

# FINANCIAL AND MONETARY COOPERATION IN SOUTH AMERICA: MAKING THE CASE FOR A DEEPER INTEGRATION AMONG THE UNASUR COUNTRIES<sup>1</sup>

## *Cooperação monetária e financeira na América do Sul: Defendendo uma integração mais profunda entre os países da UNASUL*

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### 1. Introduction

As we know, the ‘great recession’ has generated a debate about the necessity of restructuring the international monetary system (IMS), a necessary condition for the world economy to return to stability and healthy economic growth. In short, and ever since 2007, the G-20 meetings and other international organizations have proposed, in their attempt to avert any worsening of the ‘great recession’, to monitor and regulate the financial system and to negotiate a ‘new architecture’ for the IMS so that financial markets could return to performing their primary function which is to finance productive investment and consequently expand effective world demand. Unfortunately, the conservatism and conflicts of interest among the member countries of the G-20 have prevented any progress towards the possible restructuring of the IMS, at least for the present. In addition, the G-20 retreated from its initial position, preaching fiscal prudence.

In view of these developments, especially the pessimism about the progress of deeper reforms in the IMS, regional integration has become a second best strategy for the developing countries, specifically for South America countries. This point is corroborated by UNCTAD (2007), which argues that there is no better alternative available to the major emerging economies, including South American economies, than regional integration.

In this way, since the 2000s, as a result of the stagnation of the Free Trade Area of the Americas (FTAA) negotiations, the South American integration process has experienced important changes, such as

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the creation of the South America Community of Nations (CASA), in 2004, the creation of the Union of South America Nations (UNASUR), in 2007, and the implementation of some ‘institutionalities’ in the Common Market of the South (MERCOSUR). Thus, the debate on the need to consolidate a process of economic integration more consistently and robustly in South America – based on monetary and financial cooperation to ensure macroeconomic stability and avoid financial and exchange rate crises in the South American countries and the creation of a development bank to finance the regional infrastructure (roads, transportation, telecommunications, power generation and transmission etc.) – has come to be on the agenda. The reason behind it is mainly because, since the 2000s, and specifically after the ‘great recession’, the macroeconomic performance, such as growth and inflation rates and monetary and exchange rate regimes, of the South American countries has converged.

This article has two objectives: First, it aims to show that UNASUR may be an interesting project of economic integration to prevent disruptive economic situations in the South American countries.<sup>4</sup> However, it is important to mention that economic integration in South America is subject to pro-integration political action of the main countries, particularly Brazil. Second, it proposes, inspired in Keynes’s revolutionary analysis presented in his International Clearing Union, during the Bretton Woods Conference in 1944, a regional arrangement to UNASUR to assure long-term economic growth and social development in the Region. The idea is that this regional integration proposal will become more consistent the higher the convergence of the macroeconomic policies is, simply because it can induce trade and financial cooperation.<sup>5</sup> To be sure, deepening regional financial cooperation does not imply aiming for monetary integration and the adoption of a single currency. Therefore, there are no costs involved in terms of losing monetary and exchange rate autonomy by countries, differently from the European Union model.

To address this objective, besides this Introduction, the article has more three sections: Section two presents a brief historical analysis of the economic integration process in South America and analyses some selected macroeconomic and structural variables of the member countries of UNASUR to observe if these economic data are (or not) converging. Section three argues that monetary and financial cooperation can be an alternative for developing countries and, based on Keynes (1944/1980), presents a regional arrangement proposal for UNASUR. Section four summarizes and concludes.

## **2. UNASUR: a brief historical analysis and the current stage of integration**

### **2.1. A brief history of the integration economic of South America**

Historically, the idea of economic integration in South American began in 1960 when some trade agreements were signed within the Latin America Free Trade Association (ALALC). ALALC was an

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<sup>4</sup> Going in this direction, Baroni & Rubiolo (2010) present an alternative proposal for the economic integration of UNASUR.

<sup>5</sup> Despite the fact that this contribution emphasizes the main aspects of the relevant macroeconomic policies, it is important to emphasize that industrial policies, infrastructure investment and educational policies are key issues to reduce the asymmetries among the UNASUR countries. It should be noted that the need of having political institutions to mitigate social, cultural and ideological barriers are all relevant in the integration process. They are not discussed in the contribution in view of space limitation.

unsuccessful attempt to create a free trade area in the Latin America. The member-countries were Argentina, Brazil, Chile, Mexico, Paraguay, Peru and Uruguay. In 1970, Bolivia, Colombia, Ecuador and Venezuela became member countries of ALALC. In 1980, ALALC was replaced by Latin America Association for Integrated Development (ALADI). At that time, Cuba also became a member country of ALADI.

Concomitantly to the proposal of having a wider regional integration in Latin America, such as ALADI, in the late 1960s and early 1990s two sub-regional blocs were created: the Andean Community of Nations (CAN) and MERCOSUR.

CAN was created, in 1969, to achieve a sustainable and balanced economic and social development in the Andean region (CAN, 2015). The original member countries of CAN were Bolivia, Chile, Colombia, Ecuador, Peru and Venezuela. In 1977, due to political reasons, Chile decided to leave CAN and in 2006 Venezuela also left CAN to join MERCOSUR as an associate country.<sup>6</sup>

In 1991 the Asunción Treaty, signed by Argentina, Brazil, Paraguay and Uruguay, created MERCOSUR. MERCOSUR was created to be an economic and political agreement among Argentina, Brazil, Paraguay and Uruguay. Its purpose is to promote free trade area in the Region. Actually, it is a Customs Union, but, in the past, some MERCOSUR Economic Authorities (EA) proposed a regional and common currency to MERCOSUR.<sup>7</sup> In 2012, Venezuela became a member country of the MERCOSUR.

In the 2000s, CAN and MERCOSUR, the main economic integration blocs of the South America, went through periods during which questions were raised in terms of disappointing trade performance, as well as in terms of political and diplomatic experience. In this context, to avoid the weakening of these economic blocs, in 2004 CASA was created to stimulate the economic agreements between CAN and MERCOSUR, and, in 2007, CASA was replaced by UNASUR – from a treaty signed between the CAN and MERCOSUR members – to be an alternative and a more consistent project of economic integration in South America. The main objectives of UNASUR are: political coordination, free trade agreement, infrastructure integration – especially, in terms of energy and communications –, financial integration, cooperation in technology, science, education and culture, integration between business and civil society and integration and regional development (UNASUR, 2015).

All countries of South America are permanent members of UNASUR, which are Argentina, Bolivia, Brazil, Colombia, Chile, Ecuador, French Guiana<sup>8</sup>, Guyana, Paraguay, Peru, Suriname, Uruguay and Venezuela.

Table 1 shows some aspects of UNASUR countries, such as: the estimated population, official language and forms of government.

<sup>6</sup> In 2012, Venezuela became a member country of the MERCOSUR. Bolivia, Chile, Colombia, Ecuador and Peru are associated countries.

<sup>7</sup> For more details about MERCOSUR and a critical assessment of the creation of a currency union in MERCOSUR, see, respectively, Arestis *et al* (2003), and Ferrari-Filho (2001-02).

<sup>8</sup> French Guiana will be excluded of our consideration because it is an Overseas Department of France.

Table 1. Population, Official Language and Forms of Government of UNASUR

Country	Population**	Official Language	Forms of Government
Argentina	40,519,000	Spanish	Republic
Bolivia	10,426,000	Spanish	Republic
Brazil	193,253,000	Portuguese	Republic
Chile	17,190,000	Spanish	Republic
Colombia	45,512,000	Spanish	Republic
Ecuador	14,787,000	Spanish	Republic
Guyana	772,282	English	Republic
Paraguay	6,402,000	Spanish	Republic
Peru	29,552,000	Spanish	Republic
Suriname	472,000	Dutch	Republic
Uruguay	3,357,000	Spanish	Republic
Venezuela	29,183,000	Spanish	Republic

Source: CIA (2015) and IMF (2015a).

Note: (\*) Estimated population in 2010.

In 2014, the GDP of UNASUR countries, at purchasing power parity (PPP), was around USD 6.6 trillion.<sup>9</sup> Table 2 shows the GDP per capita and the Human Development Index (HDI) of South American countries.

Table 2. GDP Per Capita (2014) and HDI (2013) of the South American Countries

Country	GDP Per Capita (PPP USD)	HDI
Argentina	22,582 *	0.808
Bolivia	6,220 *	0.667
Brazil	16,096	0.744
Chile	22,971 *	0.822
Colombia	13,430 *	0.711
Ecuador	11,244 *	0.711
Guyana	6,895 *	0.638
Paraguay	8,448 *	0.676
Peru	11,817 *	0.737
Suriname	16,623 *	0.705
Uruguay	20,556	0.790
Venezuela	17,694 *	0.764
<b>Average</b>	<b>14,548</b>	<b>0.731</b>

Source: IMF (2015a) and UNDP (2015).

Note: (\*) IMF staff estimates.

<sup>9</sup> The GDP was estimated by IMF (World Economic Outlook Database, April 2015) (2015a).

According to Table 2, the economic gap between the rich and poor in South American countries is large: considering that the average GDP per capita is USD 14,548, six countries have a GDP per capita higher than the average GDP per capita, while six countries have a GDP per capita lower than the average GDP per capita. Likewise, the HDI also highlights a large gap. However, according to UNDP (2015) the HDI increased from 2000 to 2013.

Observing the steps of the South American integration process, since the 2000s the economic integration in the Region has become more dynamic. Besides the tariff and trade agreements implemented in the Region, a set of institutional bodies were created to boost the economic integration in the South America, such as:

- Structural Convergence Fund of the MERCOSUR (FOCEM): this was created in 2004 and implemented in 2005 to operate “political and economic instrument[s] to reduce existing structural asymmetries among countries and promote competitiveness and social cohesion primarily in less developed countries and regions” (IADB, 2005, p.3). Brazil is the largest contributor to the FOCEM, contributing 70% of its total resources. Argentina contributes 27% and Uruguay and Paraguay contributions are, respectively, 2% and 1%.
- Bank of the South: this was created in 2007 and its main objective is to finance and integrate the member countries of UNASUR. The task this Bank is to lend money to the member countries of UNASUR for the development of social programs and construction of infrastructure projects. In other words, the Bank of South is an alternative to the IMF and World Bank.<sup>10</sup>
- The Payment System on Local Currency (SML): in October 2008, Argentina and Brazil launched a payment system for bilateral commercial operations with their local currencies, *peso* and *real*, respectively. SML aims at eliminating the US dollar as an intermediary of commercial relations between the two countries.
- Single System of Regional Compensation of Payments (SUCRE): in 2009, the governments of the Bolivarian Alliance for the People of Our America (ALBA), a political institution<sup>11</sup>, decided to implement the SUCRE for trade relations among their member countries. SUCRE was launched in 2010 and, since then, it has allowed the offsetting of the liabilities and assets related to the commercial transactions among the member countries. In other words, the SUCRE aims at reducing member countries dependence on the US dollar as a reserve currency.

It is important to mention that the creation of these ‘institutionalities’, together with the Latin American Reserve Fund (FLAR) and Reciprocal Payments and Credits Agreement (RPCA),<sup>12</sup> are important to

<sup>10</sup> For additional details, see Suárez (2012).

<sup>11</sup> The member countries of ALBA are Antigua and Barbuda, Bolivia, Cuba, Dominica, Ecuador, Nicaragua, *Saint Vincent* and the Grenadines and Venezuela.

<sup>12</sup> FLAR is a financial institution created in 1978 whose main objective is to support its member countries (Bolivia, Colombia, Ecuador, Peru, Uruguay, Venezuela and Costa Rica) with balance of payments problems. It is considered the Andean version of International Monetary Fund (IMF); and RPCA is an agreement created in 1982 in order to allow the creation of a Reserve Fund to support the balance of payments, guarantee loans and improve the official reserves of the central banks of the member countries of ALADI. In other words, its main objective is the establishment of a regional payment agreement.

South America because they boost the monetary and financial cooperation, stimulate sustainable development by financing infrastructure projects and improve the foreign reserves of the South American countries to support their balance of payments problems.

To sum up, the economic integration process in South America became reality in the 2000s, especially after the implementation of UNASUR, due to, at least, two reasons: first, it created a set of institutional bodies that allow greater monetary, financial and fiscal cooperation among the South American countries; and second, policymakers and international institutions have argued for the restructuring of the global economic order once the ‘great recession’ has ended, encompassing both restructuring of the IMS and the speed up of the economic regional integration process.

## 2.2. The current stage of economic integration of UNASUR

As sub-section 2.1 shows, in South America the fiscal, monetary and financial integration is back to the negotiating agenda. It has created new mechanisms of cooperation, such as the FOCEM, the Bank of the South and the use of the Argentine *peso* and the Brazilian *real* as currencies to enable international transactions. Thus, in this new context, this sub-section aims to analyze the current stage of economic integration in UNASUR, in terms of monetary and financial integration and convergence of macroeconomic and structural variables, in attempt to speculate about what process of economic integration is more appropriate for UNASUR. For this purpose, our methodology consists of discussing the evidence on real and monetary-financial integration process among the countries of UNASUR. This will be undertaken in terms of some selected macroeconomic and structural variables.

Before presenting and analyzing the current stage of economic integration in UNASUR, three clarifications on the methodology are in order: first, we will exclude from our analysis French Guiana, Guyana and Suriname, because the economic statistics for these countries are not fully available. Thus, UNASUR will consist of Argentina, Bolivia, Brazil, Colombia, Chile, Ecuador, Peru, Paraguay, Uruguay and Venezuela. In fact, the exclusion of these countries does not make so much difference, especially in terms of GDP: in 2014 the total GDP of Guyana and Suriname, at PPP, was around USD 14.7 billion; this represents, approximately, 0.22% of total GDP of the Region. Second, the macroeconomic and structural variables we have chosen are average GDP growth rate, average inflation rate, real effective exchange rate (REER),<sup>15</sup> monetary regime, intraregional trade, nominal fiscal result/GDP, foreign debt, international reserves, and labor productivity. In other words, analyzing these variables, we are in effect studying, directly and indirectly, the behavior of the main macroeconomic policies, fiscal, monetary and exchange rate<sup>14</sup>, and the perspectives of productivity gains. And third, the period analyzed is from 2000 to 2013.

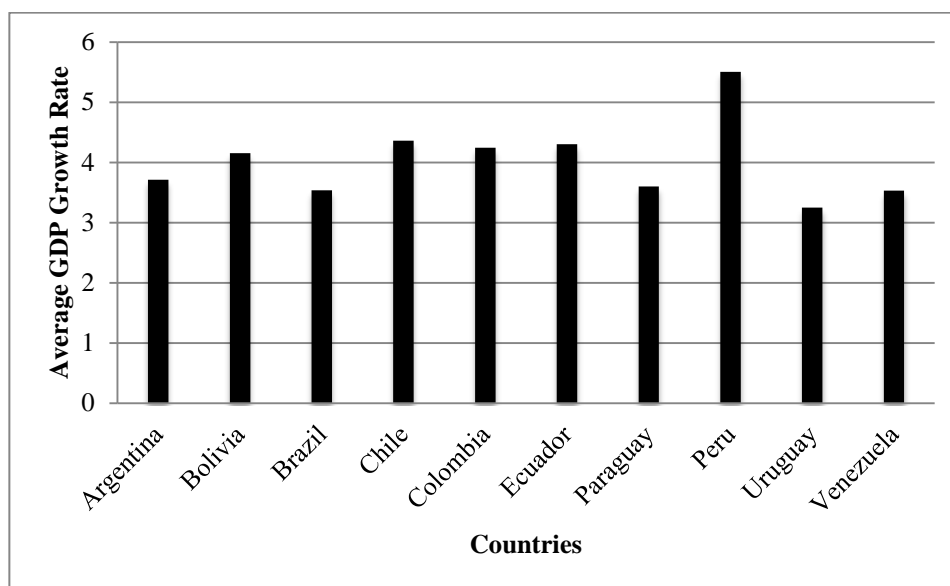
We may begin, as Figures 1 and 2 show, with the evidence on GDP an inflation rate among the countries of UNASUR. According to the authors’ calculations, based on statistical information from ECLAC (2015) and IMF (2015b), the figures indicate that over the period:

<sup>15</sup> We also comment about the exchange rate and monetary regime of each country.

<sup>14</sup> We know that the macroeconomic policies and variables, probably, were affected by exogenous factors, such as international financial crisis and ‘great recession’. However, for purposes of simplification, we will not analyze these issues.

- The average GDP growth rate for all countries of UNASUR was 4.0% per year.<sup>15</sup> Five countries (Argentina, Brazil, Paraguay, Uruguay and Venezuela) had a GDP growth lower than the average. Uruguay had the lowest average, 3.2%, and Argentina the highest among the bottom group, 3.7%. Bolivia and Colombia presented an average GDP growth of 4.2%, followed by Ecuador, 4.3%, and Chile, 4.4%. During the period under analysis, Peru had the best performance, with an average of 5.5% GDP growth rate per year.
- The average inflation rate for all countries of UNASUR was 8.5% per year, relatively low considering the historically of high inflation rates in South America during the 1980s and 1990s. Peru and Chile stand out with the lowest average inflation rates per year, 2.6% and 3.2% respectively. Following these, Colombia, Bolivia, Brazil and Paraguay also presented an average inflation rate per year below the regional average, varying from 5.1% (Colombia) to 7.2% (Paraguay). The average inflation rate per year in Uruguay was 8.5% and in Argentina 10%. Finally, Ecuador and Venezuela presented an average inflation rate per year greater than the UNASUR average, 12.1% and 24.6%, respectively.

Figure 1. Average GDP Growth Rate, %, 2000-2013

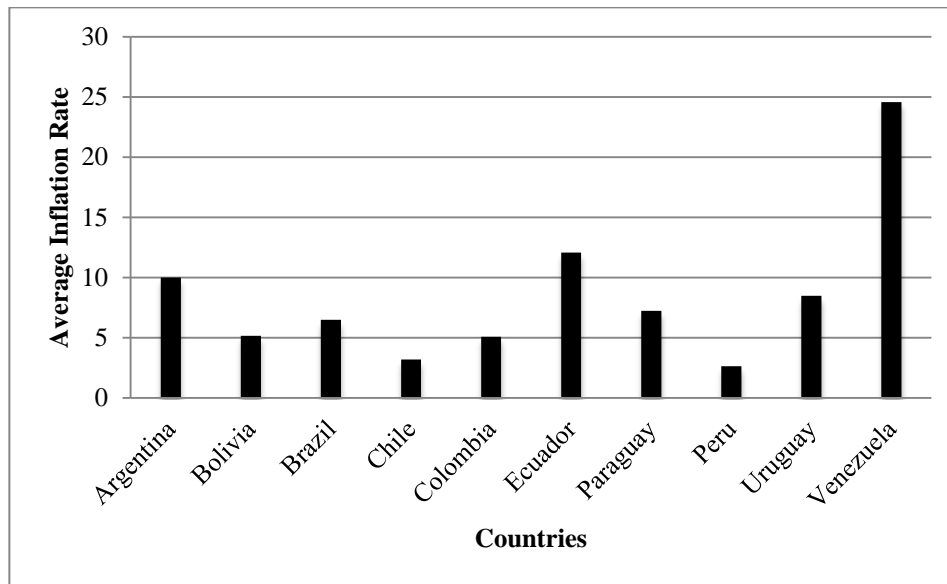


Source: IMF (2015b).

<sup>15</sup> We may compare the average GDP growth rates of North America Free Trade Agreement (NAFTA) and European Monetary Union (EMU), from 2000 to 2013; they were, respectively, 2.2% per year and 2.1% per year (average rates calculated by the author based on statistical information from International Monetary Fund, 2015b).



Figure 2. Average Inflation Rate, %, 2000-2013



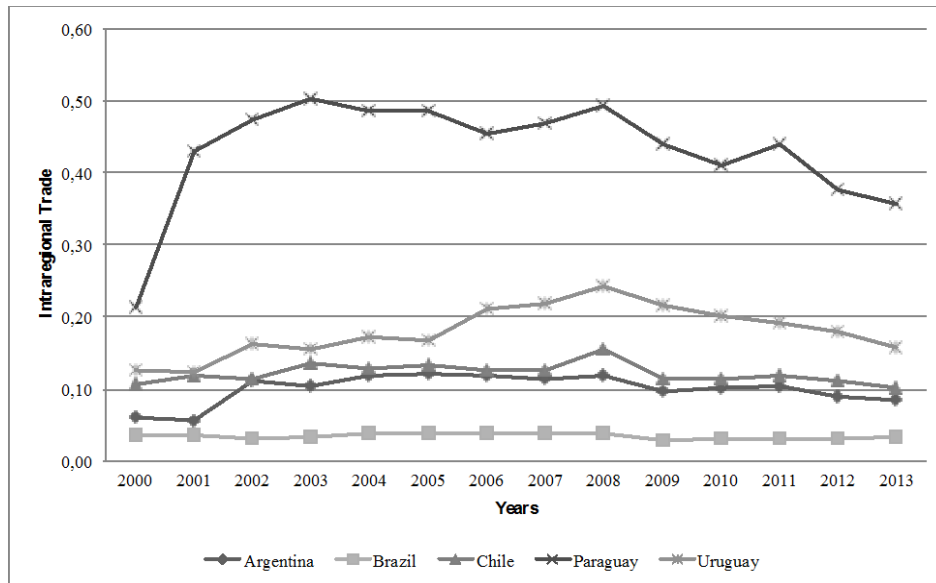
Source: IMF (2015b).

In terms of the exchange rate and monetary regimes of the UNASUR countries, we have the following: Argentina in 2001 had a currency board regime and since 2002 it has adopted a managed exchange rate regime;<sup>16</sup> Bolivia has a flexible exchange rate regime; Brazil operates a dirty floating regime in the context of an inflation targeting monetary regime; Chile, like Brazil, operates a dirty floating regime in the context of an inflation targeting monetary regime; Colombia adopts a dirty floating regime and its monetary regime is based on inflation targeting; Ecuador is ‘dollarized’ and adopts a flexible exchange regime with free convertibility; Paraguay has a dirty floating regime and, recently, adopted an inflation targeting regime; Peru also operates a dirty floating regime in the context of an inflation targeting monetary regime; Uruguay adopts an inflation targeting regime and has a flexible exchange rate regime; and Venezuela, at the beginning of the 2000s, ran a managed exchange rate regime, and, more recently, decided to control the exchange rate to avoid the ‘exchange rate pass-through’ mechanism, and continued as the only country to control its foreign currencies and manipulator of this devaluation experience. In summary, seven countries ‘manage’ their exchange rates, one country adopts USD as legal tender and two countries operate a flexible exchange rate regime. Moreover, it is important to mention that from 2000 to 2013, the real effective exchange rate (REER) of all UNASUR countries presented slight volatility and a trend of appreciation. Only recently, in 2013, due to US dollar recovery in the international financial market, the REER of almost UNASUR countries was deteriorated. This deterioration was more intense in Argentina, Brazil and Venezuela.

<sup>16</sup> The stable and competitive real exchange rate strategy was a result of the exchange rate administration by the Central Bank of Argentina and its intervention in the monetary market to control the interest rate. However, since the international financial crisis, due to the deterioration trend in the trade surplus, Argentina’s government has responded by implementing administrative controls in the foreign exchange market, in order to seek to avoid a further deterioration of its exchange rate.

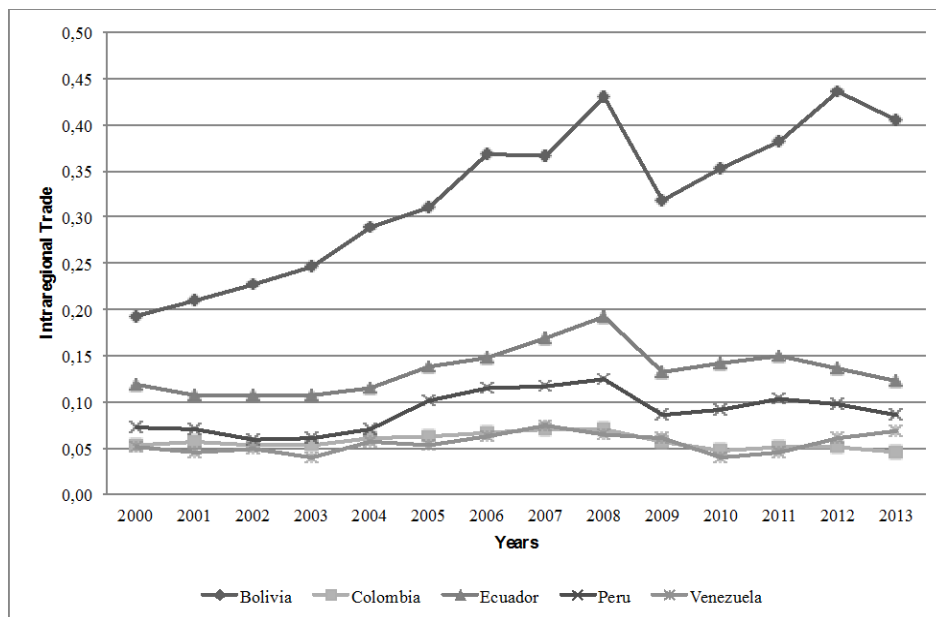


Figure 3. Intraregional Trade (Exports + Imports/GDP), 2000-2013



Source: IMF (2015c).

Figure 4. Intraregional Trade (Exports + Imports/GDP), 2000-2013



Source: IMF (2015c).

The intraregional trade (total volume of exports and imports to the Region/Total UNASUR GDP) among the UNASUR countries increased 233.2% between 2000 and 2013: in 2000, the intraregional trade was around USD 75 billion and in 2013 it reached a total of USD 250.1 billion (IMF, 2015c). However, its importance compared to GDP is still very low, as Figures 3 and 4 show, and this intraregional trade expansion, in terms of UNASUR GDP, remained relatively stable; in 2000, the ratio of total exports plus imports to UNASUR GDP was 5.4%, while in 2013 this relationship increased to 5.8%. As the figures show, the intraregional trade of UNASUR has increased and it has been important for Bolivia and Paraguay, while the intraregional trade of UNASUR has been irrelevant for Brazil, Colombia and Venezuela. Moreover, the

share of UNASUR exports in world trade is still relatively low; it increased from 2.6%, in 2000, to 3.4%, in 2013.<sup>17</sup>

According to ECLAC (2015) the data for the fiscal deficits in UNASUR countries show that: (i) from 2000 to 2003, in general, the ratio nominal fiscal result/GDP had a bad performance; (ii) in 2004 and 2005, the nominal fiscal result became a little bit better for some countries, especially Chile; (iii) from 2006 to 2008, it improved for almost all countries (the exception was Uruguay); (iv) in 2009 and 2010, there was great deterioration in the ratio nominal fiscal result/GDP that can be explained by the countercyclical fiscal policies implemented by the monetary authorities in response to the ‘great recession’;<sup>18</sup>; (v) in 2011, in general, the primary fiscal result was recovery in all countries; and (vi) from 2011 to 2013, due to the Euro crisis the main EA of the Region adopted a countercyclical fiscal policy, and, as a result, the primary fiscal result was reduced. It is important to mention that another point contributed to the primary fiscal deterioration in this period: the reduction of the commodity prices that affected, basically, the government’s revenues of Chile and Venezuela.

Foreign debt as a percentage of GDP has improved for UNASUR countries during the period under analysis according to statistical data from ECLAC (2015). As of 2000, figures ranged between 31.1% (Venezuela) and 80.3% (Bolivia). In 2013, foreign debt as a percentage of GDP ranged between 13.8% (Brazil) and 47.2% (Chile). The average figure for UNASUR countries dropped from 47.7% in 2000 to 27.1% in 2013.

According to World Bank (2015) data, the foreign reserves of the UNASUR countries, from 2000 to 2013, increased substantially: the total amount of foreign reserves in 2000 were around USD 112 billion, while in 2013 they reached USD 600 billion. While all countries increased their individual amount of reserves from 2000 to 2013, in 2013 Brazilian international reserves represented almost two thirds of the region’s total amount, USD 358,8 billion. In 2000, Brazilian reserves represented one third of the region’s total amount. During this period, Bolivia had the highest proportional increase of international reserves, from USD 1.2 billion in 2000 to USD 14.4 billion in 2013.

Finally, Table 3 shows the labor productivity of UNASUR countries. According to the data, it is possible to conclude the following: first, from 2000 to 2010, the labor productivity increased for all countries; and second, the labor productivity gap among the countries is still very large.

<sup>17</sup> Author’s calculations based on statistical information from UNCTAD (2015).

<sup>18</sup> For instance, Brazil and Chile reduced the taxes to stimulate consumption and Argentina, Brazil and Colombia increased their public expenditure. Thus, the combination of short recession and some expansionary fiscal policy produced a reduction in the fiscal balance, in 2009, that quickly improved further in 2010 (JARÁ ET AL., 2009).

Table 3. Labor Productivity (GDP per person employed), at 1990 PPP USD

Country	2000	2005	2010
Argentina	24,612	24,767	28,678
Bolivia	7,193	7,250	7,964
Brazil	12,100	12,059	13,419
Chile	28,758	30,473	30,417
Colombia	14,781	15,326	17,985
Ecuador	11,637	12,159	12,982
Paraguay	n.a.	n.a.	n.a.
Peru	11,597	13,339	14,955
Uruguay	25,358	25,436	25,681
Venezuela	23,653	26,468	28,453

Source: World Bank (2015).

Note: n.a. means not available.

Summarizing the macroeconomic and structural variables for UNASUR countries as discussed in this sub-section, we observed that: (a) average growth rate and inflation rate have been relatively similar for all countries. The exception was Venezuela, basically in terms of the inflation rate; (b) despite the difference in the exchange rate regimes, the effective real exchange rate became relatively stable for all countries. Moreover, the range of the effective real exchange rate variations was relatively close, with the exceptions of Argentina and Ecuador; (c) the volume of intraregional trade among the UNASUR countries is still low, but it improved from 2000 to 2013; (d) after 2005, the nominal fiscal result/GDP ratio, for all countries, improved considerably, even with the problems arising from the ‘great recession’ and the Euro crisis that forced countries to adopt countercyclical fiscal policies, deteriorating, thereby, the primary fiscal surplus; (e) the foreign debt/GDP ratio dropped, substantially, for all countries, except Chile (this relationship dropped only slightly in Uruguay and Venezuela), from 2000 to 2013; (f) the total amount of foreign reserves increased, from 2000 to 2013, around 432.8%; and (g) labor productivity gap is an important issue to be addressed as an strategy of development in the Region.

To conclude this section, it is important to mention that at the end of the 2000s, a set of factors contributed to the ‘convergence’ of the macroeconomic performance and to face the contagious of the international financial crisis in the main South America countries: (i) lower interest rates; (ii) public accounts in general improved with low level of indebtedness; (iii) inflation stopped rising (Argentina and Venezuela were the exception); (iv) competitive exchange rates emerged; (v) high level of foreign exchange reserves; (vi) reduced short-term external liabilities; and (vii) capital account regulations in place (CUNHA ET AL., 2011; OCAMPO, 2012).

### 3. A regional arrangement proposal for UNASUR

#### 3.1. Monetary and financial cooperation as an alternative for developing countries

The previous section showed that, historically and analytically, the economic integration process in South America has become a reality. However, as we know, there are still some problems to be overcome, such as asymmetric cyclical conditions in the economies of the Region, which means that a growing disparity of the most-developed countries in comparison to the less-developed ones is observed.

According to the post-Keynesian theory, the difficulties in integration processes can be explained by the different liquidity preferences among countries and regions with distinct levels of development. In a scenario of uncertainty, where liquidity means safety, less developed regions need to offer higher interest rates to compensate higher uncertainty. As a result, the monetary dynamic tends to increase regional disparities (AMADO & MOLLO, 2004). Therefore, to break the vicious cycle of rising regional inequalities, it is necessary the state intervention, or of a supranational regional arrangement, as will be discussed in the next section.

In spite of these inherent difficulties, post-Keynesians recognize that the advance of an integrationist project will eventually demand greater financial integration among the countries involved. As regional economic relations grow they require more sophisticated cooperation agreements, capable of transposing commercial agreements and including financial aspects (BIANCARELI, 2008).

At the same time, monetary and financial cooperation develops also as a response of the inadequacies and asymmetries of the international monetary system. In a context of financial globalization and liberalization, domestic macroeconomic policies and institutions became insufficient to deal with exogenously determined financial cycles. Collective and coordinated responses at the regional level can offer additional possibilities to foster growth and development. By working together and based on common and/or complementary interests, countries of the same region can significantly strengthen their efforts to respond to the globalization challenges. A cohesive political bloc also provides to its members greater bargaining power in the traditional multilateral institutions. To that extent, given the absence of substantial reforms in the international monetary system in the short run, regional monetary and financial cooperation emerges as the best strategy available to developing countries (SARRIERA *ET AL.*, 2010; BIANCARELI, 2008; BICHARA *ET AL.*, 2008; CUNHA, 2008; UNCTAD, 2007).

From the standpoint of the international system, regional cooperation should not be viewed as a threat, but rather as a complement capable of strengthening the global system. Ocampo (2006) argues that the international financial and monetary architecture would benefit from a network of global and regional institutions, instead of a few institutions with global reach. Going in this direction, on the one hand, a system formed by both global and regional institutions would provide greater stability to the world economy given that the increasingly global demand for financing will hardly be met by a limited number of global institutions. On the other hand, a system like this would be more balanced than the current system based on a few institutions from the standpoint of the international relations.

### 3.2. *The UNASUR Supraregional Board (USB)*

In this context, starting from the assumption that the process of economic integration in South America can be consolidated by UNASUR, this section presents a regional arrangement proposal for UNASUR based on the creation of a Regional Market Maker that is capable of boosting trade and financial relations, discipline and standardize macroeconomic policies and to prevent any disruptive situation resulting from financial and exchange rate crises. Our inspiration is Keynes's revolutionary analysis presented in his International Clearing Union, during the Bretton Woods Conference in 1944.

As we know, the Keynesian economic analysis concerning the financial and currency crises in a global world shows that the real disruptive outcomes derived from speculation in liberalized financial markets can *only* be reduced (or eliminated) if there is a market maker institution able to (i) prevent the capital volatility, (ii) assure market price stability and (iii) promote full employment economic growth.

Taking into consideration this idea, we propose a regional arrangement for UNASUR to assure macroeconomic stability, understood as sustainable economic growth, inflation under control, fiscal adjustment and external equilibrium. To address this objective, it is necessary to create a UNASUR SUPRAREGIONAL BOARD (USB) with political powers to establish (i) the adoption of common rules for macroeconomic policies<sup>19</sup>, (ii) joint programs for removal of trade barriers, (iii) the use of national currencies for intraregional transaction, (iv) a stable exchange rate system, (v) conditions for eliminating the external imbalances, (vi) the management of foreign reserves, (vii) mechanisms of capital controls, (viii) fiscal transfer to reduce structural and economic disparities among the countries, and (ix) conditions to monitor and to prevent the market failures (Ferrari-Filho, 2001-2002, 2002).

The main idea of Keynes's International Clearing Union was "the substitution of an expansionist, in place of a contractionist, pressure on world trade" (Keynes, 1944/1980, p. 176). Thus, Keynes suggested a scheme set out in a new international monetary system, based on an international currency, *bancor*, able to resolve the current financial crises and at the same time to promote full employment and economic growth in the global economy. Keynes clearly demonstrated what the world economy needed was "a *central institution* (...) to aid and support other international institutions" (*Ibid.*, pp.168-9, emphasis added).

Contrary to Keynes (1944/1980), we think that the USB does not require the establishment of a single currency to UNASUR. What is required, besides the institutional bodies created in the last three decades to boost the economic integration in the Region, is to design some rules for the governments and central banks of the UNASUR countries able to substitute the process of expanding effective demand in the South America, as occurred in the 1990s and 2000s, especially, in Argentina, Brazil and Uruguay.

In order to realize this objective, the USB should concentrate on pursuing creative policy options to reduce the real disruptive outcomes that emanate from speculative activity in financial and exchange rate markets. Thus, the USB should attempt the following policy objectives:

(i) To coordinate the macroeconomic policies among countries. It means that monetary policy should be employed to control the rate of interest, instead of controlling the stock of money to keep

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<sup>19</sup> It is important to mention that we are not proposing targets and the same macroeconomic policies for countries that have distinct characteristics. In other words, this is not the idea that 'one size fits all', as it is implicit in the EMU institutional arrangement.

inflation under control, and fiscal policy should be discretionary to support aggregate demand and, by a transfer mechanism, to reduce economic and social differences and integrate among countries' infrastructures;<sup>20</sup>

(ii) To assure that the central banks acts as a lender-of-last-resort to avoid bankruptcy of banks and financial collapse, as well as government default; as a result, disruption in the credit system related to productive activity would be avoided;

(iii) To implement a common trade policy and distribute the costs of achieving balance of payments equilibrium among the two groups of countries, those in deficit and those in surplus. The idea is similar, but on a large scale, to those existing in FLAR, as it section 3.1 shows;

(iv) To consolidate the free trade area in the UNASUR, which means to eliminate tariffs, import quotas and preferences on goods and services traded among the UNASUR countries. Currently, most trade relations among countries of the Region, for instance inside the MERCOSUR and the CAN, are determined by the principles of the Common External Tariff – that is, a standard trade duty adopted by a group of countries.

(v) To manage an exchange rate regime based on a fixed, but adjustable exchange rate system. As it is well known massive capital inflows as a consequence of large capital inflows in the form of both foreign direct investment and portfolio investment, fuelled by interest rate spreads between markets in the region and in developed economies, have produced macroeconomic problems in the main emerging countries of the region, including exchange rate appreciation and quick increase in domestic credit. Thus, the objective is to reduce the volatility of capital flows and to mitigate instability and fragility related to the speculative attacks on domestic currencies. In this context, on the one hand, reserve accumulation policies can be seen as insurance against negative shocks and speculation against domestic currency. On the other hand, another possibility is the use of capital management techniques, which includes capital controls, prudential domestic financial etc. (FERRARI-FILHO & PAULA, 2008-09<sup>21</sup>);

(vi) to promote a system of local currency payments to boost the trade and financial relations among countries. The idea is to generalize the SML system.

It should be emphasized at this point that a lesson from the current 'euro crisis' is evident. Namely that in any integration, and the South American integration as discussed in this contribution is no exception, it is very important to have common countercyclical policies of the type of the United States of Europe for example, rather than of the EMU. A single policy based on a single objective of economic policy as in the EMU, with no other policy, is based on the wrong macroeconomic model. Further policies, and fiscal policy in particular, are paramount. This is particularly important in view of the existence of more

<sup>20</sup> The proposal is similar to that of the FOCEM.

<sup>21</sup> Considering that five countries of South America have adopted the inflation targeting framework, a question that is raised is the following: how could inflation targeting and exchange rate targeting be compatible? Frenkel & Rapetti (2011) suggest a mix of administered exchange rate flexibility with active foreign exchange reserve accumulation, regulation of capital inflows and active sterilization of international reserves, combined with low domestic interest rates and fiscal restraint. To evaluate deeply the macroeconomic problems, and their consequences, to identify the trade-offs in economic policy, and to choose the right economic strategy, is the main challenge to economic policies in the South American countries.

than a single objective of economic policy as the ‘great recession’ has taught us recently. Co-ordination of policies across the regional integration is also important (ARESTIS, 2012).

In other words, our proposal removes all constrains on national-level fiscal and monetary policies, stabilizes the exchange rate, stimulates the trade relations, imposes limits on capital mobility, and encourages, through SML, intraregional trade and cooperation and preserves foreign reserves. In sum, it reduces the entrepreneurial uncertainties and develops an institutional arrangement to assure full employment economic growth and to mitigate the regional inequality among the UNASUR countries.

#### 4. Conclusion

We have argued that in the 2000s the debate on the need to consolidate a process of economic integration more consistently and robustly in South America came to be on the agenda. At least two reasons were fundamental to bring back the debate on economic integration in South America: on the one hand, a set of institutional bodies (FOCEM, Bank of the South and SML, among others) were created to boost the economic integration in the Region;<sup>22</sup> and, on the other hand, regional integration became the better alternative to the emerging economies to assure macroeconomic stability and avoid financial and exchange rate crises.

Going into this direction, the article analyzed, historically and analytically, the process of economic integration in South America, converging on the UNASUR. Our analysis showed that there is some evidence of macroeconomic convergence in UNASUR. For instance, (i) the average growth rate and inflation rate have been relatively similar for all countries, (ii) the effective real exchange rate became relatively stable for all countries, and, most importantly, (iii) the volume of intraregional trade among the UNASUR countries improved from 2000 to 2013: it increased 233.2%.

In this context, considering that the convergence of some macroeconomic variables of the UNASUR countries indicate that, in the near future, it is possible to reach the stage of a common market in the Region, it was presented a proposal, based on Keynes’ revolutionary analysis, for regional integration in UNASUR. Thus, the article proposed the creation of a Regional Market Maker to boost trade and financial relations, discipline and standardize macroeconomic policies and prevent any disruptive situation resulting from financial and exchange rate crises. In summary, what is expected from our proposal is (i) a deeply integrated market in the UNASUR and (ii) that South America’s monetary authorities can operate, jointly and convergently, fiscal, monetary and exchange rate policies in such a way as to assure macroeconomic stability, understood as sustainable economic growth, inflation under control, fiscal adjustment and external equilibrium, in the Region.

To conclude, it is important to mention that the regional integration of South America, through UNASUR, is feasible, but it is politically difficult due to the fact that: Chile, Colombia, Mexico and Peru are organizing a free trade and economic integration bloc, called Pacific Alliance; Paraguay has strong

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<sup>22</sup> Deos *et al.* (2010) emphasizes the importance of monetary and financial cooperation to the Region.



restrictions to any integration process with Venezuela; and Brazil is expected to assume the political leadership in the economic integration process. However, it is another matter.

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## ABSTRACT

The international financial crisis and the 'great recession' have substantially altered the dynamic process of the international economy. On the one hand, it has accentuated the asymmetry that exists between the economic size of emerging countries and their current role in the international monetary system (IMS). On the other hand, there is little space for substantial reforms in the global financial architecture inherited from the post-War period, particularly regarding to the Bretton Woods Institutions. In view of these developments, regional integration has become a second best strategy for the developing countries, specifically for South America countries. In this article, we investigate the existing mechanisms of monetary and financial cooperation in South America and question if they can ensure progress in regional integration. The historical and institutional analysis of the existing mechanisms in South America reveals a fragmentation of the region. Although the region has an extensive network of mechanisms for regional monetary and financial cooperation, such mechanisms are linked to different cooperation agreements. At the same time, our findings suggest that there is some evidence of macroeconomic convergence in UNASUR that justify a deeper integration among them. Thus, this article proposes the creation of a Regional Market Maker to UNASUR to boost trade and financial relations, discipline and standardize macroeconomic policies and prevent any disruptive situation resulting from financial and exchange rate crises.

**Key Words:** Finance and monetary integration; South America; UNASUR countries;

**JEL Classification:** F5, F55

## RESUMO

A crise financeira internacional e a "grande recessão" acentuaram a assimetria que existe entre a dinâmica econômica dos países desenvolvidos e emergentes, bem como resgataram a ideia de que é necessária uma reforma significativa na arquitetura financeira global. Concomitantemente, a proposição de integração regional tornou-se uma estratégia para os países em desenvolvimento, especialmente os países da América do Sul. Neste artigo, investigaremos os mecanismos existentes de cooperação monetária e financeira na América do Sul e questionaremos se eles podem garantir o progresso da integração regional. A ideia é mostrar que, por um lado, a Unasul pode se constituir em um processo de integração regional consistente e, por outro lado, propor a criação "Regional Market Maker" para a Unasul com o intuito de impulsionar as relações comerciais e financeiras, disciplinar e padronizar as políticas macroeconômicas e evitar quaisquer situações de ruptura decorrente de crises financeiras e cambiais.

**Palavras-chave:** Integração monetária e financeira; América do Sul; países da Unasul;