

Banco del Sur: Chile's Abstention

On Sunday December 9, in the Salón Blanco (white room) of Argentina's Presidential palace the Casa Rosada (just before the hand-over of Presidential power), the Presidents of Argentina, Brazil, Paraguay, Ecuador, Venezuela, Bolivia and Uruguay (the latter signed the act on December 10) officially formed the Latin American development bank Banco del Sur. According to its principal instigator, the current President of Venezuela Hugo Chávez, Banco del Sur will enable Latin American countries to "free themselves from financial dependency on official international multilateral lending agencies", that are critical of the President members of Banco del Sur, namely the International Monetary Fund (IMF), the World Bank (WB) and the Inter American Development Bank (IDB).

But despite the reproaches, the World Bank and International Monetary Fund have nonetheless been benevolent and cooperative, and publicly offered to help consolidate Banco del Sur if their help is needed.

Colombia, Chile and Peru have remained outside of Banco del Sur. In Chile some socialist senators have criticized the foreign affairs ministry for keeping Chile out of the project, arguing not in favor of Chile's or Latin America's financial liberation from multilateral lending agencies, but saying that it is Chile's obligation to participate in all Latin

American initiatives. This is a weak argument from the national interest standpoint.

Colombia has said it intends to join the bank to support the region, but that that does not mean it will abandon traditional financial institutions.

Objetives and Fundamentals

It is not clear if the Banco del Sur will seek to improve economic development and competitiveness or whether it will be used for political ends especially the 21st century socialist projects of President Hugo Chávez, who will house the bank's headquarters in Caracas and is the project's principal donor and mentor.

As well as the financial independence for Latin American countries from international lending agencies (especially the IDB, IMF and WB), the other objectives of the Banco del Sur are: to finance regional infrastructure projects, development and help to reduce poverty. These are very broad objectives if one considers the limited capital resources available.

Banco del Sur is scheduled to begin operations in 2008, with initial capital of US\$7 billion, of which US\$800 million will come directly from member states (with President Chávez offering to provide or donate an important part of that amount using income from Venezuela's oil resources), and the rest would supposedly come from bond placements in international financial markets, which is not easy to achieve at a reasonable price. The headquarters of the bank will be in Caracas, with a sub headquarters in Buenos Aires and another in La Paz, and the organism responsible for making the most important decisions will be the administrative board, composed of the finance and economy

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**Table N°1
Real GDP
(GDP Variation)**

	2000	2001	2002	2003	2004	2005	2006	2007p	2008p
Venezuela	3,7	3,4	-8,9	-7,8	18,3	10,3	10,3	8,3	4,9
Bolivia	2,5	1,7	2,5	2,7	4,2	4,0	4,6	4,0	4,3
Ecuador	2,8	5,3	4,2	3,6	8,0	6,0	4,1	1,8	2,3
Uruguay	-1,4	-3,4	-11,0	2,2	11,8	6,6	7,0	5,6	4,4
Brasil	4,3	1,3	2,7	1,1	5,7	2,9	3,7	4,8	4,5
Paraguay	-3,3	2,1	0,0	3,8	4,1	2,9	4,0	4,3	3,9
Argentina	-0,8	-4,4	-10,9	8,8	9,0	9,2	8,5	8,1	6,0
Colombia	2,9	1,5	1,9	3,9	4,9	4,7	6,8	6,6	5,4

Source: Consensus Forecasts, Moody's and IMF

ministers of member countries. It has also been proposed that the US\$800 million would come from international reserves from the central banks of member states.

Up until now, there has been no agreement on how much each member will provide. Some prefer that the proportion of the initial capital contribution be determined by the financial capacity of each country and by the size of their economies, while others prefer that the initial capital amount should be equal for all. As one of the objectives of Banco del Sur is to reduce the commitments required of debtor countries to multilateral lending agencies, it is still not clear what guarantees potential debtors will need to provide Banco del Sur to receive financing. These are only some of the many elements that are still not clear, and which the ministries of the seven member countries of the board, ought to clarify in a maximum of 60 days starting from December 9.

It has been proposed that all of the members should have equal voting rights on the board, irrespective of the amount of money they put up front. Despite objections from Brazil to this proposal, the idea of equal voting rights

proposed by the Venezuelan President has convinced the majority of members so far.

Advantages and Disadvantages

As regards the possible benefits and advantages that the creation of such a bank could bring, it is likely that it will favor mostly those entities that do not have access to financing in capital markets or other official credit lending institutions or rather that are dedicated to social projects that meet the criteria of the statutes of the bank.

If Banco del Sur were to help boost competition in the international lending sector and it were to be managed in a rational manner using an institutional structure that takes into account specialization, risk evaluation, social profitability, with sustainable, non-political objectives and with the appropriate people in charge of its operations, it could become a beneficial and successful institution. Banco del Sur could be a real financing option as a solid and efficiently run entity like the WB, IDB and IMF. Unfortunately, the probability of Banco del Sur stimulating financial competition and not being dragged down by personal agendas, politics or populists is very low, meaning that the disadvantages of forming the bank could be greater than the benefits.

Banco del Sur is unlikely to be sustainability due to the heterodox economics and ambiguity of the proposed objectives of the leaders of the member countries and the lack of a clear structure on how the bank will operate. There have been no proposals on whether projects should be evaluated and financed according to their profitability or include risk diversification, which is the case with other International lending institutions,

Graph N° 2
Assets of International Reserves
(in millions of US dollars)

	2002	2003	2004	2005	2006	Trim 3° 2007
Venezuela	12.003	20.666	23.498	29.636	36.672	29.154
Bolivia	897	1.096	1.272	1.798	3.193	4.742
Ecuador	1.008	1.160	1.437	2.147	2.023	3.611
Uruguay	772	2.087	2.512	3.078	3.091	3.540
Brasil	37.823	49.296	52.935	53.800	85.839	162.962
Paraguay	641	983	1.168	1.297	1.703	2.182
Argentina	10.476	14.119	19.646	28.077	32.037	42.891
Colombia	10.844	10.921	13.540	14.957	15.440	20.554

Source: Preliminary Balance of Emerging Economies in Latin America and the Caribbean 2007.

such as the IDB, IMF, WB and the Andean Development Fund (CAF), which are all founded on solid principles that allow them to be sustainable and provide effective support to developing nations.

The requirements for qualifying for funding are not clear, but according to the declarations of the Presidents of the member countries, especially Hugo Chávez, Evo Morales and Rafael Correa, the requirements will be more than enough to ensure the payment of the loans. It is still unclear if the Banco del Sur will seek to encourage economic development and competitiveness or whether it will be used for political ends to promote 21st century socialism projects, particularly those of Chávez, who will house the headquarters of the bank in Caracas and is the project's principal donor and mentor.

The source of funding from the member countries should not come from international reserves, of central banks especially, because that money ought to be invested in low risk funds with high liquidity, while Banco del Sur

still does not have a risk classification and its member countries have risk classifications below the investment grade (less than BBB-), which means the cost of the fund would be higher than that of the World Bank or IDB, which have AAA risk classifications.

In addition, the administrative board would be made up of the economy and finance ministers, people that are not appropriate for taking the best technical – financial decisions in the banking sector, because their decisions are slanted by the existing government administration and because they are not always specialists in the sector. President Hugo Chávez's readiness to provide more funding than the other countries and support the bank's operations with oil profits, raises questions about how much decision-making power he will have in the bank. What is more, depending on oil profits is an unwise decision as that market can be volatile.

It would be cleverer to dedicate the necessary time to first better define the objectives, the structure, how the system will operate, risk and management, amongst other things, before rushing into starting up operations. But the political factor he leverages as President of Venezuela means that it is highly likely the bank will be opened before it is ready. The Banco del Sur is definitively a redundant institution that is trying to sidestep the demands and discipline of the financial market and the existing multilateral lending agencies.

Declarations made by the Presidents Evo Morales, Hugo Chávez and Rafael Correa, show a clear political slant in their reasons for

Graph N° 3
Non Financial Public Sector Debt
(% of GDP)

	2003	2004	2005	2006	2007*
Venezuela	46,3	38,1	32,9	24,3	18,1
Bolivia	89,5	83,3	79,2	54,3	39,4
Ecuador	49,2	43,7	39,4	32,7	30,5
Uruguay	100,4	78,9	70,4	62,6	59,8
Brasil	53,7	49,3	46,7	46,0	43,4
Paraguay	46,9	41,7	32,8	25,8	21,9
Argentina	144,8	132,5	77,8	65,5	n/a
Colombia	53,9	49,2	45,8	43,1	41,9

* Preliminary figures to June 2007

Source: Preliminary Balance of Emerging Economies of Latin America And the Caribbean 2007.

founding the bank, which are in keeping with the “XXI Century Socialism”, championed by Chávez, and which are represent a threat to the sustainability of the bank. Meanwhile, Brazil’s President Lula da Silva has come across as being a bit more objective, proposing that the Banco del Sur should be a development tool.

The different visions of the project could end up being fatal for its survival and its intentions to make a real contribution to increasing competitiveness in multilateral financing.

In view of this not very promising project, Chile’s decision to continue to strengthen its relationship with existing lending agencies (particularly with the Andean Development Fund) instead of focusing on the formation of new and risky financial institutions, is positive for Chile.

Latin America already has enough official financial institutions and capital markets that

are becoming increasingly flexible and efficient projects, with economically feasible projects, both national and multi-national.

In Conclusion:

1) As the Banco del Sur is currently conceived, it will not make a significant contribution to the South American economy and there is a risk that it could generate economic distortions and negatively affect the image of its member states and users.

2) Compared to the IDB, CAF and other well established international lending agencies the bank has strong disadvantages, due to its high cost of raising capital, given its risk classification, and scarce resources compared to the combined funding of the IMF, WB, IDB and CAF.

3) There is a high probability that the Banco del Sur will be used as a political instrument to forward the ends of “XXI Century Socialism” and to make a mockery of the sound financial discipline that official financial markets and institutions demand.

4) In Chile’s case, the resources that the Banco del Sur would ask for, were it to join the bank, have other valuable uses within the economy for addressing issues of poverty and education, amongst other things.

5) Another important aspect to consider is the negative impact on Chile’s image that joining the bank would have as it is likely to be a highly politicized institution, lacking transparency and with serious question marks lying over its viability.

6) The Chilean economy has “graduated from the official credit organisms” to the extent that it is almost no longer eligible to apply for financing. It can only receive support and cooperation, and this it can receive through institutions such as the IDB and CAF that have a proven operational track record, with a larger number of members and a low level of politicization●