OSSIBLE FEATURES
OF A
ANCIAL SAFETY NET
FOR
LATIN AMERICA

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PREFACE*

At the sixteenth session of ECLA, held in Port of Spain in May 1975, the ECLA secretariat informed the member Governments of the Commission of its concern over the recent evolution of the international economic situation and its immediate and longer-term prospects. The Governments, for their part, unanimously adopted resolution 348(XVI) which recommends the secretariat to convene a meeting of a group of experts to prepare a report on possible solutions to the problems of the present situation.

The acute economic recession, the high level of unemployment and the sharp inflation being experienced by the main economies with which Latin America is linked are now being reflected in the economic development of the region and its balance-of-payments behaviour in such a manner as to cause concern in the great majority of Latin American countries. The prices of many commodities have gone down and are continuing to sink. Exports of manufactures are running into increasing competition and restrictions on access to markets. The prices of imports are rising rapidly. At the same time, the flows of financial resources to the developing world are not increasing as

*The text presented in this publication is the result of the discussions of a group of experts convened by the ECLA secretariat in accordance with resolution 348(XVI) of the Commission.

expected, and furthermore the majority of the Latin American countries are tending to be left out more and more often from international financial co-operation. The restrictions on the external sector of the Latin American economy are seriously threatening the possibilities of maintaining the growth rates of the product achieved in recent years: moreover, a number of the non-oil-exporting countries of the region have been obliged to contract short-term debts on extremely unfavourable terms, thus jeopardizing their future development.

Instability and recurrent balance-of-payments crises seem to be the dominant signs under which the region will have to live in the coming years. Development policies will be affected by this, and the active mobilization of Latin America to deal with the problem becomes more urgent than ever.

If recent trends persist, the balance-of-payments deficit on current account of the non-oil-exporting countries of the region, which more than trebled between 1973 and 1974 to a figure of 13 000 million dollars in the latter year, will continue to grow in 1975 and 1976 if any attempt is made to keep up economic development rates in line with those fixed as targets by the countries.

Praiseworthy efforts are being made internationally to find a solution to the balance-of-payments problems of the developing countries, while the developed countries are themselves endeavouring to solve their own problems by setting up defence and security mechanisms like the collective safety net recently approved by the OECD countries. A fact must, however, be stressed. All the solutions which are being arranged and discussed give special preference —and this is quite justified— to the least developed countries or those most seriously affected by balance-of-payments problems. This practice almost entirely excludes the countries of the region, which have achieved higher levels of income and thus form part of a veritable "middle class" of nations. No thought is given to adequate solutions for countries like ours, nor to the fact that the situation differs considerably from country to country within the region. These relative situations mean that the impact of the international economic situation is quite uneven and noticeably different according to the relative strength of each country or the nature of its external trade.

Some laudable efforts are being orchestrated at the regional level; these include the substantial increase in resources approved by the recent Assembly of Governors of IDB, the agreements between central banks already reached in discussions at the sub-regional level, the possible creation of a bank for the promotion of exports, and others. Such action is, however, obviously inadequate. The absence of suitable solutions for Latin America at the world level and the severity with which the international economic situation is affecting the region are forcing the political bodies to immediate action.

With the idea of initiating a discussion on the particular balance-of-payments problems experienced by Latin America and finding adequate solutions to them, the ECLA secretariat has considered it necessary to think in terms of a new effort towards Latin American solidarity and at the same time a new form of relations with the developed countries with which the region maintains close trade and financial ties.

In connexion with the first point, it is worth noting that the region has a long history of mobilizing the spirit of regional co-operation and awakening solidarity among the countries of the region when faced with difficulties of a collective nature. The interest of the central countries in a new type of dialogue stems from the importance of the sustained progress of the Latin American economy for the economies of the industrial world today. The region is now an active factor and not merely a passive spectator of world economic development. The "critical mass" of the output achieved by the region in recent years, amounting to 220 thousand million dollars –equivalent in real terms to the output of Western Europe in 1950– requires a total volume of imports of 40 000 million dollars. This makes Latin America, for each of the developed economies, a purchaser of comparable importance to the other industrial economies.

In view of the foregoing, the idea of a collective safety net to cope with balance-of-payments fluctuations, as outlined here, stems from a truly Latin American basic effort, with co-operation from the central countries. It aims to realize old aspirations of the region for suitable machinery to cope with balance-of-payments disequilibria which jeopardize internal development efforts and the continuity of national policies and to permit the necessary adjustments to be made smoothly, rather than abruptly, when called for by changes in the international scene.

This idea will surely be a hard test for Latin America's political imagination and co-operation. The region must show its political will and capacity for co-operation and organization through its own mechanisms and arrangements for taking action. This will be a key factor in bringing the developed countries into this new dialogue with Latin America. Their participation is of vital importance since the economic health of Latin America is today an important determinant in their own progress and their struggle against recession. To participate actively in this process it is necessary to understand the nature of the region's problems, which are not given sufficient attention in the solutions being discussed today at the international level.

Pursuant to the mandate given to it at the sixteenth session in respect of the Financial Safety Net, the secretariat prepared a document (E/CEPAL/L.120) which served as the basis for an expert meeting at which the draft reproduced below was prepared. Mr. Carlos Massad worked with the secretariat as consultant. The participants in the meeting were Messrs. Ricardo Héctor Arriazu, Nicolás Bruck, William R. Cline, Sergio de la Cruz, Francisco García Palacios, Roberto Gavalda, Jorge González del Valle, Morris Harf, Gustavo Petricioli, Jorge José Ponasso, Frank Rampersad, Wolfgang Renner, Carlos Sanson, Jorge Sakamoto, Walter Sedwitz, Mario Sundfeld, and Herman Van der Loos.

INTRODUCTION

Latin America faces a serious problem of trade and balance-of-payments deficits in the next few years, mainly owing to the drop in price of most of the raw materials it exports, the difficulty in maintaining high rates of growth of exports of manufactures in the face of a world recession and trade restrictions, and the rise in prices of imports due to the intensive inflationary process affecting both developed and developing economies. In addition, there are indications that the flow of private capital will subside and remain concentrated in a few countries while the flow of official bilateral and multilateral capital also will level off or be directed to the poorest countries of the world. Although there is the prospect that capital resources of the IDB will be substantially replenished, thus permitting an expanded volume of development lending, over the coming years, such lending is for specific projects and can contribute only indirectly to the solution or amelioration of the expected balance-of-payments difficulties.

It is difficult to say how long this period of stress, which affects most of the countries of the region, will last. It may be that after 1977 the situation will improve, as the OECD countries regain normal growth rates and curb inflation. On the other hand there is also a probability of continuing inflation in the industrialized countries as governments find it increasingly difficult to apply restrictive measures that could depress employment to intolerable levels. Any upward trend in primary product exports is not likely to surpass the rise in imports of manufactures, while long-term capital flows, both official and private, are not expected to compensate for the deterioration in the current account and trade restrictions may well intensify. Given these possibilities it appears only prudent to plan for difficulties lasting beyond 1977.

Concurrently with these difficulties, there is a tendency to exclude many countries of the region from the most important new mechanism of international financial cooperation, or to assign them low priority treatment, due to the fact that they have a higher per capita income than countries in other parts of the developing world.

The machinery for the stabilization of export earnings which forms part of the Lomé Convention and the proposed OECD Financial Support Fund are, among others, two recently created instruments designed to permit a more favourable evolution of the external sector in two groups of countries of importance in the world economy. Latin America's foreign trade is also of considerable importance in the world economy, especially in certain areas. For the United States' exports of capital goods, consumer durables and chemical products, for example, Latin America provides a market three times the size of Japan's and almost as large as that of the European Economic Community, while for the EEC's sales of the same products, Latin America is equal to three-quarters of the United States market and more than four times Japan's. The combined exports of these goods by the United States, the EEC and Japan to Latin America in 1973 amounted to 11 000 million dollars.

Therefore, any mechanism, such as the one proposed here, should be regarded as a device not only benefiting the region as such and favouring further progress toward economic integration, but also benefiting the world economy by contributing to the recovery of income and employment levels in the countries for which Latin America is an important market. Thus, it is desirable to create the necessary conditions to prevent a contraction of external demand on the part of the Latin American economies, pending the achievement of an orderly adjustment to the new conditions. For this purpose, mechanisms are needed to ride out the transition period until any necessary changes are introduced in the foreign trade of the Latin American countries.

Resolution 348(XVI) adopted at the sixteenth session of ECLA held recently in Port of Spain recommends the secretariat of the Commission to convene a meeting of a group of experts to seek possible solutions to the balance of payments problems of the countries of the region. In the same resolution, special attention is given to exploring the possibility of establishing a financial safety net for Latin America.

The features of this safety net depend, of course, on the nature of the problem it is intended to solve. At the same time, however, its establishment must be a reflection of Latin American solidarity and of its political will to deal with its own problems without excessive dependence on other countries or regions. In this connexion what is envisaged in the present proposal is an essentially Latin American mechanism to which other countries may adhere as associates. And while the creation of the system should not be dependent on the adherence of other countries, effectiveness demands that it should not be closed nor exclusively regional.

Apart from these considerations, the safety net is intended to avoid adjustments in the balance of payments through *(i)* a proliferation and intensification of import restrictions which would contribute to a contraction of world trade and seriously slow economic integration and *(ii)* depressing domestic growth levels to intolerable levels, with the social and political consequences such a course might entail.

While in the final analysis every country must make hard domestic adjustments if there are longer-term structural forces which generate chronic balance of payments strains, the intent of the present scheme is to provide a breathing space during which externally generated pressures of a hopefully temporary nature can be alleviated, provided of course that each country pursues at the same time internal policies that are not incompatible with the restoration of external equilibrium. The focus essentially, therefore, is to sustain import capacity and preserve credit worthiness at a time when externally-generated difficulties operate in the opposite direction. The system would not be primarily aimed at dealing with domestic economic policies, although such aspects would inevitably have to be considered when inappropriate domestic policies clearly nullified the effectiveness of the assistance provided through the Safety Net System, for otherwise there would be a waste of the system's resources which would not be acceptable to other participants.

In order to fulfill its role of facilitating the process of adjustment in the face of particularly difficult conditions, the system must constitute a source of financing *additional* to those existing at present, it must be distinct from existing development lending facilities, and its existence should not mean a reduction in the financing obtainable from other sources.

To ensure this, the safety net should be in principle, *an instrument of last resort.* In other words, the countries could have recourse to it only after having used up to a reasonable extent and on acceptable terms such existing sources of balance-of-payments financing as the international financial markets and international organizations.

With this aim in view, the system's loans generally should be granted on *commercial terms*, although *concessionary terms* should not be excluded if resources for them exist.

So as to ensure that the regional co-operation effort will produce the desired results, the safety net should provide resources subject to a decreasing automaticity. This should take into account the general economic circumstances, those of the applicant country in particular, and the most appropriate policies to follow in order to help prevent any undesirable deterioration in the rate of growth of the member countries and of the international community, within a context of increasing financial stability.

Those countries which may decide to help finance the safety net should not be required to provide the resources they have pledged unless drawings by a member country have to be directly financed. Thus, the system is conceived as *a group of commitments,* to be fulfilled only when financing is necessary. The total amount of the commitments would operate on a revolving basis, so that additional commitments would not be required every year. The total volume of the commitments must be decided with a view to forming a sufficient stock to fulfill the objectives envisaged.

Since the international economic conditions are causing generalized problems in the region, contributions from outside the region are now indispensable. As the situation becomes more normal, however, such contributions could gradually be reduced. In the long term, the region should seek to make greater use of the traditional sources of balance-of-payments financing. The system should be *self-supporting* if the idea is to make it a more permanent instrument. In any case, its characteristics and the need for its existence would have to be *reviewed periodically.*

The operation of the safety net should not require any new institutions. It should be envisaged in such a way that its operation can be handled by an existing institution, or by means of co-operation arrangements among some of them.

To sum up, the main features of the safety net that have been envisaged are its charater of an *additional* instrument, its character of *an instrument of last resort,* the *generally commercial terms* of its loans, and their decreasing automaticity. The system has been conceived as a *set of commitments* which will not increase, with contributions from outside the region at first, *and there will not be any need to establish new institutions.*

The system would be made up of member countries and associate countries. The member countries would be those countries of Latin America and the Caribbean which might wish to join the system. The associate countries would be those countries from outside the region which contribute resources to finance the operations of the system, on terms to be determined. Both member countries and associate countries would be termed participating countries. Those organizations helping to finance the operations of the system, on the terms to be agreed by it, would be termed contributing organizations.

1. Objectives

The objective of the safety net is to provide the countries of the region with additional external balance-of-payments financing through mutual co-operation and the collaboration of agencies and countries outside the region. In particular, the safety net would aim at ensuring a smoother adjustment vis-à-vis balance-of-payments fluctuations, while maintaining the dynamism of the economy during the process of adjustment. To achieve this, the safety net would minimize the need for reversible conjunctural measures and would facilitate changes in economic policies and structures designed to ensure a more balanced development of external trade by the countries of the region. The operation of the system would take into account the need to defend, back up and promote the progress made in Latin America in the field of economic integration. Adherence to this system would involve a commitment, in principle, to avoid using restrictive trade or international payments measures.

2. General concept

The safety net (system) would operate by means of commitments by the governments (central banks) of the region to provide the system with an agreed amount of resources for established periods (credits). When a member country of the system fulfilled the requirements established for obtaining financial support, the executive body of the system would determine the manner of financing such support, either by sharing out the total cost of drawings among the non-applicant member countries, the associate countries and the contributing organizations in proportion to the contributions pledged by each in the available total, or by issuing securities for sale on international markets with the collective guarantee of all the participants in proportion to their quotas. The system would thus be open to resources coming from institutions, countries or markets outside the region.

3. Operation

The system would operate in principle as an instrument to be used as a last resort, after the applicant country had made reasonable use of its own reserves and of other sources of financing such as international markets and organizations. It would not be required that the country should have *exhausted* such sources. The executive body would decide in each case. All operations of the system would be expressed in terms of Special Drawing Rights.

The system would be established for an initial period of five years. At the end of the fourth year, its operation would be examined and it would be decided whether or not it should continue to operate, and if so on what terms.

4. Contribution of member countries in accordance with their quotas

Each member country's contribution to the system would be determined in the form of quotas established on the basis of a group of quantifiable variables. A country could voluntarily increase its contribution, provided such an increase were approved by the governing body of the system. The quotas would also serve to distribute the participating countries' financial rights and obligations and to graduate the automaticity of the loans. The quota-based system of voting would be defined in such a way as to take account of equity and the effective participation of all member countries. The quotas of the associate countries would be determined in the light of their contributions, and the quota and voting system would be so designed as to permit the participation of the associate countries in the taking of decisions without adversely affecting the Latin American character of the scheme.

5. Forms of financing the loans granted by the system

The safety net would finance the drawings either by distributing them among the non-applicant countries in proportion to their quotas, or by directly placing securities on the international markets. The contribution of the debtor countries of the system to the financing of the drawings would be determined by the executive body. Countries could voluntarily authorize bigger drawings against their credits than the amounts for which they were actually liable.

If drawings were financed by distributing them among the countries, the individual contributing countries could choose the most suitable method of financing their contribution, including:

(a) Direct financing in convertible currencies or in SDRs. Contributing countries could pay their contribution in national currency if they were prepared to guarantee its automatic conversion without cost to any other currencies which the applicant country might require. In any case, the executive body of the system would periodically determine which currencies would be considered to be convertible for the purposes of the system.

(b) Providing their individual guarantee for securities so that the system could obtain resources on the international markets. If, for any reason, method *(b)* did not permit the pledged resources to be raised within a reasonable period of time and on reasonable terms, the country would have to use method *(a)* until such time as the difficulties preventing the effective use of method *(b)* were solved.

(c) Authorizing the system to sell securities on their financial market, with their individual guarantee. In this case, the member would undertake to convert the resources obtained in its own currency into actually convertible currencies or SDRs, and to make good any deficiency in terms of time, cost, etc., by means of method *(a)*.

If drawings were financed by placing securities issued by the system on the international markets, this would be carried out with the collective guarantee of all the member countries, in proportion to their quotas. All guarantees given by the system would be considered to be valid until such time as the commitment guaranteed was paid off. The system could also grant guarantees to countries so that they could obtain financing on the international markets.

6. Characteristics of loans granted

The interest charged to debtors would be related to the cost of obtaining the resources and the yield that could otherwise have been obtained from the resources contributed. The maturity periods would be not longer than five years, renewable up to an additional three years in absolutely exceptional cases subject to the unanimous approval of the members of the executive body of the system. Repayments would in principle be in the form of six-monthly instalments, and, depending on the circumstances, grace periods of up to three years could be considered. The system could also envisage earlier repayments when the debtor's economic situation and the needs of the system so warranted.

The use of the system's resources would be subject to a decreasing degree of automaticity, governed by the relation between the amount of resources drawn from the system and the user's quota. The bigger a loan was with respect to the quota, the fuller would be the consultations and studies needed and the more specific would be the conditions to be satisfied in order to draw successive portions of the loan granted.

Generally speaking, the system would not grant concessionary credits. In the event of there being concessionary resources available, however, the system could consider granting loans on such terms to countries whose economic situation justified them.

There would be a ceiling on drawings, related to the user's quota. This ceiling could be exceeded in special cases with the unanimous approval of the members of the executive body of the system.

The system would include a guarantee that the value of the resources contributed would be maintained constant, in a manner to be determined by the governing body.

7. Institutionality of the system

The institutionality of the system should be so designed as to facilitate the achievement of its objectives. In particular, it should provide an adequate guarantee to contributors, both from within the region and outside of it, in order to attract a substantial volume of contributions. The decision-making machinery should be such as to guarantee the application of the principles laid down in section 4. Efforts would be made to avoid the creation of new institutions for the operation of the system, by using such an existing financial institution as could ensure its proper operation, including the minimum operational facilities and staff required.

The governing body of the system would be a Board of Governors. There would also be an executive committee appointed to ensure both representativity and prompt action.

The legal aspects of the system will be studied at the technical level in due course.

8. Scope of the system

Possible users of the system would include countries of Latin America and the Caribbean which might wish to adhere to it. In any case, the system would not enter into operation until half the countries of the area, representing at least two-thirds of the total quotas programmed for the area, had formalised their adherence.

Those countries which were members of sub-regional integration agreements could, if they wished, join the system as a group. They would then have to designate the country or institution which would represent them in their relations with the system. In all cases, however, the need criterion and conditionality would be applicable to each individual country.

Contributors to the system could include countries and organizations desiring to contribute on such terms as the system may lay down and subject to its approval. The system would seek to obtain the support of countries and organizations from outside the region.

9. Size of the system

The sum of the 1974 current account deficits of the countries of the region amounted to some 13 000 million dollars, and this figure is expected to increase in 1975 and 1976. The sum of the overall deficits of the countries, in contrast, came to a little less than 1 600 million dollars thanks to movements of medium-term and long-term capital. If it is right to assume that the latter cannot be expected to improve substantially, then it is likely that the sum of the overall deficits will tend to increase in the years ahead.

In order to finance three years' overall deficits some 5 000 million dollars would be required, while some 3 000 million dollars would be required to finance two years' deficits. The system should be capable of providing the resources needed in order to make a substantial contribution to financing the overall deficits not covered by existing machinery.

The total size of the system would be financed from both regional resources and resources coming from outside the region. The competitive remuneration of these resources could open up possibilities for obtaining financing from outside the region on a substantial scale.

In any case, the adherence of a member, country or institution to the system would not mean the immediate use by the latter of all the resources pledged. Use of the resources pledged could take place gradually with the passage of time.