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POSSIBLE FEATURES OF A FINANCIAL SAFETY NET FOR LATIN AMERICA

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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 the rise in prices of imports due to the intensive inflationary process affecting both developed and developing economies.

These difficulties are seriously affecting most of the non-oil-exporting countries in the region. The most difficult period will probably last until 1977: in the course of a few years the OECD countries may be expected slowly to regain their normal growth rates and to reduce the rate of inflation, foreign trade prospects of Latin America could then improve.

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 OECD Financial Support Fund are 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, which 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, the dynamic and orderly expansion of Latin American trade is important not only for the countries of the region but also for the world economy, and it is consequently desirable to create the necessary conditions

/to prevent

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, suitable 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.

In order to fulfil 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. Its existence should not mean a reduction in the financing obtainable from other sources.

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

With a view to encouraging the countries to use the safety net only after recourse to other sources, its loans should be granted on commercial terms rather than on concessionary terms.

So as to ensure that the regional co-operation effort will produce the desired results, the safety net should provide resources subject to a certain conditionality. 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

Those countries which may decide to help finance the safety net should not be rquired 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 character of an additional instrument, its character of an instrument of last resort, the commercial terms of its loans, and their conditionality. 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.

/1.Objectives

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-a-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. Adherence to this system would involve a commitment, in principle, to avoid using restrictive trade or international payments measures with respect to other member countries of the system. Use of the system's resources would be subject to certain conditions,as described below.

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 of the system fulfilled the requirements established for obtaining financial support, the executive body of the system would share out the amounts drawn among the non-applicant member countries and associate countries in proportion to the percentage of the contributions pledged by each in the available total. The system would be open to resources provided by institutions or countries outside the region, which would not be eligible to use the safety net. The system might eventually develop into a safety net of broader scope, possibly including other parts of the developing world.

/3. Operation

3. Operation

The system would operate as an instrument to be used as a last resort, after the applicant country had had recourse to a reasonable proportion of its own reserves and to other sources such as the international financial market and international financing agencies, particularly IMF. It would not be required that the country should have exhausted such sources, however. All operations of the system would be expressed in terms of Special Drawing Rights.

The system would be established initially for a period of three years. At the end of the second year, its operation would be examined and it would be decided whether or not it should continue to operate.

4. Distribution of the total size of the system among the countries

Each country's contribution to the system would be determined in the form of quotas established on the basis of a group of quantifiable variables, such as those used in determining country quotas for the IMF. A country could voluntarily increase its contribution, provided such an increase were approved by the organs of the system. The quotas would also be used in determining the number of votes of each country in the governing body in distributing the members' financial rights and obligations, and in scaling the terms of the loans. The quotas of contributing countries outside the region would be determined on the basis of the amount of their contribution, once this had been accepted by the organs of the system.

5. Forms of financing the loans granted by the system

The safety net would finance the drawings and distribute them among the non-applicant countries in proportion to the lines of credit provided. Countries indebted to the system would be exempted from paying their contribution, except in the case of any advance repayments that might be made by this means. Countries could voluntarily authorize bigger drawings against their credits than the amounts for which they were actually liable.

/The individual

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 purposed of the system.

(b) Providing their individual guarantee 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).

In addition, the system could sell securities in the international markets on the basis of a collective guarantee provided by all members in proportion to their quotas, and it could also provide guarantees to the countries so that they could obtain financing in the international markets. Any guarantee provided by the system would be understood to remain in force until the guaranteed liability was fully paid.

/6. Characteristics

6. Characteristics of loans granted

The interest charged to debtors would be a floating rate related to the rate of inter-bank loans in London or to other pertinent rates, according to the currency concerned plus a margin at least equal to that prevailing in the market for low-risk operation.s The maturity periods would be not longer than five years, renewable up to an additional three years in absolutely exceptional cases. Repayments would 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 certain objective indicators of the debtor's economic situation so warranted.

The use of the system's resources would be subject to an increasing degree of conditionality, in relation to the amount of resources drawn from the system.For loans not higher than a certain proportion of a country's quota, the operation would depend only on verifying the need for it, in the light of pre-established criteria, and the amounts could then be drawn immediately. For loans between that proportion and another larger proportion of the quota, an additional requirement would be a detailed report of the policies which the applicant country was implementing to solve its financing problems, plus approval by the system of such policies. Finally, if the loan sought were even larger, another requirement, in addition to a discussion of the policies implemented by the applicant country, would be an undertaking to reach specific quantitative targets over a certain period of time. In this case, the drawings would also be distributed over time, up to a maximum of three years. If these targets were not attained, the applicant's right to draw on the system's resources would be suspended. The system would envisage the possibility of reviewing the targets according to the circumstances but each review would be considered as a new application to draw.

/Generally speaking,

Generally speaking, the system would not grant concessionary credits. The concessionary elements would depend basically on bilateral negotiations or other forms of negotiation outside the system. In the event of there being concessionary resources available in any proportion, however, the system could from time to time establish those countries which, because of their situation, were eligible for concessionary loans (favoured nations). The terms of the concessionary credit would be determined beforehand, in the form of a discount on the prevailing rate plus the customary margin.

Concessionary loans would be limited to a certain proportion of the credit with which the favoured nation had provided the system.

There would be ceiling on drawings other than that established by applying the "need" criterion, except in the case of concessionary loans.

7. Instituionality of the system

The system would be attached to an existing financing institution (the International Monetary Fund and/or the Inter-American Development Bank) and for its operations it would use the staff and facilities of that institution and also of others by special agreement between the member of the system and the institutions concerned. The executive body of the system would be an Executive Committee composed of five members who would be elected by the member countries by a weighted vote based on the amount of their quotas. The members of the Executive Committee would not represent countries or groups of countries but the region as a whole and, therefore, the system. No member country could divide its vote. For these purposes the countries could elect executive directors in the above-mentioned institutions, who, if elected, could fulfil both functions. In all cases, every country requesting drawing facilities would send a representative to the meeting at which its case was to be considered.Countries outside te the region contributing resources would be considered as associate countries, in which case the number of members of the Governing Council would be raised to eight, at least five of whom would be elected by the member countries.

/The governing

The governing body of the system would be composed of one top-level financial representative of each member and associate country.

The decisions of the executive body would be adopted by an unweighted vote and a two-thirds majority of those present.

The decisions of the governing body would be adopted by a weighted vote, with at least a two-thirds majority, provided that not less than two-thirds of the member countries of the system had voted in favour.

The voting status of institutions adhering to the system would be established in the agreement accepting their adherence.

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 half of the total credit programmed for the area, had formalized 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 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 all countries and institutions desiring to contribute.

9. Size of the system

The sum of the current account deficits of the deficit countries of the region in 1974 amounted to around 13,000 million dollars, and is expected to increase in 1975 and 1976. The sum of the overall deficits of the deficit countries, on the other hand, was slightly under 1,600 million, thanks to the medium-and long-term capital movements. If it may safely be assumed that no substantial improvements can be expected in these movements, then it must be accepted that the total overall deficit is likely to increase in the next few years.

To be able to finance the overall deficits over a period of about three years, the system's total resources should be approximately 5,000 million dollars. To finance the overall deficits over two years would require about 3,000 million. Anything below this figure would be too low, since the countries drawing resources from the system could hardly contribute towards financing it.

From the foregoing observations, it is clear that on a country adhering to the system would not be called upon to provide resources amounting to its total contribution immediately, but only over a period of probably two years or more.