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Multilateral development banks regional integration

The G20 agenda

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International financial relations are characterized by asymmetries which have a structural nature and cannot be overcome by deepening liberalizing strategies. These asymmetries are originated by the international currency hierarchy, defined by the very different degrees of use of national currencies at the international level. For peripheral countries, these asymmetries imply recurring difficulties in accessing hard currencies, engendering Balance of Payments crises; at the same time, they also create problems for the long-term financing. The two problems are analytically different, but in our view they are deeply related.

Despite the structural nature of these problems and the difficulty of overcoming them with specific measures or instruments, our argument is that regional financial cooperation initiatives can play a fundamental role in confronting their effects. It can be done: i) in terms of short-term financing (reserve sharing and trade facilitation), ii) in terms of long-term financing (development banks and regional bond markets), or even in iii) macroeconomic coordination efforts. In the Latin American experience, there are practically no effective examples of macro coordination, but in the first two dimensions there are a series of initiatives and institutions, with successes and challenges to be taken into account.

This note advocates that they should act in a holistic and targeted manner to face structural difficulties, instead of being just guided by market failures or transitory missions.

Multilateral development banks (MDBs) are, in our opinion, the ideal candidates to fulfill these tasks, given their size, history, knowledge of the region and financial resources. In line with the priorities of Brazil G20 presidency, we see the reform of MDBs - inspired by the motto "bigger, better and more efficient" - as a great opportunity in the intended direction. Going beyond the almost consensual increase in the capitalization of these institutions, we defend five lines of concrete action in the face of the expanded financial needs that mark the current context: i) the granting of loans in local currencies; ii) granting concessional loans also to middle-income countries; iii) permanent action in the provision of short-term liquidity in reserve currency for countries experiencing Balance of Payments difficulties; iv) support for the creation and development of regional financial cooperation initiatives such as local currency payment systems, reserve sharing funds and regional bond markets; and v) deepening the dialogue between MDBs and Credit Rating Agencies (CRAs).

INTRODUCTION

In the context of increasing geopolitical tensions and discussions about a possible “de-globalisation”, the pertinence of regional economic cooperation gains momentum. This may be particularly important for peripheral countries because of their structural problems and the consequent hindrances to socioeconomic development. In the monetary-financial sphere, these hindrances are strongly related to the asymmetries of the International Monetary and Financial System (IMFS), which engender deep problems for countries which occupy a subordinate position . Among others, those related to financing are especially important for the concerned economies. On the one hand, countries issuing peripheral currencies have an economic performance conditioned by their capacity to access (or not) the key currencies of the world economy. On the other hand, these countries typically have a poor structure for long-term financing, even in terms of the national currency.

The difficulties are notorious in Latin America, a region with recurrent balance of payment (BoP) crises, high interest rates, highly volatile exchange rates, and a lack of investment funding. Hence, despite specificities — which may deepen or alleviate the obstacles — it is essential to recognise these are common regional problems. In light of that, national policies are welcome, but it is also important to highlight the need for regional cooperation.

In this note, we propose a methodology that organises the regional initiatives related to financial cooperation in three different axes: (i) short-term financing (aiming at alleviating possible problems in BoP), (ii) long-term financing (development financing), and (iii) macroeconomic coordination. This heuristic approach brings light to the different possibilities of cooperation. Still, the analytical division may not overshadow the perception that the hindrances they aim to face are entirely intertwined: they are all inherent consequences of the asymmetries of the IMFS. Hence, despite the pertinence of this analytical division, we will treat these three dimensions in an integrated manner and suggest that political strategies for regional integration should also use this holistic approach.

Despite episodic proposals for a regional currency in Latin America, the region has never developed the third axe (macroeconomic coordination). Yet, interesting initiatives with diverse degrees of success exist for the two other axes. A particular attention here is paid to the multilateral development banks (MDBs) operating in Latin America, within a perspective which perceives these institutions as engines for broader financial cooperation, potentially encompassing the three axes defined above.

The hypothesis is that MDBs play a significant role in the region – notably for financing infrastructure – but that they should be strengthened and modernised to cope with the current urgencies and the crucial necessity to articulate economic, social and environmental agendas. Brazil's G20 presidency is a good window of opportunity for such reforms.

1. MONETARY AND FINANCIAL VULNERABILITY OF PERIPHERAL ECONOMIES

This paper uses a specific conceptual framework aimed at understanding the monetary and financial aspects which may hinder the development process in peripheral countries. The basic idea is that peripheral countries are structurally vulnerable due to the asymmetries that define the contemporaneous International Monetary and Financial System (IMFS).

1.1. CURRENCY HIERARCHY, A BROAD THEORETICAL APPROACH

With its origins dating back to the late 1940s, the Latin American structuralist tradition can be defined, first and foremost, by the idea of unequal development of national economies. Rejecting the notion of development as a gradual and cumulative process, the seminal works of Raul Prebisch and his followers at ECLAC explained the world as a "centre-periphery" economic system, with a derived international division of labour, a trend to Balance of Payments (BoP) crisis and the underdevelopment as a self-reinforcing situation. Through the following decades, among many theoretical improvements, the emphasis was still on the productive roots of these asymmetries: the technical progress was unevenly distributed worldwide. However, in the last quarter of the 20th century, this perspective was no longer enough to explain international economic relations. Some novelties of this era - especially regarding monetary and financial aspects - should be explicitly considered in the theoretical framework.

Coherently, the departing point of a renewed interpretation of international aspects of development in this tradition starts with definitions of the new period. "Financial globalisation" emerges firstly as a period of higher mobility of capital (in contrast with the regulated Bretton Woods era); the (dirty) floating exchange regime as the predominant choice; and the US Dollar still as the top currency of the international monetary system. Yet, the contemporary US dollar is quite different from the one which characterized the Bretton Woods System: it is a floating, financial and fiduciary currency, with its strength reinforced by the sophistication, liquidity and depth of US financial markets (Prates, 2002). ll these ingredients together result in four major characteristics of the contemporary International Monetary and Financial System (IMFS): i) a higher potential of conflicts between domestic and international goals of macroeconomic policy; ii) “short-termism” and speculation as the norm (not the exception) of all economic agents; iii) cycles of asset inflation and deflation, leading to important wealth effects with macroeconomic implications; and finally iv) crises understood as intrinsic or endogenous components of the “finance-led capitalism” (i.e. no need to ad hoc or exogenous shocks to provoke the crises). Those conclusions are not exclusive to this interpretation and have close connections with many other strands of the literature. Still, its distinguishing mark is focusing on the consequences of these features for peripheral economies, using a typical structuralist concept: the asymmetries.

Prates (2002), following Ocampo (2001), defined these dimensions of centre-periphery relations as marked by three big asymmetries: monetary, financial, and macroeconomic. Each has its definition and implications, and they are interconnected, but the monetary one is the more important. But what exactly do those concepts mean?

“Monetary asymmetry” is taken here as the definition of a structural aspect of international economic relations. It comes from the fact that there is nothing such as a global currency and, as a consequence, that external transactions require the international use of the national currencies. This use is - and has always been -very unevenly distributed among the different players. Whether as a means of payment, a unit of account, or especially a store of value, each epoch has its own “pyramid” of national monies. Contemporarily, the US dollar is at the top of this hierarchy, followed by a few other "hard currencies" like the Euro, Yen and Sterling pound. The Chinese renminbi is becoming part of this group. Peripheral or inferior currencies, at different degrees, play a minor role in this system because they are not representatives of general wealth at the international level (De Conti, 2011; De Conti et al., 2014). This position is the basis for the comprehension of the structural vulnerability of peripheral economies.

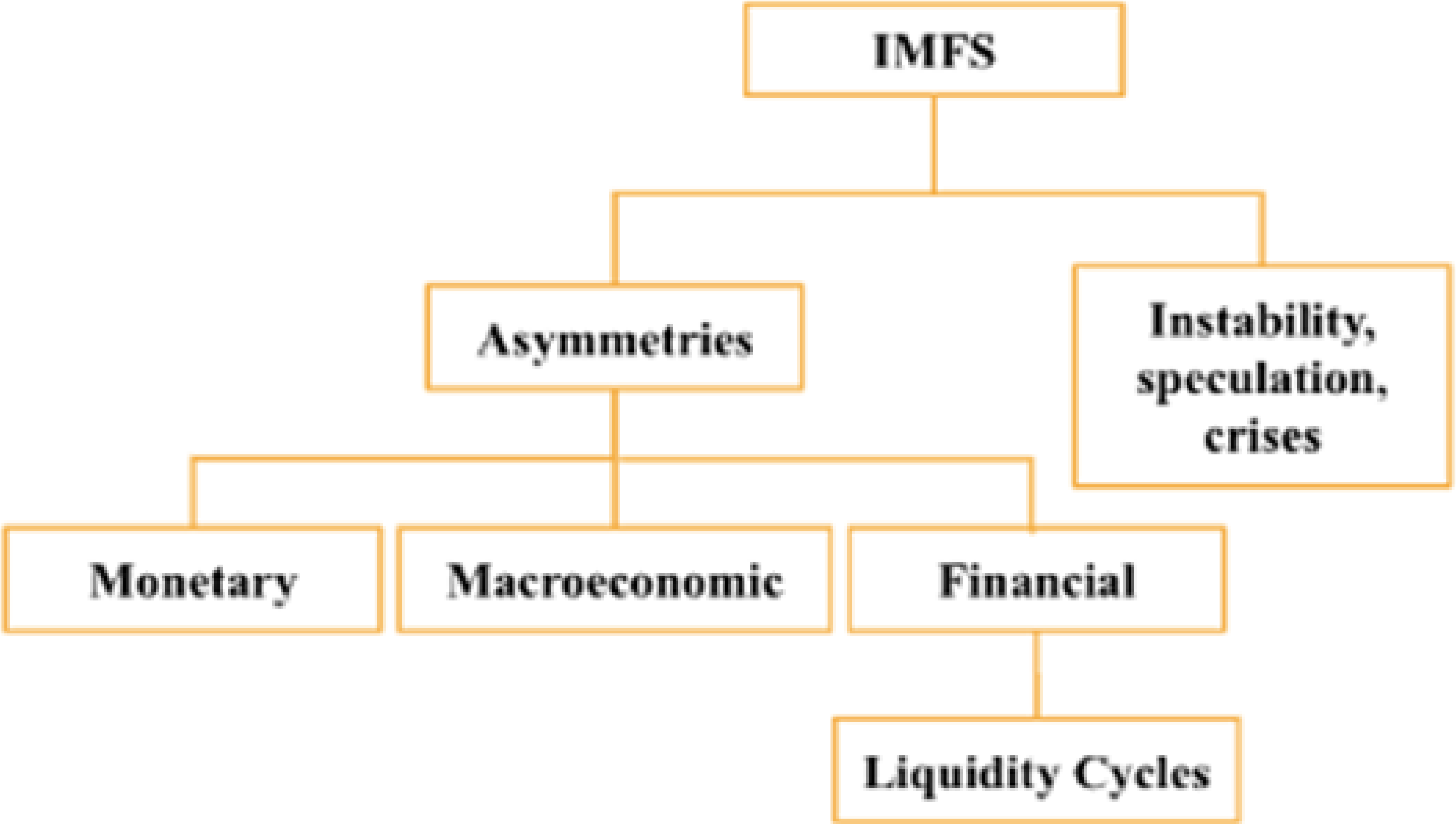
One side of this vulnerability is related to the lower level of policy autonomy - the macroeconomic asymmetry. For the issuers of low-quality currencies, not only is the domestic interest rate subject to external constraints even without a fixed exchange rate regime, but the behavior of the exchange rate itself is also strictly influenced by capital flows and expectations from international financial markets. The other side is the financial asymmetry. The basic idea is that financial globalisation is an integration of unequal partners, with "emerging markets" constituting a marginal share of global portfolios (Prates, 2002). As such, they are the first candidates to distress selling in moments of risk aversion or losses in other markets.

Another way to describe this structural position is to face international capital flows to peripheral economies mainly driven by external (or "push") factors, typically the interest rates in hard currencies and risk aversion in global financial markets. Assets denominated in inferior currencies are not a good store of value; holding them is usually a transitory situation for global investors. As such, capital flows to these countries have a more speculative nature, always subject to “sudden stops” or, in a more appropriate description, sudden reversals in the risk/return assessments by international money managers.

These recurrent episodes of “flight to quality” are part of a broader movement best described as “international liquidity cycles” (the last important concept to emphasise here). As described in Biancareli (2009), the search for yield in assets denominated in “weaker” currencies is always a reduction in risk aversion from global investors or a decrease in their liquidity preference. The “high tide” phase is described as an optimistic period when the expectations about future earnings support the growing financial operations in risky “regions”, increasing financial fragility. When some event shifts the general state of expectations, the “low tide” can start.

To sum up, our theoretical foundation for analysing regional financial cooperation in Latin America is a structuralist comprehension of international economic relations. Specifically, this approach sees the roots of centre-periphery structure not only in the technical progress but also in the quality of national currencies. Figure 1 organises the key concepts, whose implications for the particular topics of the paper are developed in the next section.

Figure 1: The "currency hierarchy approach": a summary



Source: Authors' elaboration, based on the literature.

1.2. CHALLENGES ACCESSING HARD CURRENCY AND POOR STRUCTURE FOR LONG-TERM FINANCING

Structurally submitted to the vulnerabilities and hindrances discussed above, the integration of Latin American countries into the world economy entails the permanent task of obtaining hard currencies in international markets. This access occurs mainly through exports (of goods and services) and through investments of non-residents (which include Foreign Direct Investments, portfolio investments and other modalities of loans) (4). Regarding exports, the region specialises in agricultural and mineral commodities, so in addition to the unavoidable changes in the exported volumes, the situation is very uncertain because of the high volatility of commodity prices. As for non-residents' investments in the region, they are profoundly dependent on the general state of confidence at the international level – i.e., the global liquidity preference (Biancareli, 2009; Mello, De Conti and Rossi, 2019).

It means, therefore, that access to hard currency in Latin America is precarious and dependent on two cycles: on the one hand, the well-known commodity price cycles, which have a significant impact on the results of the trade account; on the other, the already discussed international liquidity cycles, which determine the results of the financial account. Moreover, it is crucial to understand that these two cycles tend to be strongly correlated. In moments of stress in the world economy, the lack of hard currency comes from both dimensions (the productive one and the financial one).

A detailed historical discussion goes beyond the scope of this article, but an overview of the recurrent balance of payment crises in Latin America is already eloquent. In some contexts, this lack of hard currency hits specific countries, either because of domestic reasons or because they are more vulnerable to the shifts in the international cycles. Venezuela and Argentina are currently facing severe social and economic problems related to a lack of US dollars. In some other contexts, this shortage of hard currency hits the whole region. The consequences tend to be very serious. First, the economies are generally very dependent on imports, and the lack of hard currency sometimes means a scarcity of basic goods, such as food and medicines.

(4) In some countries – e.g. in Central America –, remittances from emigrants are also an important – or even the most important – source of hard currency.

Second, the scenario normally evolves into an exchange rate crisis. If it happens, various economic problems arise, including strong inflation pressure and – very importantly – troubles in the payment of external debt, given the currency mismatch and the depreciation of the national currency (details below).

In recent history, the paradigmatic case was in the 1980s, when the hardest external debt crisis led to the so-called "lost decade" in the whole region. The crisis was triggered by the "strong dollar policy" implemented by Paul Volcker in 1979, which culminated in a sudden shift in the international liquidity cycle with a hike in the interest rates in the USA and a shortage of US dollars for most peripheral countries. Consequently, many Latin American countries defaulted on their external debts, having to get loans from the International Monetary Fund (IMF). The economic policy was then completely reoriented in favour of exports and the payment of the debt services. In some countries, the public sector took on an important part of the private sector's debts, creating harsh fiscal problems (Cruz, 1982). As a result, the decade was characterised by very high inflation rates, unstable economic growth and, in a broader sense, the collapse of the "developmentalist" model (Vernengo, 2019).

In the 1990s, there were other episodes of "sudden stops" of private capital flows for Latin American countries, engendering sharp exchange rate devaluations in 1994-5 in Mexico, 1999 in Brazil and 2001-2 in Argentina. In the aftermath of these crises – and with the reversal in the international liquidity cycle, making private capital available again for the system's periphery – many countries adopted a strategy of accumulating enormous amounts of international reserves. These efforts have costs, but the idea is precisely piling up a stock of hard currency, which may serve as a buffer to face the recurrent reversals in international liquidity cycles. This strategy, however, is not available for all countries because it is conditioned by the monetary authorities' access to hard currency during the ascendant phases of the cycles.

In addition to this self-protective strategy, countries may search for access to the "Global Financial Safety Net" (Fernández-Arias and Levy-Yeyati, 2010). This net comprises institutions and arrangements that provide short-term liquidity in moments of stress, namely the IMF, bilateral currency swaps agreements between Central Banks, and regional financial arrangements (Zucker-Marques et al., 2023).

The IMF is normally seen as a lender of last resort because of the conditionalities it imposes on the borrowing countries, but also because of the stigma of these operations. Bilateral currency swap lines became very common after the outbreak of the Global Financial Crisis (2007-8) – mainly those with the Federal Reserve and the People's Bank of China. Still, they follow the IMFS hierarchies, meaning they are mostly available for the Global North. In fact, Zucker-Marques et al. (2023) show that most Latin American countries have no access to currency swap lines (5). Against this background, regional financial arrangements may constitute important mechanisms for liquidity provision, as discussed in Section 2.

All in all, international reserves and access to this "Global Financial Safety Net" offer great relief in moments of stress, providing liquidity in hard currency for these peripheral economies. Therefore, they are part of a strategy enabling these countries to deal with some of the short-run constraints deriving from the currency hierarchy, discussed in section 1.1. Nonetheless, they do not mean any kind of redemption from the problems emanating from the asymmetries of the International Monetary and Financial System (IMFS) – not even in the short run, let alone in the long run.

A crucial problem that persists in these countries, even in situations in which they manage to have more access to hard currency, comes from the financing mechanisms in national currencies. In most peripheral countries, financial institutions have enough incentives to provide short-term loans, normally benefiting from very high interest rates (details below). Nonetheless, these loans' availability and cost may be important problems. Empirical studies (e.g. Rosa, 2019) demonstrate that the provision of short-term domestic credit, even in local currency, oscillates in line with the different phases of the international liquidity cycles. This is so because of the strong impacts of these cycles on the overall economic dynamism of these countries and the effects on many variables that are crucial for determining the level of credit in the economy. As a consequence (and counterintuitively), even for short-run domestic credit in local currency, the availability and the cost suffer direct impacts of alternating phases in the international liquidity cycles.

(5) Argentina was one of the few exceptions in the region with access to currency swap lines with China, but this line was suspended by Beijing after Javier Milei took office declaring that he would not make business with communist countries.

When it comes to the provision of long-term loans, the problem is even more serious. History shows that in the light of the mistrust of the ability of peripheral currencies to store value over time and of the macroeconomic asymmetry which characterises these countries – discussed above – both international and domestic investors are strongly discouraged from allocating their resources to long-term assets in these currencies. The main reason is precisely the high volatility of the interest and exchange rates, which may provoke relevant losses for these asset holders. We can, therefore, state that in peripheral countries the problems associated with short-run credit and the strong hindrances to the constitution of long-term credit mechanisms are actually the two sides of a coin. More concretely, they are the two dimensions of the crucial problems we observe in the financing structure of Latin American countries, given the peripheral position of their currencies at the IMFS.

To cope with these problems, many countries in the region created mechanisms to provide public credit. For short-run loans, the important benefit is that they are less sensitive to the oscillations of the international liquidity cycles – and in some situations, they can even be used for anti-cyclical policies (e.g. in the aftermath of the outbreak of the global financial crisis). For long-run credit, some institutions were created to allocate long-term financial assets as funding for long-term investments. The main important national institution in the region is the Brazilian Development Bank (BNDES). Created in 1952, most of its funds come compulsorily from a share of the Workers' Support Fund (FAT in the acronym in Portuguese), allowing long-term loans with relatively low interest rates. Regionally, the Development Bank of Latin America and the Caribbean (CAF) is an important initiative, which will be discussed in section 2.2.

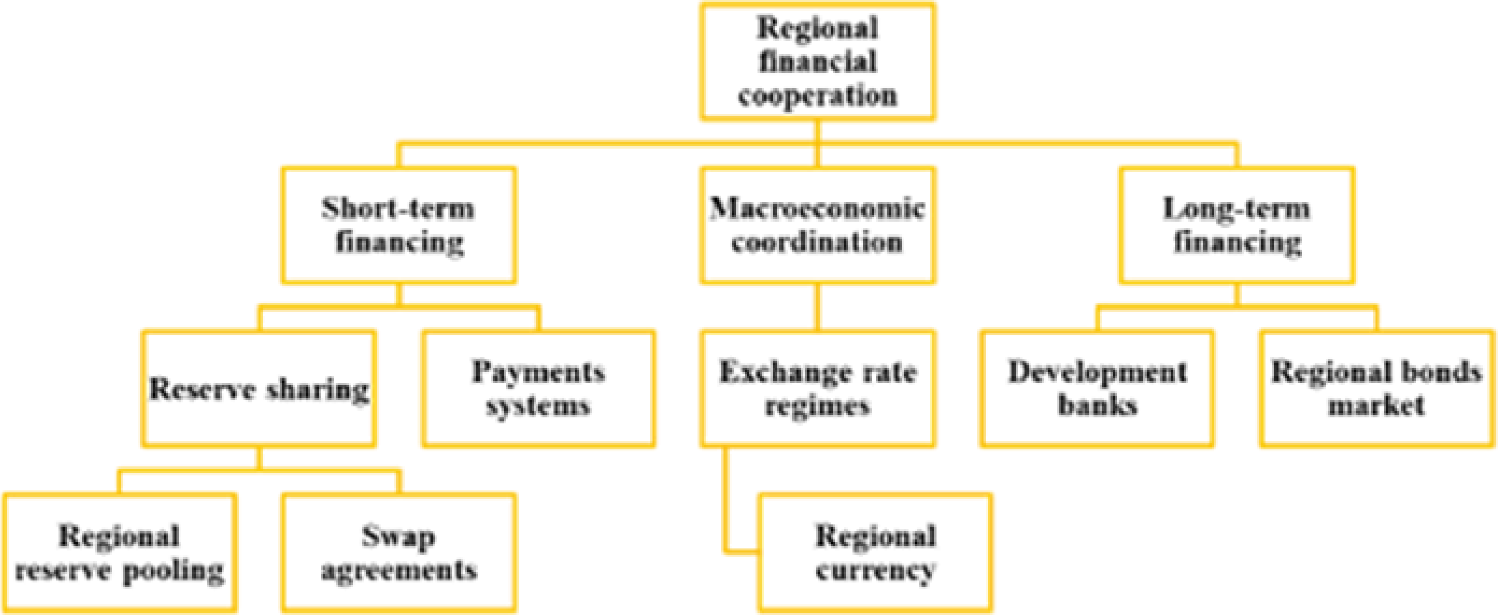
This scarcity of mechanisms for long-term financing in Latin America and the structural problem of access to hard currency entails another recurrent problem for the region's economies. Given the insufficiency of domestic long-term financing, companies and governments often took advantage of the ascendant phases of the international liquidity cycles to get loans at the international markets (and in hard currencies). These loans may appear as a good business because interest rates are usually lower than the domestic ones, but also because in some moments of the recent period, many Latin American countries adopted managed exchange rate regimes (especially in the 1990s) and in other moments the national currency had an appreciation trend (e.g. from 2005 to 2008). Yet, regardless of the exchange rate regime, whenever there is a sudden stop, which leads to a stringent lack of hard currency, the outcome is the depreciation of the national currency. Companies with a "natural hedge" – such as oil exporters - can absorb these exchange variations. However, for most companies – as well as for the public sector, in the case of sovereign debts –it may constitute a severe problem, ensuing defaults and, in the case of some private companies, bankruptcy.

The paradoxical conclusion is, therefore, that the shortage of hard currency is a historical and structural problem in Latin America, but easy access to hard currency through loans or the reception of portfolio investments may also entail severe problems. After all, countries integrated into financial globalisation but in a peripheral position are permanently subject to the oscillations of the world economy – in particular, of the twin cycles, i.e., the commodity price cycles and the international liquidity cycles. To cope with these challenges, countries may implement national strategies, but there are clear benefits if they manage to develop regional cooperation, as we will discuss in section 2.

2. REGIONAL FINANCIAL COOPERATION: PURPOSES AND EXPERIENCES

The background argument of the present paper is that regional cooperation in financial issues can be a powerful tool not only to enhance regional trade but also to deal with all the hindrances and challenges faced by peripheral economies in contemporary IMFS. However, the efforts of cooperation in this field can vary widely. To organise precisely the range of possible regional financial cooperation mechanisms, Figure 2 shows the different initiatives according to their different purposes: (i) payment facilitation and short-term financing (BoP), (ii) long-term financing (financing for development), and (iii) macroeconomic coordination. Our subsequent discussion follows this typology to describe the experiences in Latin America, as well as their roles and potential. With an important caveat: there is no record of relevant initiatives in the third axe (macroeconomic cooperation) in the region.

Figure 2: Regional Financial Cooperation diagram



Source: Authors' elaboration, based on UNCTAD (2007).

2.1. SHORT-TERM FINANCING

As discussed in Section 1, the most explicit consequence of the inferior position of peripheral countries in the currency hierarchy is the recurrent problem of hard currency shortages, in the form of vulnerability to "sudden stops" and "flights to quality" and a direct linkage to international liquidity cycles. At the first level of the diagram, short-term financing refers to initiatives that seek to deal with these financing needs associated with BoP or short-term flows. They can be subdivided into two subcategories.

Regional payment systems are international mechanisms designed to facilitate and reduce foreign transaction costs between residents of countries subscribing to the agreement, intending to encourage trade between countries and to reduce the need for foreign currency in intra-regional trade. These systems allow, for example, a company (or a person) residing in Brazil to purchase a good or service from a company (or a person) in Argentina without incurring foreign exchange transaction costs. In the absence of agreements, the Brazilian company is obliged to pay the costs of purchasing foreign currency. In a regional payment system, by definition, the same company could settle the transaction in its own currency as if it were a domestic transaction, and it is up to the central banks, at the end of a period, to settle only the final net amount. Transitory liquidity is granted between central banks, allowing cancellations of mutual obligations between surpluses and deficits over a period so as not to settle immediately in hard currency. In addition to reducing firms' costs (and stimulating intra-regional trade), these mechanisms reduce foreign exchange needs (Fritz et al., 2014).

Concerning the historical experience of Latin America, there are a variety of initiatives implemented over the last decades in the field of regional payment systems (described below). Still, increasing difficulties have marked the last years.

• ***1966: Agreement on Reciprocal Payments and Credits (CCR-ALADI)***

Within the framework of the Latin American Free Trade Association (ALALC), in 1960 the Agreement on Reciprocal Payments and Credits was created. In 1982, after the Latin American Integration Association (ALADI) constitution, the CCR assumed its current nomenclature. Since its inception, the system has been integrated by Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Mexico, Paraguay, Peru, Uruguay, Venezuela, and the Dominican Republic. In summary, through the CCR, the central banks provide temporary liquidity and register debits and credits from commercial operations. The debits and credits of all countries are cleared multilaterally every four months to settle only the resulting net balances accumulated. The multilateral clearing of payments is centralised in the Banco de la Reserva del Peru, which receives the records, transmits the balances, and allows the reduction of currency transfers between the participating countries (IPEA, 2022).

The role of the CCR was enhanced in times of scarce international liquidity, especially during the 1980s (it represented 90.9% of intra-regional imports in 1989, for example). From the 1990s onwards, with the internationalisation of the financial system in South America, greater access to international liquidity and the end of the mandatory use of the agreement, the CCR use declined. In addition, countries tend to prefer to receive cash payments in hard currency rather than carrying other's debts for four or eight months. These are, in fact, bilateral loans, which are subject to an interest rate fixed by an average of the 4-month LIBOR plus a small spread so that the surplus countries could prefer the remuneration of reserves rather than obtaining this rate under another sovereign risk. In addition, in 2000, the Brazilian Central Bank determined the reduction of the assumption of other countries and banking risk, therefore limiting the operations carried out in the CCR for up to 360 days and determining the requirement of advance payment for imports over US$ 100 thousand originating outside Mercosur, Chile and Bolivia. As a result, Brazil started to use the agreement less. Then, the Argentine Central Bank adopted a similar practice. For these reasons, in 2003, operations through the agreement accounted for only 1.5% of intra-regional imports (Severo, 2011; Fritz et al, 2014; IPEA, 2022).

From 2003 onwards, during the Lula and Dilma Rousseff administrations in Brazil, two changes recovered the use of the CCR: the relaxation, by the Brazilian Central Bank, of the restrictions related to the value and term of operations under the CCR and the stimulus for exports of engineering services linked to financing from the BNDES-Exim program, which could use the CCR as a guarantee instrument. During the Bolsonaro government, in April 2019, a note from the Brazilian Central Bank unilaterally announced the paralysis of the Brazilian use of the CCR.

• ***2008: Mercosur Local Currency System (SML)***

The SML is an optional bilateral financial mechanism that allows participant countries to use their own currencies in commercial transactions with each other without the need to use foreign currencies and, like the CCR, stimulates intra-regional trade and reduces the need for foreign exchange. The main contrast with more complex mechanisms, such as the CCR, is that it does not require any type of credit risk or a central bank absorbing other country sovereign risks. For this reason, it is more accepted by the bureaucracies of central banks. The operation of this short-term financing mechanism between Argentina, Brazil, Paraguay, and Uruguay takes place through multiple agreements signed bilaterally between the central banks (Argentina and Brazil, signed in 2008; Brazil and Uruguay in 2014; Argentina and Uruguay in 2015; Paraguay and Uruguay in 2015; Brazil and Paraguay in 2016; Argentina and Paraguay in 2019) (IPEA, 2022).

Regarding the use of SML, its use is incipient. The share of Brazilian exports made with local currency in total bilateral trade was very volatile until 2013 and had little expansion in the case of imports. An imbalance prevailed in each country's use of the system, reflecting the different incentives granted to stimulate its adoption by companies. One of the main problems is that in the context of an asymmetric IMFS – as discussed in section 1.1 – export companies usually prefer receiving US dollars over the national currency (especially for Argentina, considering the long-lasting crises of the Argentine peso).

• ***2010: Single System of Regional Payments Compensation (SUCRE)***

In April 2009, the member countries of the Bolivarian Alliance for the Peoples of Our America (ALBA) discussed the idea of a virtual currency that would be used between central banks as a unit of account for intra-regional commercial transactions. The result was the so-called Single System of Regional Payments Compensation (SUCRE, for its Spanish acronym). The initiative seeks to reduce transaction costs in intra-regional trade by using national currencies and to shorten the need for foreign exchange by allowing for late settlement of commercial transactions – elements similar to CCR and SML.

A key feature of SUCRE's proposal is creating a regional unit of account to replace the dollar in settling regional transactions. Its use does not imply the physical issuance of Sucres and is restricted only to the settlement of intra-regional trade payments at the level of central banks. Sucre was conceived to be a common unit whose value derives from the basket of currencies of the member countries, weighted by the relative economic size of the national currencies and their countries. Sucre is also a voluntary payment system. If a country decides to use Sucre as a unit of account for a particular product in intra-regional trade, a central clearing house would assign an initial number of sucres. The clearinghouse would also be responsible for the clearing and periodic settlement of payments in sucres between central banks (Fritz et al., 2014).

Its implementation was quite limited, and at the beginning, between 2010 and 2011, for example, it was used for only a small number of food products. The increasing restrictions in the sub-region make it difficult to assess the mechanism adequately.

Mechanisms for sharing international reserves are designed to finance BoP deficits at a low financial cost without the need to resort to the IMF or to complement it, thus constituting a shared way of reducing the vulnerability of peripheral economies to possible external constraints.

In the category of regional reserve fund in Latin America, the following stand out:

1978: Latin American Reserve Fund (FLAR).

Initially only as the Andean Reserve Fund, it was created in 1978 as an agreement in response to the need of Bolivia, Colombia, Ecuador, Peru, and Venezuela to address the problems of imbalances in the external sector of their economies and facilitate the Andean integration process. In 1989, it was transformed into the Latin American Reserve Fund (FLAR), incorporating Costa Rica, Uruguay, Paraguay, and Chile in 2001, 2008, 2015, and 2022, respectively. Despite its high volume of reserves since 2005, Brazil has never joined the FLAR.

FLAR has evolved from a reserve pool structure to a regional financial intermediary structure. It has access to its own paid-up capital and international financial markets to increase its resources. In addition, FLAR receives deposits from central banks, official institutions, and multilateral entities in the region, both member and non-member countries (FLAR, 2022).

To date, it has granted more than 50 credits and, in some historical episodes, has granted more loans than the IMF to its member countries. In extreme cases, FLAR has facilitated some member countries' return to international markets. Finally, it is worth noting that, in its current dimensions, it is a very modest mechanism for countries such as Brazil and Argentina, which would not make much difference from the point of view of protecting them from BoP crises. The gains, for Brazil, for example, would therefore be much more political and strategic than economic-financial and would not harm the country's large reserves.

Currency swaps are arrangements in which central banks of the participating countries agree on the immediate provision of liquidity to partner countries for a certain period in exchange for the partner's local currency. According to Marques et al. (2023, p. 3), they are interesting tools for providing liquidity "due to their immediate availability, their absence of conditionality, and their often very large financing volume". An agreement signed between two peripheral countries may define liquidity provision in their local currencies or US dollars. Yet, given the hierarchies of the IMFS – discussed in section 1 – these agreements are naturally more useful when they provide access to central currencies. Not by chance, most of the currency swaps are bilateral agreements signed by the Fed, the European Central Bank, the Bank of England, the Bank of Japan, the Swiss National Bank and the Peoples' Bank of China (PBOC) with high- or middle-income countries. Latin American countries have signed currency swap agreements with the Fed (Brazil and Mexico) and the PBOC (Brazil, Argentina, Chile and Suriname). However, currency swaps between Latin American countries are still non-existent. Nonetheless, the foment to regional payments in domestic currencies may incite the creation of regional swap agreements in local currencies as an important part of the general framework for Latin America's financial integration.

In addition to the Central Bank swap lines, innovative instruments are under consideration. For example, an initiative of Brazil's Ministry of Finance with the Inter-American Development Bank to stimulate foreign investments related to the green transition in the country through a financial platform aiming at reducing the exchange rate risk of such investments. Among other tools, this platform will offer swap lines for the investors. (6)

2.2. LONG-TERM FINANCING

The most generalised and effective international cooperation experience for long-term financing is the case of multilateral development banks (MDBs). The essential characteristics of MDBs are: i) each institution has an independent legal status, governed by international agreements and not subject to national regulation; ii) public policy mandate; iii) owned by two or more countries, which provide capital and development funds; and are iv) financially self-sustaining and with the capacity of leveraging resources in international capital markets (Xu, Ren and Wu, 2019; Fleiss, 2021, Chiliatto and Prates, 2022).

The financial model of these banks allows these institutions to finance development projects at low financial costs, with long maturity periods (reaching more than 30 years), in addition to generating sufficient income to pay for their administrative activities, borrowings expenses, knowledge products, multiple forms of transfers, and also the accumulation of net income as additional equity so allowing MDBs to grow “organically”.

(6) Details available at: https://www.iadb.org/en/news/idb-brazils-ministry-finance-ministry-environment-and-climate-change-and-central-bank-join

The World Bank (as the first MDB) had the main goal of financing the reconstruction of the devastated Europe after World War II. Founded together with the Bretton Woods agreement in 1944, where the US dollar was established as the central currency, still pegged to a fixed and convertible rate to gold (7). As discussed below, the main argument was to create a Bank with a higher capital contribution from countries with “excess capital” to allow financing flows for those countries lacking access to “capital”.

It is crucial for the discussion of this paper that, understanding the structural challenges imposed by the currency hierarchy, countries with peripheral currencies fundamentally will have worsened conditions of accessing both short-term and long-term financing. Therefore, the need for continuously strengthening MDBs is not only justified by the old argument of war reconstruction or the current dominant argument of institutions that justify their existence to fill gaps of “market failures”, but they are relevant because they can contribute to overcoming a structural constraint imposed by the IMFS on peripheral countries in accessing long-term financing given the fact those countries are not issuers of hard currencies.

To understand the financial model of MDBs, in a simplified fashion, multilateral banks are established with capital contributions from member countries: paid-in capital contributions, which are resources disbursed by the countries; subscriptions of callable capital, unpaid, that function as guarantees subject to disbursement to meet financial obligations with third parties if needed - to date, no multilateral bank has ever made a call. With development mandates, MDBs do not distribute profits to shareholders but accumulate their net income as capital (returns from projects financed by the banks and interest payments from borrowers, which increase the total equity of MDBs but do not affect voting power).

With this capital, MDBs manage to issue debt in capital markets and leverage their capital resources. These are institutions with a robust proportion between equity and their portfolio of assets, abundant liquidity, and recognised conditions of preferred creditors, a product of the permanent support of the member countries. With solid governance, they are institutions well evaluated by rating agencies, allowing debt issuance at a relatively low financial cost and facilitating resource leveraging from (conservative) investors seeking AAA bonds.

(7) See Helleiner (1994).

With its equity and borrowings, MDBs build their portfolio of assets: development loans and liquid assets. Development loans are the most powerful tool of these banks, financing operations with sovereign guarantees (governments as clients) or without sovereign guarantees (usually private sector). They finance projects in different sectors: transportation, energy, housing, education, health, agriculture, science and technology, institutional development, etc. Operations, in general, are accompanied by technical support for project design and execution under internationally recognised environmental and social standards. Multilateral banks are not under the supervision of any central bank and, therefore, do not have access to a lender of last resort. As a consequence, investments in liquidity are part of safe planning of the execution of financial expenses, protecting themselves (with reserves relatively higher than those of commercial banks) from stress scenarios or difficulties in accessing markets. In this quite efficient model, MDBs mobilise resources with relatively small spread and long term. Even so, the spread allows MDBs to generate income to finance administrative activities, pay borrowing costs, make transfers to special development funds and accumulate net income, capitalised again as retained earnings.

An important peculiarity of the model is its cooperative nature, which includes institutions formed by advanced and developing economies (Molinari and Patrucchi, 2020). The establishment of MDBs in which the shareholders are countries of greater and lesser relative development brings together shareholders in different positions in the currency hierarchy - i.e., with different degrees of access to international capital markets. It means that the cooperation allows all borrowers, even the poorest and smallest, or with the most peripheral currency (or no domestic currency at all), to access low-cost resources and longer terms, more compatible with development needs. Furthermore, net income, mostly generated by large and middle-income borrowing nations, allows these institutions to robustly finance their activities, transfers, concessional resources and recapitalise the bank with the accumulation of retained income.

- ***Main MDBs working in Latin America***

The differences between institutions arise, in a historical perspective, due to the geopolitical specificities of the time of their agreements. In other words, the key elements that help explain the differences between each of the institutions are the political moments experienced by the MDB in the creation and institutional development over the years - whether through the entry of new member countries or by new agreements during capital increases deliberations. Recent studies, such as those by Artecona, Bisogno and Fleiss (2019) and Fleiss (2021), present the main MDBs offering financing and knowledge services for Latin America and the Caribbean. Aspects related to the composition of their governance, the evolution of portfolios and financing flows to the region are discussed. They argue that, even during periods of questioning of multilateralism, these institutions maintained important participation as sources of financing and knowledge services.

Babb (2009) analyses the evolution of the main multilateral banks over several decades. Just as the concept of “development” has changed over time, the political position of the main shareholders and the particularities of bureaucracies have also influenced the agenda and instruments of banking: its loans for investment projects, loans for budget support associated with policy reforms; the influential (academic and political) activities of knowledge generation and dissemination.

The main three banks working with Latin America and the Caribbean are presented below. Still, it is important to highlight that the proliferation of MDB, after the creation of the World Bank 80 years ago, continues. During the 21st century, new banks have continued to emerge, such as the New Development Bank (NDB) under the BRICS forum and the Asian Infrastructure Investment Bank (AIIB). These are, for example, institutions that come to cooperate with the existing traditional institutions but are also a product of the developing countries' demand for a new international financial architecture, which should be capable of reflecting the multilateral world as of today and not emulating the world of post-war times (8).

(8) For details about the creation of the NDB see, for example, Batista Júnior (2016).

- **World Bank**

Of the main banks, the World Bank (specifically, the International Bank for Reconstruction and Development [IBRD]) has its founding date in 1944, at the Bretton Woods conference when the International Monetary Fund (IMF) was also created, and the pillars of the postwar international monetary system were established, which would be in force until 1971 (9). Without focusing on aspects of the influence of political power, Gurría and Volcker (2001) argue that the World Bank was founded to transfer investment capital from rich countries in capital to poor nations in capital. The initial idea of a bank would be elementary, but perfectly adapted to the opportunities and limitations of the immediate post-war period. With private capital flows restricted and financially risky, many countries could not attract foreign private capital to finance socially productive investments. The solution was to create an institution backed by the capital commitments of the United States and other capital-rich nations that could borrow at lower rates in private markets and lend to those in urgent need (initially, the war-torn nations and those relatively less developed).

It is the post-war geopolitical context that marks the founding of the governance of the World Bank. In other words, the moment of emerging hegemony of the United States and a prominent role for Western European countries that founded the institution is reflected in its governance. Although the bank has evolved during the last eight decades, the conditions of 1944 still affect a structure in which developed countries (and non-borrowers) control the shareholding power.

(9) Helleiner (1994) describes the main pillars agreed during Bretton Woods.

- **Inter-American Development Bank (IDB)**

The IDB is not a product of Bretton Woods. Still, as presented by Díaz Bonilla and Del Campo (2011), the discussions of a Latin American regional bank precede the World Bank's creation. The idea was already present at the first Pan-American Congress, which met in Washington in late 1889 and early 1890. Later, in the 20th century, during the mandate of US President Roosevelt, the creation of an Inter-American Bank (BIA) was discussed in 1940. The BIA would be a bank with characteristics of a central, commercial and investment bank, but it was an idea that did not advance because the war had interrupted negotiations. It should be noted that, according to the authors, during the deliberations of the BIA, Harry Dexter White was one of the representatives of the US Treasury, and this experience probably influenced him in the negotiations with Keynes, years later, at Bretton Woods.

Anyhow, it was finally in 1959 that the creation of the IDB was completed. It was a historical moment when the Cold War guided the Pan-American agenda, and countries were experiencing economic and social deterioration. Furthermore, associated with these factors, political events in 1958, during Vice President Nixon's visit to the region, and then the Cuban revolution in January 1959 marked the era.

As a result of this moment, in the initial IDB agreement, a majority shareholding was assigned to developing countries (60% for the region and 40% for the United States). This is the main difference between the IDB and the World Bank, which at that time generated disparaging comments such as the “debtors' bank” (Díaz-Bonilla and Del Campo, 2011).

- **Development Bank of Latin America and the Caribbean (CAF)**

Discussions for creating the Andean Development Community (CAF) took place during the 1960s when Andean integration was advancing. The founding agreement was signed in Bogotá in 1968, and the first loans were approved in 1971. During the nineties and the beginning of the 21st century, CAF opened its capital to other Latin American partners, expanding to the region - today CAF is called the Development Bank of Latin America and the Caribbean. The institution has always been strengthened as a bank of borrowing shareholders, without the figure of large shareholders from advanced economies.

Humphrey and Michaelowa (2013) identified that the demand of countries, when choosing each bank as a source of financing, depended on the governance structure, particularly during the beginning of the 21st century, in which middle-income countries had a trajectory of relatively high economic growth, economic stability, fiscal and debt stability, large levels of reserves and access to capital markets. These authors propose that the balance of power within institutions, and its implications in terms of costs and operating procedures, affect demand decisions.

The capital composition of these banks is also a result of their governance structures. In other words, the distribution between a greater or lesser share of paid-in, callable capital and accumulated net income is also a result of the composition of voting power. While the CAF relies heavily on paid-in capital, the IDB and the World Bank (both AAA and with high participation of developed member countries) have historically relied on callable capital. Throughout the capital increases, the participation of paid-in was reduced, despite the fact that, especially after the global financial crisis of 2008, the rating agencies have attributed less importance to callable capital. Currently, the S&P, for example, only considers the callable capital of countries that have a rating equal to or higher than the institution (10).

Added to this context, of a lower recognition by rating agencies of callable capital, are the natural difficulties of political coordination to achieve multilateral agreements for capital increases. As a result of these factors, accumulated net income has gained more importance in the IDB and the World Bank. The CAF (rated below AAA) has little callable capital, capital increase discussions are easier to reach consensus (borrowing members broadly control the institution) and less importance has been given to generating income as a capitalization instrument (through income accumulated).

(10) For a discussion about credit rating agencies methodologies and how they are affecting MDB, see Humphrey (2018).

Humphrey (2014) has pointed out that historically CAF has chosen not to strategically generate high income in order to maintain the lowest possible spreads, while other institutions have used net income as an indirect way to capitalize the banks. It is argued that net income has been used as an alternative to capitalizing MDBs and also to finance concessional operations (for example, to poorer or post-conflict countries). That is, interest payments from borrowers generate income (particularly middle-income ones) for MDBs, and the accumulation of income reduces the need for capitalization by member countries.

As described before, from its equity, MDBs access resources in capital markets to leverage resources with borrowings and with that build their development loans portfolio. The World Bank, due to its global reach and more diversified portfolio, has a lower penalty in capital adequacy and portfolio concentration measures, managing (under its internal financial policies and the current methodologies of risk rating agencies) to remain AAA with a less conservative leverage ratio. The IDB, also AAA, but a bank with a smaller number of clients and geographically concentrated, reaches a smaller degree of leverage. CAF (not AAA) has lower leverage than the previous two. Just as a general reference, based on an analysis of financial statements of these institutions during most recent years, for every dollar of equity, the IDB issues (and leverage) a bit more than $3 of debt; the World Bank slightly more than $5 and CAF almost $2.5.

3. BRAZIL'S G20 PRESIDENCY: AN AGENDA FOR THE MDBS

In the light of all structural hindrances created by the asymmetries of the International Monetary and Financial System, discussed above, we claim that the Multilateral Development Banks (MDBs) may be crucial institutions for the foment to regional integration. Given their size, structure and expertise, the MDBs may design strategies to cope with these hindrances through a holistic perspective, dealing simultaneously with the problems related to both the short- and the long-term financing.

In this sense, we claim that Brazil's G20 presidency is a window of opportunity for important reforms in the MDBs, in line with the observations above. In fact, the historical resistance of the G7 countries to an agenda of transformations of the MDBs has been shaken by two major events of the current economic and geopolitical context. First of all, the ecological crisis urges massive investments in the whole globe aimed at the green transition, and these investments require gigantic amounts of long-term financing, including concessional financial resources to middle income countries. Second, the progressively increasing geopolitical rivalry between the two largest economies nowadays, are accompanied by increasing bilateral financing flows and tensions that could lead to geoeconomic fragmentation.

As a result, countries seem to be now convinced about the pertinence of a "balance sheet optimization" of the MDBs, allowing them to increase their relevance and hence the possibilities of financing the abovementioned investments.

This possibility of higher leverage rates of the MDBs is in itself very good news for peripheral countries having to deal with the asymmetries of the IMFS. Yet, in addition to the motto "better, bigger and more effective", which is being used for the reforms pushed by the G20 (G20, 2024), we claim that actions dealing with the particular problems discussed in this paper would be also essential.

First, MDBs could develop better conditions for loans in local currencies with competitive pricing. This would not only eliminate the exchange risk for the borrowers, but would also foment the international usage of these national currencies and, correspondingly, reduce dependency on a single currency. These operations would be enabled by developing treasury operations to manage financial resources in different local currencies, by developing innovative instruments to better deal with exchange rate risk, or also by considering forms for the MDBs themselves or national banks intermediating the operations to absorb part of that risk - as suggested, for example, by Eichengreen and Haussmann (2005) two decades ago. The technical issues involved are non-negligible (11), but the G20 is bringing political will.

(11) According to Eichengreen and Haussmann (2005), the proposed "road to redemption" from the original sin should start with the creation of an index of emerging market economies' exchange rates and the issuance of notes by the World Bank and other IFIs denominated in this index. This would foster the creation of international markets for assets denominated in these currencies.

As a matter of fact, the New Development Bank (NDB) - the so-called BRICS Bank - aims to reach at least 30% of its loans in national currencies.

Second, we claim that the higher capitalisation of the MDBs should allow them to concede concessional loans to middle-income countries - without reducing the availability of resources to low-income countries. Currently, most volumes of concessional resources provided by MDBs are focused on low-income countries, or highly vulnerable states, something we obviously support. Usually, for middle-income countries concessionality is possible when combined with a specific trust fund (those usually have a specific mandate, such as climate, water, etc), with that MDBs can blend ordinary capital resources with a trust fund with concessional terms. However, as many countries are stating recently, middle-income countries do need concessional resources for funding the transition to low carbon economies, otherwise market prices and market incentives will not bring enough. This combination of concessional loans with loans in national currencies would enable these countries to execute the investments which are required for the green transition, for the industry 4.0, for shifts responding to the current changes in the Global Value Chains (GVCs), and in general for a wider adaptation to the changing global economy.

Third, we believe that in addition to the long-term credit lines, MDBs should have different types of instruments to provide support for countries in need of liquidity. The recent experience with the pandemic and some national crises (e.g. in Equator) make evident that in the context of financial globalization and high volatility of capital flows, this quick access to short-term financing is crucial for many peripheral countries. As discussed above, problems related to both short- and long-term finance are ultimately the two sides of the same (peripheral) coin, so MDBs have to be ready to assist countries in both dimensions perennially.

In addition, one way for MDBs to be more creative when supporting regional integration is to provide assistance to the creation and modernization of mechanisms for regional integration, such as the existing arrangements for payments in local currencies or for reserve sharing, or even regional bond markets. Specific channels may be created to foment the regional usage of the national currencies and MDBs can help bring trust to these regional payment systems.

Last, but not least, it is worth noting that the decision of the G20 and MDBs to continue and strengthen dialogues with Credit Rating Agencies (CRAs) aiming at improving mutual understanding in relation to the methodologies for assessing MDBs credit worthiness is very necessary (G20, 2024). Concrete results are possible and were already delivered in these dialogues, but in line with the arguments raised above, we claim that these interactions can deliver more on topics such as an appropriate recognition of the value of callable capital and attributing proportional importance to the preferred creditor status of MDBs. In addition, a critical topic for the current G20 presidency is the rechanneling of SDRs to MDBs; under that matter, the dialogue with CRAs will be very important when designing instruments for this process of rechannelling SDRs for MDBs (such as hybrid-capital).

4. FINAL REMARKS

Discussions about the existence, importance and different roles played by multilateral development banks, as well as the other regional financial cooperation mechanisms described in this paper, are quite common in economics literature. Yet, they are usually discussed within a narrow perspective. On one hand, MDBs are seen only as a second-best solution, given the incompleteness and other imperfections in credit markets. More specifically, those institutions are sometimes presented as simple transitory arrangements, having a reason to exist while these imperfections persist (which is supposed to be a matter of time and progress in capital and market development). On the other hand, initiatives for regional payment facilitation should be designed and implemented only to reduce transaction costs, avoiding risk sharing or deeper financial involvement. Macroeconomic cooperation and, in advanced stages, efforts towards monetary integration are always evaluated from the perspective of the Optimum Currency Areas assumptions - which unavoidably presses for contractionary macroeconomic policies and raises issues about policy autonomy.

Our perspective, as argued above, is quite different. We depart from a theoretical framework that understands the challenges of peripheral countries as a consequence of their position in an asymmetric world, structurally divided through a centre-periphery cleavage that in the last decades is not only derived from technological and productive issues. The international importance of national currencies - especially in the function of store of value - is the origin of a currency hierarchy that imposes a series of negative consequences to the base of the pyramid - i.e., countries that issue low-quality monies. Among these consequences, we emphasize two: the vulnerability to the intrinsically volatile nature of international capital flows, specifically in the form of international liquidity cycles, and the extreme difficulties associated with long-term financing in these countries.

More than merely identifying these phenomena - which is also a growing concern for mainstream literature - we state that those hindrances are structural. They are neither transitory nor can be addressed through market reforms or additional liberalisation. In other words, the message is that financial issues - domestic or regional - in Latin American countries cannot be comprehended without considering the asymmetric nature of the International Monetary and Financial System.

However, this does not mean that those economies should only press and wait for reforms at the global level. Despite all the difficulties, regional efforts and initiatives of financial cooperation have an important and broad role to play.

Based upon this theoretical framework, the analysis of the Latin American experiences, developed in Section 2, brings to light some important questions. First of all, the adversities for deeper financial integration in the region may not be fully explained by the lack of good institutions or the political twists in the region. While these factors may play a role, the main obstacles arise from the asymmetries of the International Monetary and Financial System. After all, in the current context of financialisation and financial globalisation, the peripheral position of the region at the IMFS makes it inherently attached to the centre of the system - notably, the USA. In particular, the structural need for hard currencies - especially the world economy's key-currency - imposes an (asymmetric) attachment to the system's centre.

However, this does not mean that deeper financial integration is impossible. A stronger regional integration - in all dimensions, including the financial one - may be an imperative step to minimise the effects of the currency hierarchy.

Yet, the critical point to grasp is that the foundations of this financial integration have to be defined in line with a solid understanding of the asymmetries of the IMFS and its implications, which are not only related to micro and macroeconomics but also - and very importantly - to the sphere of political economy.

Regarding short-term financing, the initiatives for liquidity provision in hard currency are not opposed to struggling against the IMFS asymmetries. In fact, they are essential tools to curb the perverse effects of these asymmetries. Yet, they should be complemented by initiatives discussed in the article to foster the use of local currencies. Unlike analyses that claim that deregulation is the best way to enhance the international use of a national currency, we argue that financial regulations are critical to reducing the economic vulnerability of Latin American countries. The regional use of the national currencies has to be encouraged through specific channels, constructed for this purpose.

To conclude, we claim that given their size, structure and expertise, the multilateral development banks are in a privileged position to foster regional financial cooperation, addressing the hindrances emanating from the monetary-financial asymmetries through the holistic perspective adopted in this article. The reforms in the MDBs system which are being discussed under Brazil's G20 presidency offer a good window of opportunity for such changes.

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