. SUCRE differs from local currency trade initiatives because the former creates a completely new unit of account.

Regional development banks are an additional cooperative mechanism placed between these decentralized initiatives and the "High Command." An expansion of regional provision of development finance in Latin America has come from the Andean Development Corporation, which will soon supplement the newly inaugurated Bank of the South, with initial capital of US$20 billion. These regional institutions present a mounting challenge to more traditional sources of funding, such as the recently re-capitalized Inter-American Development Bank and the Bretton Woods institutions. More specifically, most Latin American governments have consistently resisted engaging in International Monetary Fund credit programs in the 2000s owing to the tight conditionality on local policy planning and the expensive political burden derived from the IMF's bad reputation in local electorates.

IMF NO LONGER THE EPICENTRE

This confluence of factors translated into a sharp drop of regional reliance on IMF funding. In 2005, Latin America made up 80 percent of the IMF's lending portfolio,

Decentralizing finance, page 44

Decentralizing finance continued from page 43

a share that had dropped to 1 percent by 2008. While IMF loans to Latin America stood at US$48 billion in 2003, they dropped to less than US$1 billion before the crisis. With the onset of the crisis, three Central American countries, Mexico, and Colombia have applied for loans. However, the crisis has not changed the long-term trend, which has been favoured by booming commodity markets. While most countries paid off their debts, Argentina is also refusing to follow precedent and go back to the IMF in order to renew negotiations with the Paris Club. Reversing the trend from borrowers to lenders, in June 2009 Brazil, Russia, and China announced that they would buy IMF bonds in order to reduce their dependence on the US dollar and diversify foreign currency reserves.

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If meaningful IMF reform continues to prove politically difficult, the relevance of these decentralized financial and monetary arrangements might grow. Not only would they permit decentralization and greater pluralism in international financial governance, they can also contribute to global stability by reducing the United States' burden to provide liquidity to the world economy. They might also throw some useful sand into the entirely free-flowing regime of finance. Paradoxically, the IMF might be forced to turn away from the former highly indebted developing world to the newly highly indebted European countries if voluntary debt markets turn thumbs down on them.

Argentina's turnaround continued from page 42

ENTER THE HEADWIND

The universal child allowance implemented in October 2009 has been a measure with high positive impact on public opinion. However, it will cost about ARS 8 billion in 2010, equivalent to 6 percent of the monetary base. On the one hand, the universal child benefit may be seen as major policy with distributive effects. On the other hand, it may be seen as a way of catching up with inflation, or even worse, as a policy that simply fuels further inflation. However it is identified, the government is caught in a race between rising prices and social spending. Thus, inflation and the fiscal deficit are the two most serious challenges CFK will have to face in the short term. The question is: How long can the government continue to fund increased public spending without going to the international financial markets?

> Argentina's fragmented opposition has failed to form a united front against the government despite winning control of Congress in last year's mid-term election.

INFLATION: THE BIG UNKNOWN

The other question is: How much inflation can be tolerated next year? Inflation is a particular concern for CFK's government because it has a larger impact on the poor, who make up her support base, and this could weaken her politically. Public spending is surging at a rate of about 30 percent, and analysts say the use of central bank reserves to service debt is also stoking inflation. On the other side, opposition proposals in Congress to hike pensions and cut controversial taxes on grains exports would strain the budget and could trigger a controversial presidential veto.

HER RUNNING BATTLES WITH BIG BUSINESS AND THE MASS MEDIA

The picture gets more complicated when media and business enter the scene. CFK has been at odds with the Clarín media group for two years. She stepped up her drive against the conglomerate by accusing Clarín and its competitor La Nación of plotting with the military junta to buy leading newsprint supplier Papel Prensa in 1976. The government rescinded the broadcast rights of Clarín's paid-up TV sports channel to air live Argentine first-division football. State-run television has taken over and broadcasts all matches for free. Second, the government announced that another Clarín company, Fibertel, could no longer operate as the Internet supplier to its more than one million users because it did not have, and had never had, a licence to do so. No doubt the battle against the media groups Clarín and La Nación will only intensify in the run-up to next year's presidential elections.

In short, the road ahead looks rough and rocky, with global and domestic trends pushing in different directions. Add to this a fragmented opposition and the confrontational style of the Kirchners, and what you have is a very uncertain picture. Will she be able to bring together fortune and virtue without him?