

## The Bank of the South<sup>1</sup>

### What is the Bank of the South?

On December 9<sup>th</sup>, 2007, representatives from Argentina, Bolivia, Brazil, Ecuador, Paraguay, Uruguay, and Venezuela met in Buenos Aires, Argentina, to launch “el Banco del Sur” or the Bank of the South (BoS). With the creation of the Bank, the leaders of Latin America envisaged a new development institution to help promote growth and tackle poverty. The BoS was originally proposed in 2006 by Venezuelan president Hugo Chavez. Chavez, along with other South American leaders, wanted a Bank that would allow them to assert their political and financial independence from traditional international financial institutions (IFIs), like the International Monetary Fund (IMF) and the World Bank, and put an end to decades of structural adjustment policies imposed by the IFIs on countries in Latin America.

### Why now?

Many Latin American countries argue that the conditions attached to IFI loans - privatization, deregulation, and economic liberalization - have failed. The IFI model of development has generated more poverty and inequality, and a permanent drain of capital and resources from countries to transnational corporations by way of interest payments and profit remittances<sup>2</sup>.

Against this context, the rising price of export commodities has led to an unprecedented accumulation of foreign exchange reserves and increasing terms of trade in South American countries. Real GDP in South America grew by over five percent annually between 2005 and 2007, and is expected to ebb only slightly in 2008 as a result of the financial crisis that began in the United States<sup>3</sup>. As a result, in early 2006, Argentina and Brazil paid their remaining IMF loans ahead of schedule, and in July 2006, Uruguay announced a \$900 million payment to the IMF, which amounts to half of their debt to the institution<sup>4</sup>. Oil-rich Venezuela, which recently repaid its World Bank loans five years ahead of schedule, severed ties with the IMF and World Bank in May 2007<sup>5</sup>. The IMF, as a result, has lost nearly all of its influence in South America with lending falling to under \$50 million, less than 1 percent of its global loan portfolio<sup>6</sup>.

The emergence of numerous left-leaning leaders in South America has also led to a trend towards greater regional integration and less reliance on IFI-imposed solutions. Alongside Venezuela’s Hugo Chavez came Brazil’s Luiz “Lula” da Silva, Argentina’s Christina Kirchner, Chile’s Michelle Bachelet, Bolivia’s Evo Morales, Ecuador’s Rafael Correa, Uruguay’s Tabaré Vázquez and now Paraguay’s Fernando Lugo. From this group, only Chile, who along with non-BoS members Peru and Columbia, have been resistant to a new regional financial institution.

<sup>1</sup> This brief was prepared for the Halifax Initiative by Brian Hermon, with comments from Fabrina Furtado, Jubilee South, Jorge Marchini, Professor of Economics, University of Buenos Aires, and John Dillion, KAIROS - Canadian Ecumenical Justice Initiatives.

<sup>2</sup> Fabrina Furtado. “South Bank: A Peoples Perspective.” International Development Economics Association. 14 Feb 2008. On-line:

[http://www.networkideas.org/alt/feb2008/South\\_Bank.pdf](http://www.networkideas.org/alt/feb2008/South_Bank.pdf)

<sup>3</sup> IMF Survey Online. “Latin American Growth to Continue Strong.” International Monetary Fund. 9 Nov 2007. On-line:

<http://www.imf.org/external/pubs/ft/survey/so/2007/CAR119A.htm>

<sup>4</sup> Observador Newspaper. “Uruguay Made Early Debt Payment.” European Network on Debt and Development (EURODAD). 16 July 2006.

On-line: <http://www.eurodad.org/aid/article.aspx?id=132&item=1304>

<sup>5</sup> Mark Tran. “Venezuela Quits IMF.” The Guardian. 1 May 2007. On-line: <http://www.guardian.co.uk/business/2007/may/01/venezuela.imf>

<sup>6</sup> Mark Engler. “Latin American Banks on Independence” In These Times. 22 Jan. 2008. On-line:

[http://www.inthesetimes.com/article/3497/latin\\_america\\_banks\\_on\\_independence](http://www.inthesetimes.com/article/3497/latin_america_banks_on_independence)

Accordingly, the founding members of the BoS have expressed a commitment to use the Bank to break with IFI policies of the past, recover the fiscal sovereignty of the South American people, and stop the transfer of resources from the South to the North. In the same spirit of financial independence and in parallel to the BoS, another regional bank, the Bolivarian Bank for the Americas (ALBA) was established in January 2008 between Cuba, Bolivia, Nicaragua and Venezuela. ALBA promotes economic integration and infrastructure development<sup>7</sup>.

### **What is the structure of the Bank?**

The bank will be headquartered in Caracas, Venezuela, with offices in Bolivia and Argentina, and its board will be comprised of the finance ministers from founding states. The Bank will consist of a Board of Ministers, an Administrative Board, an Audit Board, and a Board of Directors, and an executive committee to do the day-to-day work of the Bank.

Participants at the 2007 launch agreed that the BoS would be guided by three priorities:

1. financing the economic and social development of countries belonging to the Union of South American Nations (UNASUR);
2. strengthening regional integration; and,
3. reducing asymmetries and promoting the equitable distribution of investments among BoS members.

The Bank's founders agreed that the primary recipients of its loans should be national development banks and public financial institutions. Lending arrangements will also differ depending on the objectives of the recipient. Participants agreed that the Bank should have a number of lending instruments ranging from ordinary loans at non-concessional interest rates (close to market) for those projects anticipated to generate a profit, and concessional loans (less than market rate) for projects with high social returns but less profitability.

Members also generally agreed that, "without putting at risk the Bank's viability, all efforts need to be made to make sure that this would be a genuine development bank that would ensure resources were made available to projects and beneficiaries without access to credit"<sup>8</sup>. Providing loans to organizations with lower credit ratings, but with social development objectives in mind, and ensuring that the BoS does not attach conditions to its loans, represent its biggest departure from IFI policies in South America. While the broad principles of the Bank's structure have generally been agreed upon, member governments have been slower to agree on specific governance and structural issues.

### **What are the problems with the Bank of the South?**

Well beyond the 90-day window assigned in December 2007 to resolve outstanding structural challenges, many disputes remain that are holding the Bank back from starting its operations.

#### *Voting Power*

Although the founding declaration of the Bank states that "the Bank of the South will have an equal representation of each of the South-American countries based on a democratic operational system," there are concerns about the power balance between the governments involved.

Argentina, Brazil, and Venezuela support a proportional system of voting rights, with decision-making power commensurate with the financial resources each member gives. In contrast, the less wealthy members, Ecuador, Bolivia, Paraguay, and Uruguay, favour a system that gives

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<sup>7</sup> For more information on ALBA see On Line: <http://www.cpsa-acsp.ca/papers-2006/Kellogg.pdf>

<sup>8</sup> European Network on Debt and Development. "Latin Americans Agree to Further Details for Bank of the South." 2 July 2008. On-line: <http://www.eurodad.org/aid/article.aspx?id=132&item=2494>

all members equal voting power. Venezuela has also proposed that capital contributions be proportional to each country's relative share of the regional economy or regional population; that the contributions be voluntary; and that they be no less than that pledged to the IFIs<sup>9</sup>.

Despite the various proposals, the voting structure remains unresolved. Most recently, Brazil and Argentina attempted to "qualify" the 1-country 1-vote system, arguing that it would only be applicable during the annual meeting of the Bank's board and not for day-to-day operations<sup>10</sup>.

### *Capital Contributions*

Bank's members agreed to begin operations with an authorized capital stock (shares issues by the Bank to raise funds) of US \$20 billion and a subscription base of US \$7 billion. Argentina, Brazil, and Venezuela would pay in \$1 billion each, Ecuador and Uruguay \$400 million each, and Bolivia and Paraguay \$100 million respectively. The remaining five members of UNASUR, all of whom have been asked to join the Bank, would be expected to provide the remaining subscription capital. All member states agree that the IFIs should be able to invest in the Bank, although without a vote<sup>11</sup>. Members were also expected to pay in a minimum of 20 per cent of the subscription base immediately (10 per cent of which can be in local currencies). Once finalized, all of these decisions still need the final approval of each country's respective parliaments, a fact that may further delay the start of operations.

Despite the tentative agreement on the initial capital base, there are different positions among members on how the Bank's capital should be raised. For instance, in order to have sufficient guarantee of future capital, Brazil favours using the capital markets of member countries to raise funds by, for example, issuing bonds. Ecuador, meanwhile, favours raising money for the Bank by withdrawing resources from member states' exchange rate reserves as well as looking to international donors for periodic replenishments<sup>12</sup>.

### *The Brazilian Dilemma - how best to remain a regional powerhouse?*

Initially Brazil was not interested in joining the BoS, arguing that the National Bank of Economic and Social Development of Brazil (BNDES) already performed the same function. Brazil's position, however, changed as the BoS gained momentum and Brazil feared losing influence in the region by not participating. Either way, in contrast to the social development programs that some members envisage for the Bank, Brazil seems set on using both BNDES and the BoS to expand Brazilian capital and influence into the region through infrastructure and export development via the Initiative for Regional Infrastructure Integration in South America (IIRSA).

IIRSA has been adopted as a regional development plan by UNASUR, and is investing heavily in transportation, energy, and telecommunications with a view to creating ten "hubs" of economic integration across the continent. Over 40 mega-projects and hundreds of smaller infrastructure projects, worth tens of billions of dollars, have been identified for IIRSA funding<sup>13</sup>.

South American civil society organizations (CSOs) fear that the projects IIRSA funds will have enormous social and environmental impacts, displacing millions and leading to massive deforestation. If Brazil sees IIRSA as their model of South American integration and BNDES as the financial vehicle for furthering this integration and investment, critics argue that there is little room for broader social development initiatives in the BoS with Brazil at the helm<sup>14</sup>.

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9 Bank Information Center, "Bank of the South." Nov. 2007. On-line: <http://www.bicusa.org/en/Search.aspx?s=bank+of+the+south>

10 Eric Toussiant. "A Future for the Bank of the South." Politis. Sept. 2008. On-line: <http://www.cadtm.org/spip.php?article3677>

11 Fabrina Furtado, op. cit. footnote 2.

12 Ibid.

13 Bank Information Center. "IIRSA CCT Meeting." 29 Sept. 2008. On-line: <http://www.bicusa.org/en/Article.10920.aspx>

14 Fabrina Furtado. "Country Perspective on the Banco del Sur." Halifax Initiative: The Changing Face of Development. April 2008.

### *Civil Society Concerns*

In contrast, South American CSOs have argued that what should separate the BoS from IFI policies is its focus on social development and the environment. By focusing on IIRSA, CSOs fear that the Bank's first funding project may be an 8,000 km gas pipeline running from Venezuela to Argentina, a project they are not convinced will have an impact on either poverty reduction or social development. In two open letters to the presidents of the Bank's founding members, southern CSOs strongly condemned using the BoS to finance IIRSA<sup>15</sup>.

### **Reactions to the Bank of the South**

Reactions to the BoS have been mixed within the financial community. Publicly the IMF, the World Bank, and the Inter-American Development Bank (IDB) have been supportive of the BoS, suggesting that there is room for another development bank in Latin America. Nobel prize winner and former World Bank Chief Economist Joseph Stiglitz endorsed the BoS, calling it an opportunity to reflect the perspectives of the South, and "a good thing to have competition in the market, including the market for development lending"<sup>16</sup>.

Criticism of the BoS has been mostly directed at Venezuelan President Hugo Chavez and his perceived "anti-American project" against the Washington's IFIs<sup>17</sup>. More interesting is the response of Peru, Chile, Surinam, and Guyana, who are members of the IDB but have so far resisted joining the BoS. They have said the BoS is not a priority and that other financial institutions, like the Andean Development Corporation (CAF), the IDB, and the World Bank, are serving their needs<sup>18</sup>. There is some evidence that these four countries may change their minds once the BoS begins operations<sup>19</sup>.

### **What is the status of the Bank of the South today?**

A year since the Bank of the South was launched, a number of key structural and policy issues remain. And now the current financial, food and fuel crisis may also threaten the availability of member country resources for the project. As a result of these various hurdles, it seems unlikely that the Bank will begin operations before even mid-2009. Intentions to establish a stabilization fund and regional monetary system – two complementary objectives discussed in relation to the BoS at the December 2007 launch – seem even further off.

As the 2008 global financial crisis has seen the loan portfolio and influence of the IMF grow once again, the time is right for a regional alternative to the IFIs. The BoS is a powerful idea. What remains to be seen is whether the BoS can live up to its original promise, or whether it will revert to the limitations of its IFI predecessors.



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15 For more information see on line: [http://www.oid-ido.org/IMG/pdf/LETTER\\_TO\\_PRESIDENTS\\_19junio07.pdf](http://www.oid-ido.org/IMG/pdf/LETTER_TO_PRESIDENTS_19junio07.pdf) and <http://www.cadtm.org/spip.php?article2974>

16 Rory Carroll. "Nobel Economist Endorses Chavez Regional Bank Plan". The Guardian. 12 Oct. 2007. On-line:

<http://www.guardian.co.uk/business/2007/oct/12/venezuela.banking>

17 The Economist. "Hugo Chavez Moves Into Banking". 12 May 2007. Vol 383. Issue 8528.

18 Eduardo Tamayo. "The Bank of the South in Debate". American Latina en Movimiento. 14 May 2007. On-line:

<http://alainet.org/active/17443>

19 Stephen Lendman. "The Bank of the South: An Alternative." Center for Research on Globalization. 29 Oct. 2007. On line:

<http://www.globalresearch.ca/index.php?context=va&aid=7207>