

**REGIONAL INTEGRATION IN THE AMERICAS:
THE IMPACT OF THE GLOBAL ECONOMIC CRISIS**

***A Role for Regional Integration Agreements
in the Architecture of International Finance?***

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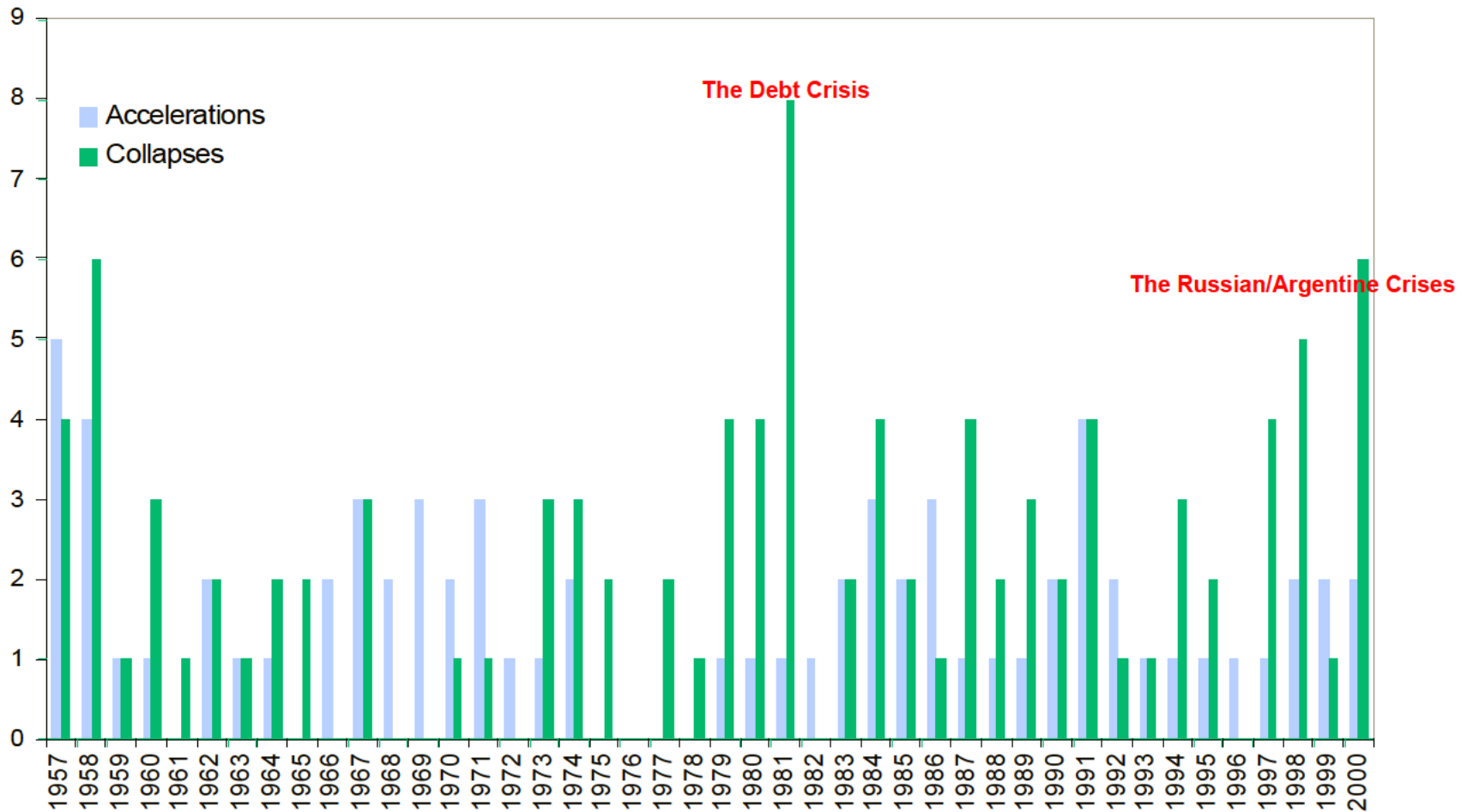
***Volatility and Crises Matter in LA and
the pre-crisis IFA was not effective at
reducing volatility***

Excess volatility in Latin America: some stylized facts

- ✓ *Aggregate volatility is substantially higher than in developed countries*
- ✓ *Consumption is usually more volatile than income, and investment volatility is high as compared to international standards*
- ✓ *Crises have been frequent. Several countries experienced at least one important crisis in the “Second Globalization” period but the frequency of these crisis occurrences differs*
- ✓ *The simultaneous occurrence of financial and real shocks (for example, interest rate and terms of trade shocks) compounds the size of growth collapses*

The Latin American region is particularly sensitive to financial shocks: more frequent collapses in 1981, 1998-2000

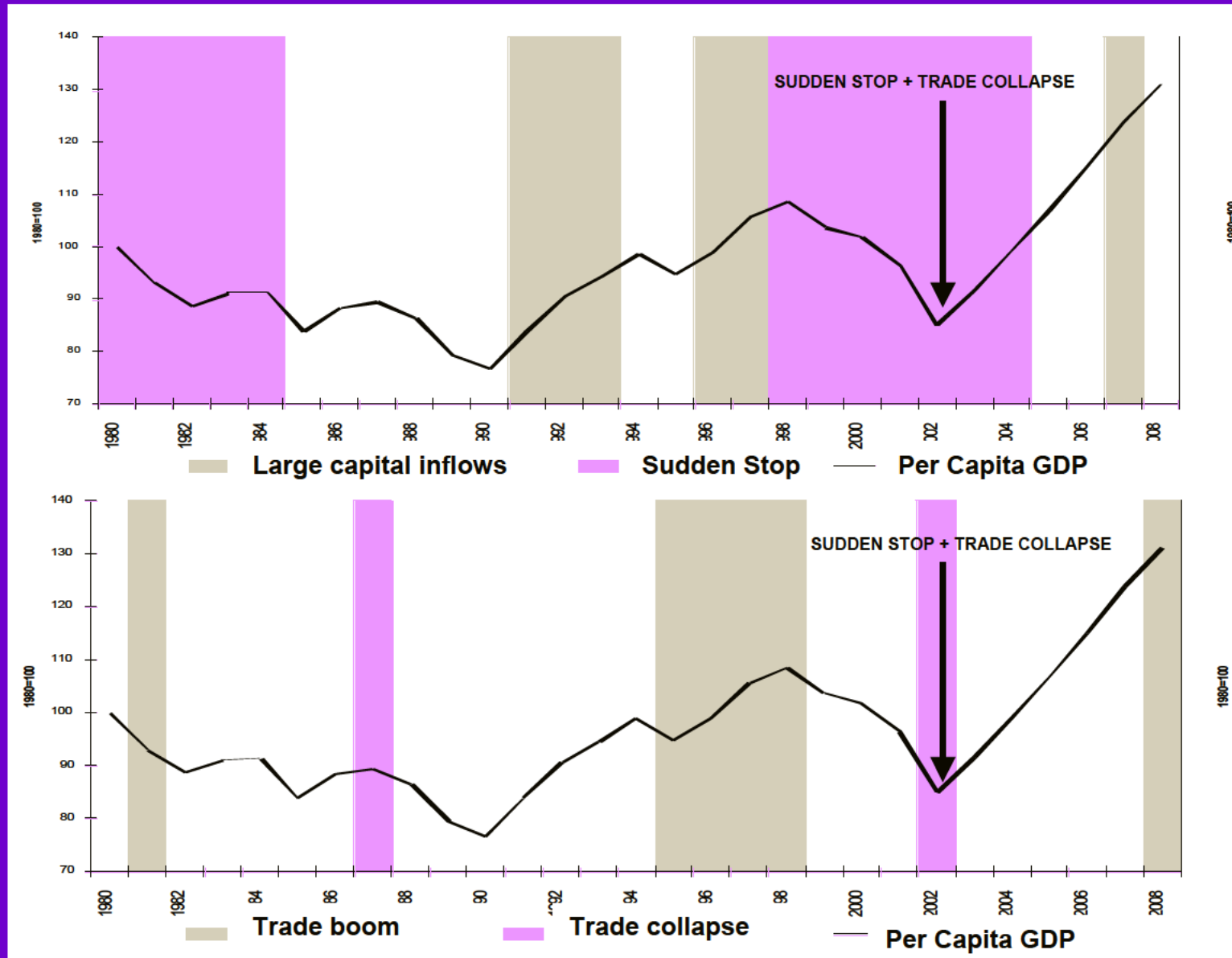
Latin America: initiating accelerations and collapses



Sudden stops and large trade shocks occur frequently. Example, LAC-7

	Trade Shocks	Sudden Stops
Argentina	1986-87; 1993; 2002-03	1980-84; 1994-96; 1998-2004
Brazil	1986; 1999-2003	1981-85
Chile	1985-86; 2002-03	1981-86; 1998-2000
Mexico	1986; 1992-94; 2003	1982-85; 1994-97
Colombia	1983; 1985; 2002-04	1998-2002
Peru	2001-04	1981-86; 1997-99
Venezuela	1986-88; 1998; 2002-03	1980-86

A simultaneous sudden stop and trade collapse. Example: Argentina



Weaknesses of the pre-crisis IFA from the LA point of view

- ✓ *Financial stress, associated with sudden changes in risk aversion and domestic deleveraging, causes strong output losses and has long-lasting deleterious effects on the aggregate investment rate*
- ✓ *Currency and term mismatches play a role in nurturing financial disequilibria*
- ✓ *The government acts as insurer of last resort and the fiscal imbalances provoked by the bailout of the banking system tends to erode public debt sustainability and affects political legitimacy*
- ✓ *The authorities are unable to implement appropriate anti-cyclical policies in a context in which capital flows behave pro-cyclically*
- ✓ *The resources that international financial institutions (IFIs) provided to counterbalance capital outflows and ease the credit crunch in the past did not suffice to significantly smooth aggregate fluctuations*
- ✓ *More often than not, the conditionality attached to the funds did not help, either*

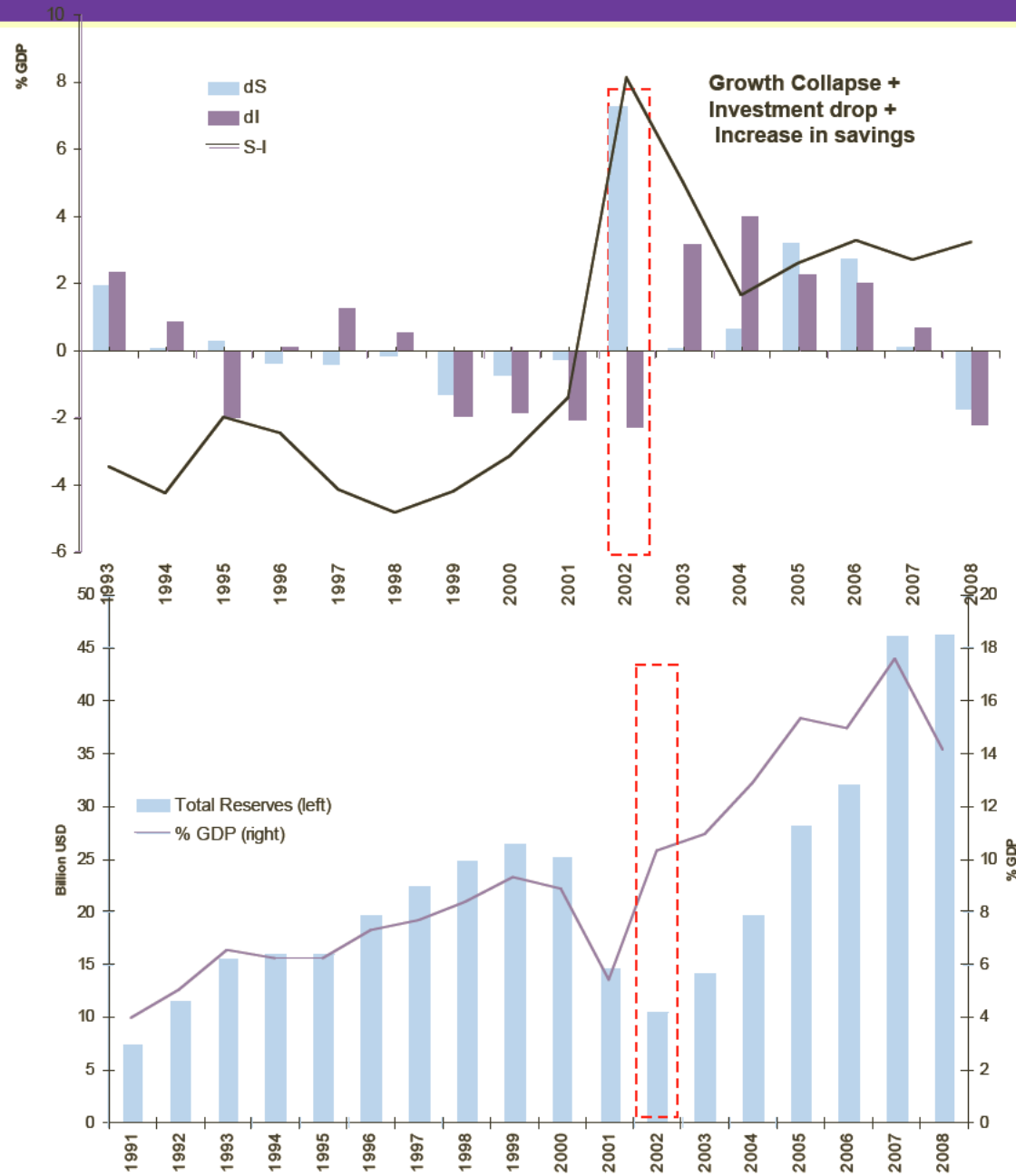
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*Volatility and a weak IFA provided
incentives for
self-insurance in the 2000s*

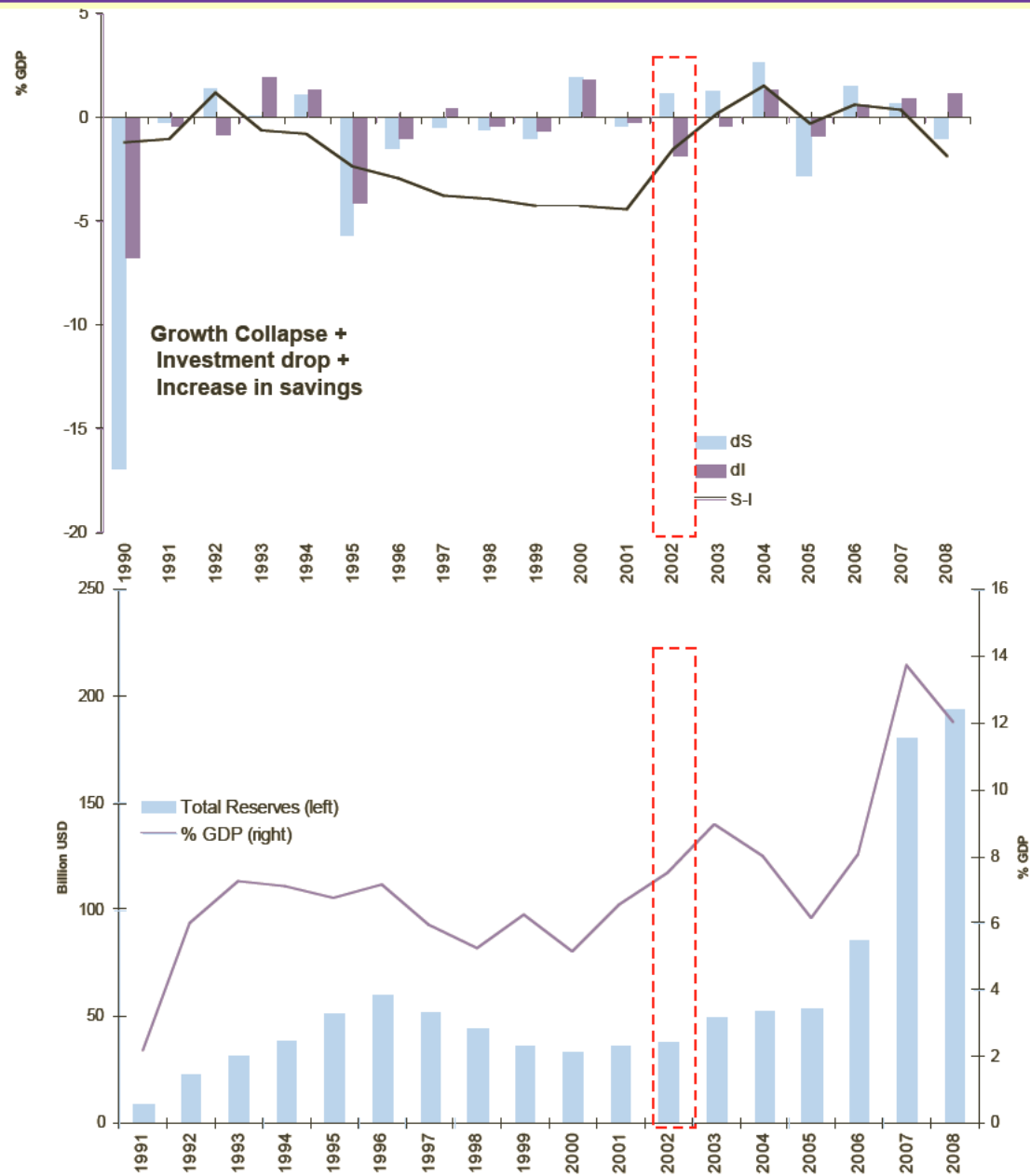
Self-Insurance in the Emerging Economies

- ✓ *A number of emerging countries that experienced episodes of financial stress and sudden stops in the 1980s and 1990s adopted a self-insurance strategy in the period prior to the international crisis*
- ✓ *The widespread use of self-insurance strategies has fed global imbalances*
- ✓ *Some examples:*
 - *Argentina*
 - *Chile*
 - *Brazil*
 - *Korea*
 - *Indonesia*
 - *Thailand*
 - *Russia*

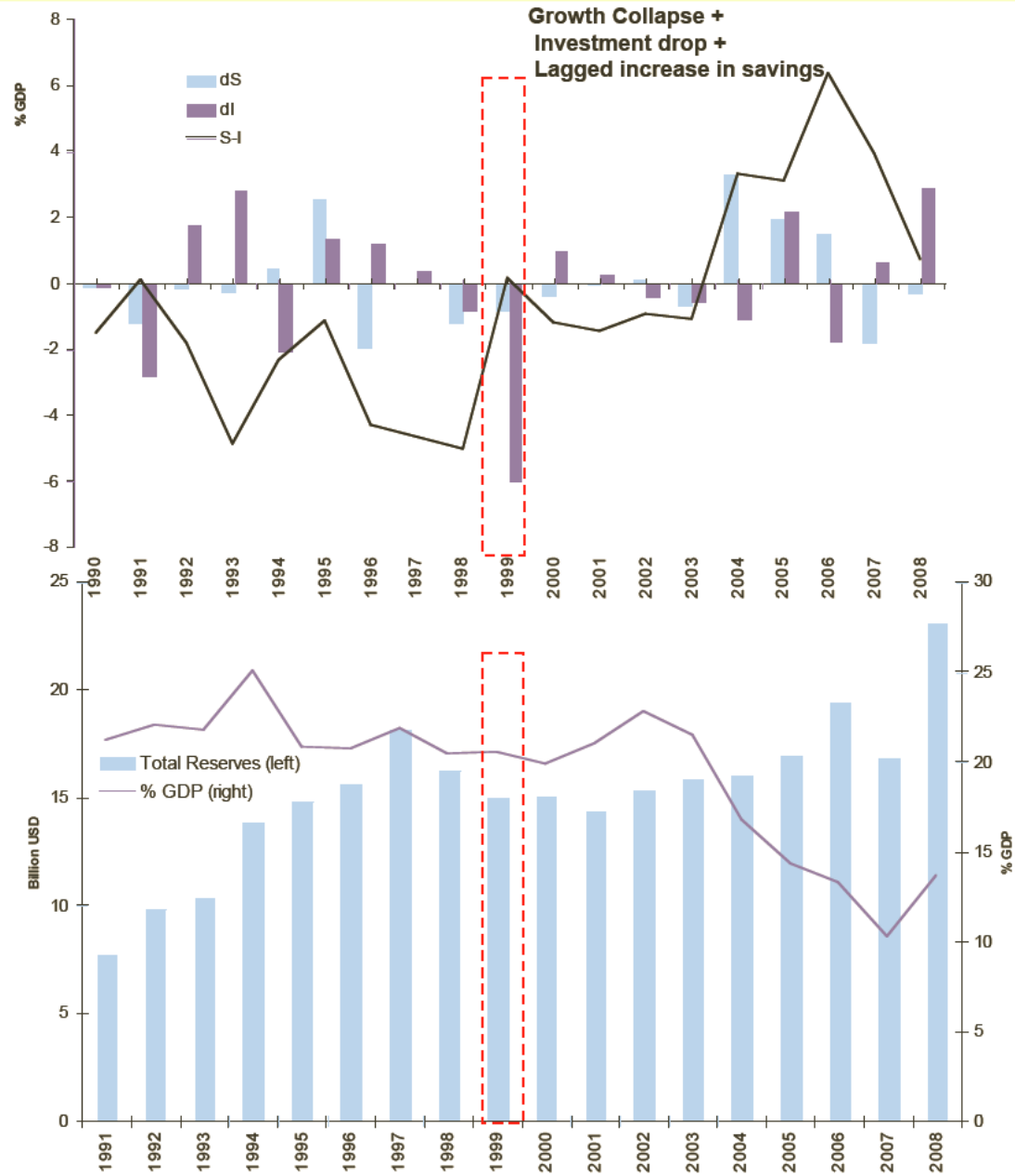
Argentina



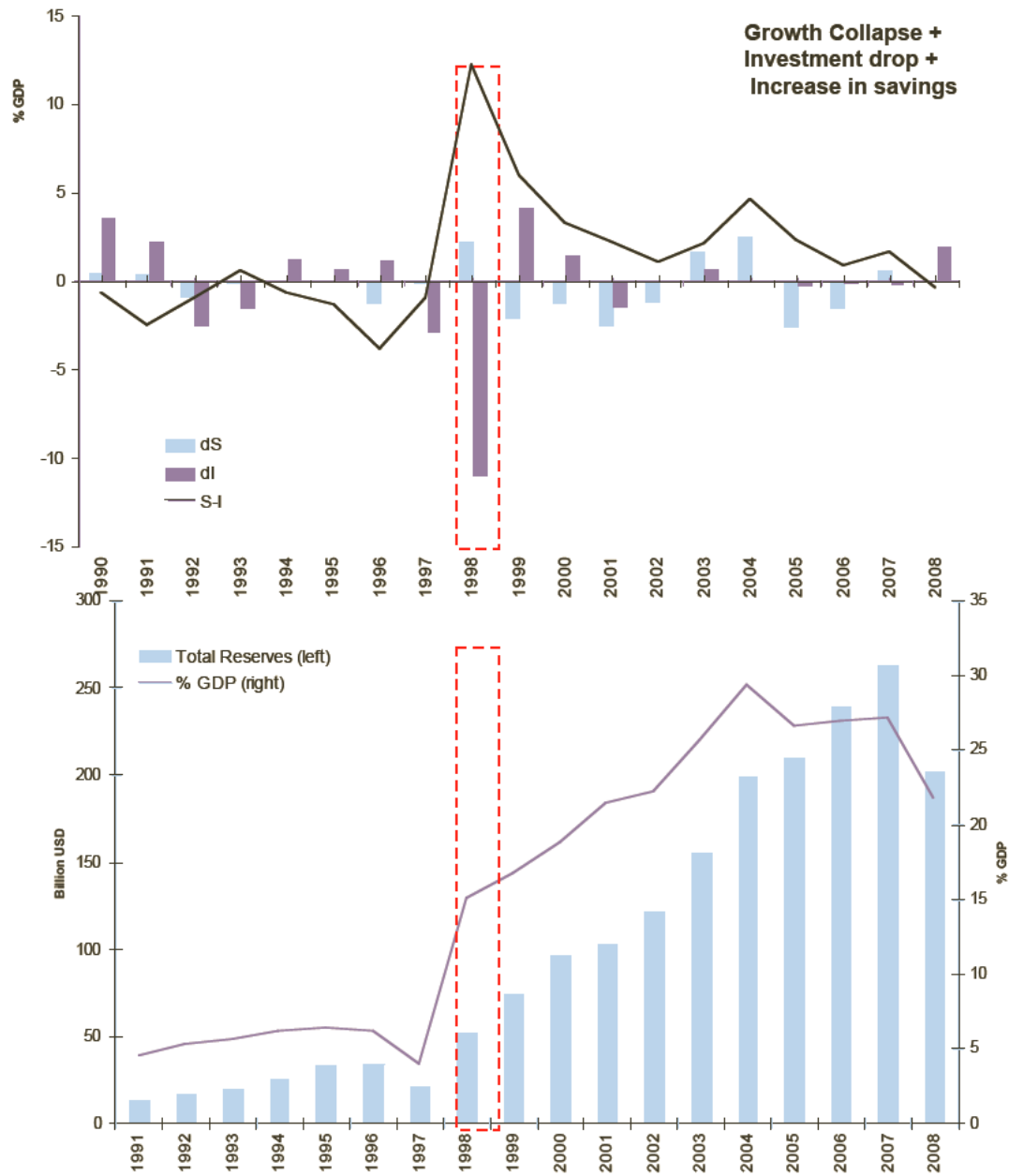
Brazil



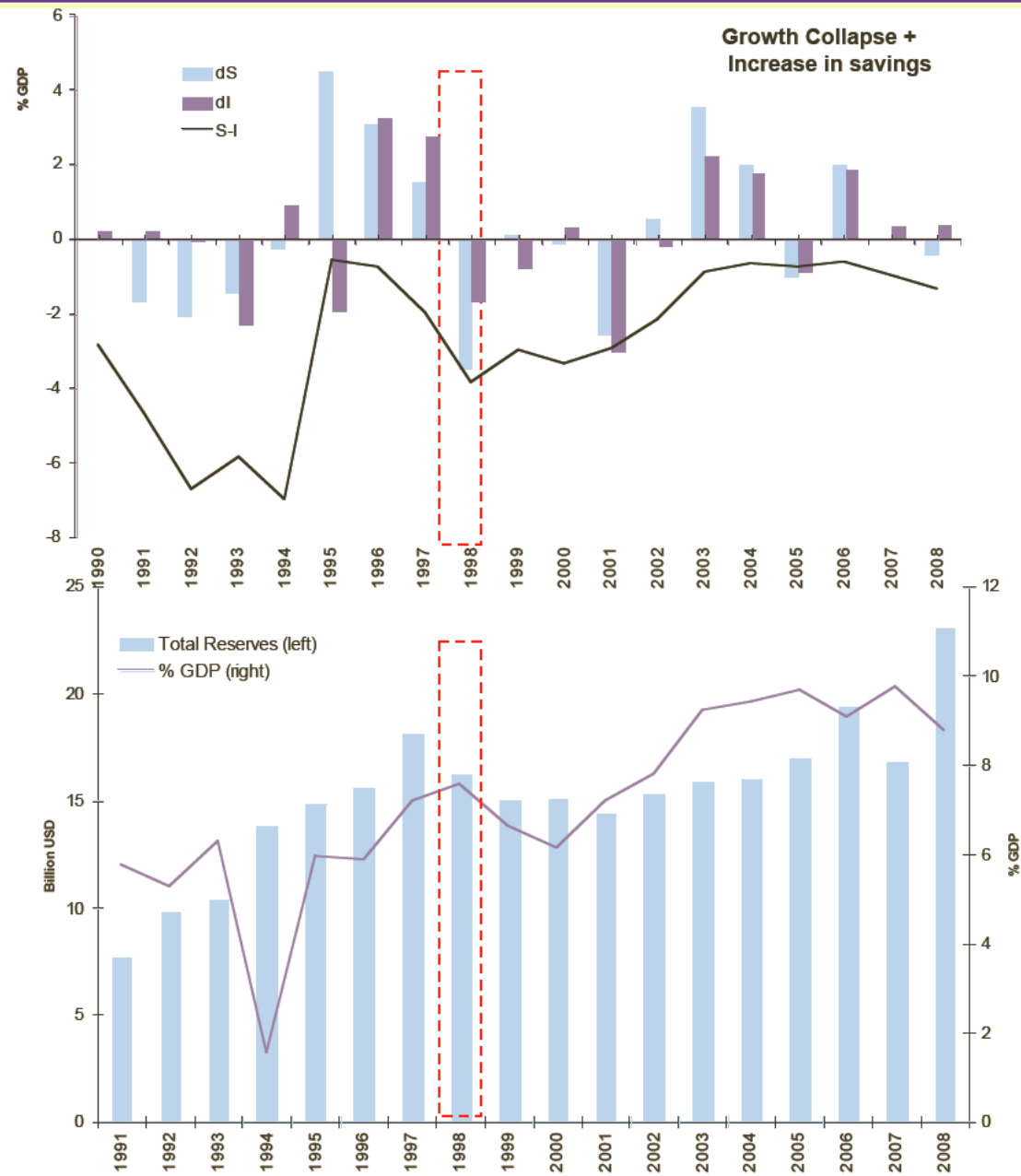
Chile



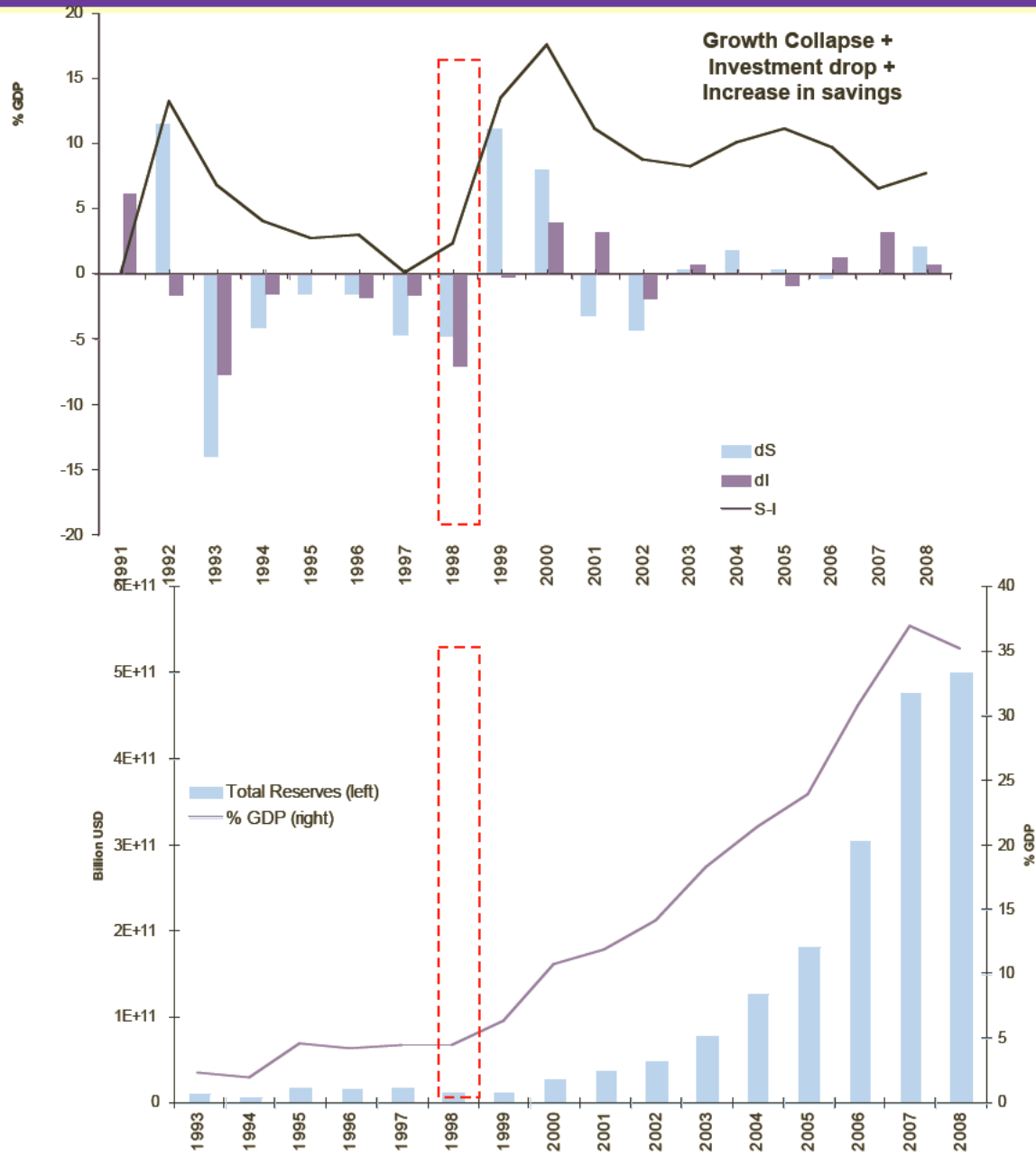
Korea



Mexico



Russia



Global failures and the reform of the IFA

✓ ***Self-insurance might hinder global recovery. The continuous generation of trade surpluses contributes to the preservation of the existing global imbalances:***

Δ Trade Surplus \rightarrow - Δ Imports

✓ ***Self-insurance is a sub-optimal response from the national economy point of view: valuable savings are diverted from productive investment:***

- Δ investment \rightarrow - Δ Imports

✓ ***Excess volatility and crises create incentives for self-insurance; hence, mechanisms to smooth the cycle and reduce vulnerability should be placed at center stage***

✓ ***The role of the IFA is to prevent the occurrence of global coordination failures associated with liquidity provision, pro-cyclical capital flows, and flawed regulations***

✓ ***The reform should be conceived as an institution-building exercise to be undertaken at the national, regional, and multilateral levels***

✓ ***Regional agreements can be instrumental at facilitating the reform of the IFA.***

The role of Regional Agreements in the mitigation of global imbalances

- ✓ ***Regional Agreements can play a significant role in sustaining and promoting international trade in a world in which trade is not dynamic and beggar-thy-neighbor policies are a threat***
- ✓ ***Regional Agreements can provide the framework for coordination and institution building, in particular with regard to:***
 - ***The design of mechanisms to manage international liquidity, reducing the costs of and incentives for self-insurance***
 - ***The cooperation concerning the design and implementation of standards and codes***
 - ***The reduction of macro volatility via the coordination of macroeconomic policies***

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***A stability-friendly IFA and the
possible contribution of Regional
Agreements:***

An Exercise in Institution Building

- **G20**
- **International Financial Institutions**
- **FSB (Standards & Codes, New Mandates)**
- **Criminality, Tax Havens, Off Shore Centers**

IFA

**REGIONAL
AGREEMENTS**

- FINANCIAL
INFRASTRUCTURE**
- **Legal and Judicial Infrastructure**
 - **Regulatory Framework**
 - **Policies and Practices Affecting Financial Sector**
 - **Corporate Governance**

DFA

- MACROECONOMIC
REGIME**
- **Exchange Rate Regime**
 - **Capital Account Regime**
 - **Monetary Regime**
 - **Capacity to Manage National risk**

Building the rules of the game after the crisis: the regional dimension

- ✓ ***Institution building is difficult in LA economies and recommendations about standards and codes produced by the FSB or policies pushed by IFIs will not be enough***
- ✓ ***The regional level can act as an intermediate step to articulate national and multilateral efforts: Three LA countries are members of the G20, two of them also belong to MERCOSUR***
- ✓ ***Regional arrangements can supply key regional public goods. Lack of success in providing these public goods will result in suboptimal, probably unstable, unilateral solutions***
- ✓ ***A blueprint and appropriate context-dependent strategies for institution building and enforcement are needed and regional arrangements can contribute to “internalizing” FSB and G20 recommendations, building a sense of policy ownership***

Building the rules of the game after the crisis: the regional dimension

- ✓ ***Regional Agreements can provide the framework for institution building concerning three pillars: Liquidity assistance + Monitoring and surveillance + Exchange rate coordination.***

- ✓ ***The emphasis should be on:***
 - ***The design of mechanisms to manage international liquidity, reducing the costs of and incentives for self-insurance; example: the Chiang Mai Initiative, the FLAR***
 - ***The reduction of macro volatility via the coordination of macroeconomic policies***

- ✓ ***Regional partners should cooperate concerning:***
 - ***The implementation of instruments that encourage more stable private flows (counter-cyclical guarantees); explicit introduction of counter-cyclical criteria in the design of prudential regulatory and supervisory frameworks;***
 - ***Market-mechanisms that can better distribute the risk throughout the business cycle in the member countries (GDP-indexed and local currency bonds?)***

- ✓ ***An evolutionary approach to institution building can help (Swap Arrangements, Bonds Markets)***

Building the rules of the game after the crisis: the regional dimension

✓ Regional Agreements can play a significant role in sustaining and promoting international trade in a world in which:

- Trade is not dynamic and beggar-thy-neighbor policies are a threat***
- Unilateral initiatives, such as aggressive exchange rate policies can harm intra-regional trade in existing regional agreements***

✓ Political legitimacy matters for institution building: The goal of mobilizing resources for development must be part and parcel of the strategies to strengthen the banking sector and capital markets. Example: strengthening regional development banks

✓ Institutional mechanisms should be designed at the regional level to mobilize the resources of countries that are generating a structural surplus. Example: initiatives to increase regional financial integration

Thank you!

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