The Dollar Bloc, Exchange Rate Regime Options and the New Regional Financial Architecture

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(This presentation is personal and not necessarily reflects an institutional stance)

New realities, new theoretical challenges

- Historical experiences in exchange rate stabilization should be reconsidered due to fundamental changes in the global market structure.
- The change from the emphasis in the trade balance and the PPP approach to the more capital account oriented studies is not enough.
- The elasticity approach to external adjustments becomes more and more inadequate. Current accounts consist not only of trade balance in goods and services, but of income accounts based on outstanding stocks of cross-border assets.
- Trade balances structurally conditioned by productive matrix. Limits in the Balassa-Samuelson approach of productivity differential growth
- External transactions now are much more complicated and diversified than before due to increasingly sophisticated international vertical division of labor and more pervasive intra-firm and administrated trade.
- Globalized production networks respond to much more than the mere management of the traditional policy instruments like the exchange rate and the interest rate

The international organization of credit...

- With Bretton Woods, came the consolidation of the dollar’s hegemony, with the consequential submission of powers of those countries in its orbit (foreign exchange markets, reserve currency, international trade and finance currency, commodity markets price, etc)
- US became the world creditor since then (Keynes, Triffin’Dilemma).
- End of dollar-gold standard in 1973: US increasingly becomes world debtor. Anyway: US is the big banker
- US “exorbitant privileges” remain: international seigniorage, efficiency benefits, financing massive current account deficits, better returns in foreign investment, etc…
- This financial system, in the framework of the international division of production of the postwar era, has shaped relationships of dependency in countries of the south.

...and the "dollar bloc"

- The changes enacted since the 70's, with the transnational financiarization, and above all after the external debt crises, have only exacerbated this dependency.
- LAC maintains –since long before Bretton Woods- an scheme of dependency in its commercial relations with the North, specially with the U.S. Despite diversification, commodities remain the major export for most LAC countries
- LAC countries have grown mutually confronting each other and looking up at the North (same type of products, same markets), instead of looking for neighbors' complementation.
- This has facilitated a "penetration" of the dollar's logic in LAC economies, weakening our macroeconomic sovereignty and sustainability.

“Dollar bloc”, external debt crisis and the erosion of monetary sovereignity

- In the common desperation of LAC (and many other developing nations) to obtain a net balance in dollars to pay the debt, the faculties of monetary and fiscal policy were eroded, condemning the region to a new process of permanent devaluation.
- Desperation for divises surplus resulted in a contradictory process (pass-through effects, race to the bottom, balance sheet effects, etc)
- Structural reforms introduced, as a by product, the erosion of national currencies and the increasing vulnerability in the external sector.
- Mundell’s trilemma became increasingly binding in macroeconomic policy
- Dollarization as an extreme example

International cycles and LAC growth sustainability

- LA must take advantage of a very special international juncture to build a robust institutionality that sets the foundations for a long term project. Crucial provision of regional public goods
- There were also favorable conditions during the 70's (NOEI, OPEC, UNCTAD) that were quickly torn apart due to the changes in the economic policies of the US
- Now, there are significant danger for a bad turn in the current favorable conditions for LAC (raw material speculation, financial uncertainty, etc)
- Structural responses to the erosion of the US's hegemony, the reduction of the capacity of seignorage of the dollar, the relative autonomy of interest rates, the wane in power of the IMF and WB, etc.
- Unknown intensity of the current international crisis
- Not true the orthodox proposition: "As long as capital is invested in most productive opportunities anywhere, national saving can be said to be effectively used and to enhance national as well as global welfare".

The need for a Regional New Financial Architecture

- Democratic and transparent governance and proportional and equitable responsibility
- Simultaneous construction of a new process of integration, moving towards three basic components: a development bank, a regional central bank, and a common monetary system
- Efficient and technical operability oriented towards another kind of development and new relationships between states, firms and popular economies

Three basic pilars in the Regional New Financial Architecture

a) Create the Bank of the South, as an alternative development bank

b) Strengthen the functions of the regional central bank (probably through a strengthening of the Fondo Latinoamericano de Reservas FLAR)

c) Give coherence to these two processes –within an inherent logic, with the impulse of a common monetary system linked to the strengthening of interregional commercial ties with a vision of creating a regional currency

Political and economic advantages

- Opens the doors for countries with diverse political, financial and economical realities, to fit into this new impulse towards a process of integration whose key reference point is the UNASUR, but being able to transcend it
- One must not move in sequential terms: this must be a simultaneous effort, in which the maturity of one component with demand of others.
- The growing synergies would create new cohesion in the most intense of cohesive processes.
- Unlike the European pattern, LAC trade integration urgently requires a new type of incentives

Capital, leverage and monetary stability

- For instance, in the capital structure of the Banco del Sur there must be space for both national currencies and the regional currency.
- These currencies must also be included in the placement operations and as such must maintain cross demands in other member countries
- To make it sustainable, it is necessary to strengthen functions of the regional central banking network and to improve the macroeconomic convergence, that guarantee that the regional currency works and that the national currencies can relate to each other in other terms

Commercial, financial and monetary Integration

- It is not possible to separate the dynamics of commercial and financial flows of the productive system, from the functioning of the economy
- For the horizon of a common currency-or of a regional account unity- to be sustainable, there must be a system that allows deepening of these ties.
- It is not about strengthening commercial relationships where they are not convenient; we have to make changes in the productive structures so that they are complementary amongst themselves.

NFA and productive transformation

- It is very difficult to move ahead with a new international financial architecture if one does not work simultaneously on a new domestic financial architecture and a new productive system in our respective countries.
- The economy is not flat: the productive system is hierarchical, and if strategic sectors of the economy are going to benefit, a new powerful system of powerful interests committed to integration can be built.
- Today the commercial dependency with the North is sky high, and with the change of the productive system, great returns will be generated.

Thanks