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THE BANK OF THE SOUTH

Santiago Ojea Quintana

I. INTRODUCTION

On December 9, 2007, in Buenos Aires, Argentina, the former president of Argentina, Mr. Nestor Kirchner, joined the presidents of Bolivia, Mr. Evo Morales, Brazil, Mr. Inacio Lula da Silva, Ecuador, Mr. Rafael Correa, Paraguay, Mr. Nicanor Duarte Frutos, and Venezuela, Mr. Hugo Chávez Frías, in signing the Bank of the South's Foundational Act ("Act"). The purpose of the Act is to create a development bank ("Bank of the South") to finance the economic and social development of its members, strengthen integration, reduce inequalities, and promote equitable distribution of investments among its members.12 As of 2008 Chile, Colombia, and Peru have decided not to join the new bank, though their incorporation may take place in the future, as some of the current members have disclosed.3

The Bank of the South's head offices will be located in Caracas, Venezuela, with two subsidiaries to be situated in Buenos Aires, Argentina, and La Paz, Bolivia.4 Originally proposed by Mr. Chávez as a Latin American monetary and financial alternative to the International Monetary Fund ("IMF") and the World Bank, creation of the Bank of the South was quickly supported by Argentina, Bolivia, and Ecuador. Brazil, Paraguay, and Uruguay later expressed their support.

This paper analyzes whether the Bank of the South can be successfully implemented, considering the circumstances surrounding its creation and the differing interests of its members.5 I conclude that even though South

1. Though the President of Uruguay, Mr. Tabaré Vázquez, was not present in the launching meeting, Uruguay did become a member of the Bank of the South.

2. FOUNDATIONAL ACT OF THE BANK OF THE SOUTH, provision 1 (Dec. 10, 2007) (stating that the parties entering into the Act agree to create a development bank called Bank of the South, the purpose of which will be to finance economic and social development of the countries of the Union de Naciones Sudamericanas (UNASUR), the members of the Bank, in a well-balanced and stable manner by the use of internal and external regional savings, and to strengthen integration, reduce inequality, and promote equitable distribution of investments among the members).


4. FOUNDATIONAL ACT OF THE BANK OF THE SOUTH, supra note 2, at provision 2 (stating that the Bank of the South will be headquartered in Caracas, Bolivarian Republic of Venezuela, and its subsidiaries will be located in Buenos Aires, Argentina, and La Paz, Bolivia).

America is experiencing a favorable economic period that ought to favor the creation of a regional financing tool like the Bank of the South, the different interests converging into the Bank of the South will likely impede its creation in a competitive and successful manner.

II. WHAT IS GOING ON IN LATIN AMERICA?

Latin America is undergoing an outstanding macro-economic period. In April 2008, the Inter-American Development Bank ("IDB") held its annual meeting in Miami, Florida. In his message to the gathering, the bank’s president, Luis Alberto Moreno, noted that "despite the recent instability in international financial markets and the projected slowdown in the U.S. economy, the outlook for Latin America and the Caribbean is brighter than it has been in decades."6

The emergence of China and India in the global economy, and the robust economic performance of the United States and the European Union prior to the current subprime mortgage crisis, created an increasing demand for commodities and expanded global liquidity, thereby facilitating new investments in Latin America.7 As a result, the Latin American region grew by more than 4 percent a year for the past three years, and by 5 percent in 2006. Additionally, there has been a reduction in the unemployment rate.8 Between 2005 and 2006, inflation also fell from 6.1 percent to 4 percent.9

For most of the regional economies within Latin America, the cost of capital is the cheapest it has been in two decades.10 Currently, many of these economies may be better served by private banks than by International Financial Institutions ("IFIs"), since it is very difficult for IFIs to compete on price against private banks.11 Several countries in the region have taken advantage of the growing trend of investment in Latin

that Latin American governments – in the face of non-fulfilment [sic] of the many goals periodically set regarding regional integration – react by setting even more ambitious goals. Within the kingdom of 'magic realism', rhetoric usually takes place of the patient setting up of institutions and long-standing commitments. It is with this kind of scepticism [sic] that most part of the regional public opinion, analysts, and even governments, have undertaken the proposal to set up the Bank of the South.

8. Id.
9. Id.
America and the low interest rates available in the markets by accumulating international reserves. This has substantially improved the currency and maturity composition, and helped maintain current account and primary fiscal surpluses.\textsuperscript{12} The enlargement of budget surpluses and the increase in international reserves have aided some Latin American countries in raising their credit ratings and reducing their debt-to-GDP ratio.\textsuperscript{13}

Similarly, most of the countries in South America have diminished their exposure to the influence of IFIs. Only Peru and Paraguay have entered into new stand-by agreements with the IMF in 2007.\textsuperscript{14} Argentina and Brazil have taken advantage of their economic growth and high commodity prices to pay off their debt to the IMF,\textsuperscript{15} as have Venezuela,\textsuperscript{16} Uruguay, and Ecuador.\textsuperscript{17} Whereas in 2005, 80 percent of the eighty-one billion dollar loan portfolio managed by the IMF was allocated to Latin America, today, only 1 percent of the portfolio is tied to that region.\textsuperscript{18} Furthermore, as illustrated in the chart below, demand for the World Bank Group’s loans in Latin American and the Caribbean is faltering.\textsuperscript{19}

Despite the favorable macroeconomic progress that Latin America is experiencing, the main challenge the region should face in the coming years is to transform the present growth trend into sustainable and equitable growth, thus reducing poverty and inequality.\textsuperscript{20} The achievement of this goal will require, among other structural reforms, new and greater investment in infrastructure, energy, health systems, and education.\textsuperscript{21}

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\textsuperscript{13} Id.


\textsuperscript{15} Hugo Chavez Moves into Banking, supra note 12.


\textsuperscript{18} McElhinny, supra note 15.

\textsuperscript{19} Hugo Chavez Moves into Banking, supra note 12.


\textsuperscript{21} World Bank, supra note 13, at 60; Moreno, supra note 7, at 25-26.
\end{flushleft}
III. IS A REGIONAL FINANCING INSTITUTION A CONTROVERSIAL PROPOSAL?

The creation of a regional financing institution, such as the Bank of the South, for the purpose of financing development projects in the region and taking on the negative effects caused by international financial markets crises, might well help South America consolidate the growth period that is experiencing. Indeed, this idea is supported by various sectors.22

Some believe that a regional financing institution is necessary to counterbalance the influence of Bretton Woods institutions in South America, groups held primarily responsible for the economic failures the region has experienced to date.23 Over the past decades, both the IMF and the World Bank have encouraged Latin American economies to adopt free-market capitalism and curtail social spending. This resulted in widespread anger over "what was broadly seen as outside interference that enriched foreign companies."24 Hence, the IMF and World Bank are now seen as dominated by the United States, and as having imposed the "Washington Consensus" of macroeconomic stability at the expense of other, more important, priorities.25

22. Papa, supra note 5.
25. Hugo Chavez Moves into Banking, supra note 12 (this vision also receives support from Mark Weisbrot, co-director of the Center for Economic and Policy Research,
Furthermore, credibility upon the soundness of the policy reform programs of IFIs is dramatically decreasing with the recent financial crises hitting the international markets. It has been pointed out that “at the beginning of this decade, scepticism [sic] in Latin America was sealed when Argentina disregarded IMF advice by defaulting on its debt and then experienced robust economic recovery.”26 Venezuela’s Minister of Finance, Rodrigo Cabezas, has further stated that ‘if the IMF does not abandon its record of implementing tough policies with regards [sic] to emerging countries and being totally benevolent to developed countries, as it was in the last U.S. mortgage crisis, it will struggle to regain its credibility.’27

In addition, since the breakthrough of the Asiatic crisis in 1997, there has been a constant call from developing economies to reform international financial architecture, which has not yet been implemented.28 Furthermore, despite calls from a majority of the member nations of the IMF and the World Bank to open up the search process to permit appointment non-American and non-European leaders of the IMF and World Bank, a neoconservative European (Robert Zoellick) and an American (Paul Wolfowitz) were recently appointed.29

The “anti-Washington Consensus” sectors are not only backing implementation of regional financing alternatives, but so are some “moderate” sectors.30 The Executive Secretary of the Economic Commission for Latin America and the Caribbean of the United Nations, Mr. Jose Luis Machinea, has affirmed:

The financial volatility of the region’s countries has been exacerbated by the lack of suitable mechanisms for providing emergency financing to countries experiencing balance-of-payments financing problems as a result of external shocks. The lack of an emergency financing network at the regional and international level has led countries to move towards a policy of self-insurance consisting essentially in the accumulation of international reserves, which is very far from being the most efficient option for protecting against the vagaries of the world economy. In recent years there has been a flurry of proposals for reforming world financial institutions and markets. However, the strategies developed to improve global financial arrangements have underplayed the potential role of regional financial

27. Id.
29. Id.
30. Papa, supra note 5.
institutions.”

Even the World Bank’s vice president for Latin America, Ms. Pamela Cox, has admitted that “The Banco del Sur is a complement, not a competitor,” and the World Bank’s president, Mr. Robert Zoellick, has offered advice to the new bank on transparency issues. This means that regardless of how creation of the Bank of the South is justified, the notion that a regional financing institution could operate as a window through which funds could be rapidly mobilized to South America in order to develop South American projects and assist countries affected by external shocks, is widely supported and ineffectively criticized.

It could further be said that the current economic period that Latin America is experiencing is optimum for implementation of a new regional bank and, moreover, that creation of such an institution might well help the region consolidate the growth trend that is experiencing. As noted above, international liquidity has allowed several countries in South America to accumulate considerable amounts of reserves which can make establishing the Bank of the South possible. Both the Declaration of Quito, entered into on May 3, 2007, and the Declaration of Asunción, entered into on May 22, 2007, point out the historic opportunity that South American countries have to create the Bank of the South.

Finally, it also seems indisputable that a financing institution “of their own,” such as the Bank of the South, would allow South American economies to manage their own public policy agendas, as opposed to the Washington-oriented IFIs whose plans and major decisions are still controlled by developed economies and do not always coincide with the decisions and needs of developing economies. Even Nobel Prize-winning economist Joseph Stiglitz endorsed the creation of the Bank of the South, arguing in October 2007 that “[o]ne of the advantages of having a Bank of the South is that it would reflect the perspectives of those in the south.”

32. Heredia, supra note 24.
33. Papa, supra note 5.
34. Id.
35. DECLARATION OF QUITO (May 7, 2007) available at http://www.cadtm.org/spip.php?article2630 (stating that the Ministers ratified the historic opportunity held by the countries of South America.; DECLARATION OF ASUNCION (May 22, 2007) available at http://mef.gov.ec/pls/portal/docs/PAGE/MINISTERIO_ECONOMIA_FINANZAS ECUADOR/INTEGRACION%20SUDAMERICANA/ARCHIVOS2007/DECLARACIONDEASUNCION.PDF (stating that there was coincidence as to the necessity of seizing the historic opportunity that the countries of Latin America have to carry out the constitution of the Bank of the South).
36. Papa, supra note 5.
useful alternative to the World Bank and the International Monetary Fund.” 38  “Developing nations must create their own mechanisms of finance instead of suffering under those of the IMF and the World Bank, which are institutions of rich nations. . . it is time to wake up”, current Brazilian President Mr. da Silva said at a conference held in the Republic of Congo in October 2007, despite his differences with Venezuelan President Mr. Chávez regarding what the Bank of the South ought to be. 39

At this point in the paper, the reader may be thinking that all of the circumstances described above should result in a synergy spurring the implementation of the Bank of South. Although I agree in theory with this statement, my opinion is that other forces and conflicts coming from the members of the new bank are blocking its creation process and, ultimately, will continue to block the bank’s implementation given the irreconcilable positions that are generating these conflicts or forces.

IV. LET’S MOVE FROM RHETORIC TO PRACTICE

As noted by The Economist, “[r]ather than a gesture of defiance, the bank looks like an object lesson in why South American unity is so hard.” 40 Even if the Bank of the South constitutes an attractive proposal offering tangible benefits to South American economies, there are three critical circumstances that, in my opinion, will block the Bank of the South’s implementation: (1) the differing and opposite motivations that Brazil and Venezuela, two of the most influential economies in the region, have for becoming a member of the new bank; (2) the conflicts amongst the bank’s members caused by the one country, one vote system and the contribution system that should be adopted; and finally, (3) the effect that the “no-conditionality” premise adopted by the Bank of the South will have upon the cost at which the bank will raise funds in the global markets, thereby affecting its competitiveness in relation to other multilateral institutions operating in the region.

A. Political Consensus

The political and economic motivations which Brazil and Venezuela, two of the most influential members within the Bank of the South, had for deciding to become a member of the Bank of the South demonstrate that a real consensus between them for purposes of creating the bank is actually absent. In fact, it has been said that the debate over the Bank of the South actually reflects a broader struggle between Brazil and Venezuela for spreading their influence in South America. 41

From the very beginning, Venezuelan President Mr. Chávez perceived the Bank of the South as a political tool for his “Bolivarian revolution,” which would free other countries in the region from the “oppression” of

38. Id.
41. Hugo Chávez Moves into Banking, supra note 12.
Bretton Woods institutions.\textsuperscript{42} Before the launch meeting in December 2007, Mr. Chavez indicated the bank was an instrument for independence.\textsuperscript{43} The current high oil prices have allowed Venezuela to adopt a hostile position against Washington and the IFIs, even when doing so alienates foreign investors.\textsuperscript{44} Venezuela recently paid off 3.3 billion dollars of debt it owed to the World Bank\textsuperscript{45} and threatened that it will withdraw from both the World Bank and the IMF, which Mr. Chávez has referred as "part of the damnation that has fallen over us, the throwing-in, the shock-policies that spread starvation, misery and poverty and also violence among our peoples."\textsuperscript{46} Nonetheless, Mr. Chávez has not executed such a decision to date.\textsuperscript{47} However, Mr. Chávez has failed to note that pulling out of the IMF "would amount a technical default on Venezuela's bonds and would raise the cost of future borrowing in global markets."\textsuperscript{48} Moreover, walking away from the World Bank would cause Venezuela to default on bilateral investment treaties it has signed with many countries that use the World Bank's investment-dispute machinery.\textsuperscript{49}

Those effects might explain, therefore, why Argentina, Bolivia, Brazil, and Ecuador have rejected the idea of pulling out of the IMF,\textsuperscript{50} despite the fact that many of those countries' presidents share Mr. Chávez's leftist ideology, such as Bolivian President Mr. Evo Morales, who has declared that Bolivia will pull out of the World Bank's International Center for Settlement of Disputes\textsuperscript{51}, and shares Mr. Chávez's concerns about failure of the IFIs' policy reform programs in South America.

Even though Mr. Chávez has not been able to convince the other members to quit the IMF, he can likely count on the fact that in every other matter Bolivia and Ecuador will support Venezuela's positions regarding the Bank of the South.\textsuperscript{52} Moreover, Mr. Chávez might also be able to rely on Argentina's vote, considering the benefits that it is gaining by exporting food to Venezuela,\textsuperscript{53} though it has been said that Argentina is trying to hedge its alliances with both Venezuela and Brazil to ensure that neither gains the upper hand in regional politics.\textsuperscript{54}

It is the positions of Chile and Brazil however, which might jeopardize

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\textsuperscript{42} Bolivarian Finance, supra note 41.
\textsuperscript{43} Lanzan el Banco del Sur, supra note 3.
\textsuperscript{44} Hugo Chávez Moves into Banking, supra note 12.
\textsuperscript{45} More Equal Power Distribution in Banco del Sur Demanded by Venezuela, supra note 17.
\textsuperscript{46} Lanzan el Banco del Sur, supra note 3.
\textsuperscript{47} Heredia, supra note 24.
\textsuperscript{48} Id.
\textsuperscript{49} Hugo Chávez Moves into Banking, supra note 12.
\textsuperscript{50} Id.
\textsuperscript{51} More Equal Power Distribution in Banco del Sur Demanded by Venezuela, supra note 17.
\textsuperscript{52} Bolivarian Finance, supra note 41.
\textsuperscript{53} Barrionuevo, supra note 11.
\textsuperscript{54} More Equal Power Distribution in Banco del Sur Demanded by Venezuela, supra note 17.
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successful implementation of the Bank of the South.\textsuperscript{55} Chile has attended some of the negotiation meetings as an observer but it has not joined Mr. Chávez's initiative.\textsuperscript{56} It has been said that the absence of Chile, the twenty-sixth most competitive economy in the world and the first most competitive in Latin America, according to the 2008 Report on International Competitiveness published by the International Institute for Management Development,\textsuperscript{57} constitutes a major impediment to implementation of the Bank of the South.\textsuperscript{58} Brazil was originally against creation of the Bank of the South, and even though lately it has gone along with the new bank, it has also been trying to retard the creation process.\textsuperscript{59} Historically, Brazil's President Mr. Lula da Silva did little to limit Mr. Chávez's influence in the region, in part for the purpose of looking good in front of his leftist-oriented Worker's Party.\textsuperscript{60} However, Brazil has recently distanced itself from Venezuela as a result of Mr. Chávez's assaults on Venezuelan democracy.\textsuperscript{61} Brazil's communication minister has expressly condemned Mr. Chávez's assaults on the Venezuelan media,\textsuperscript{62} and stemming from the RCTV case,\textsuperscript{63} the Brazilian Senate has yet to clear the way for Venezuela's incorporation into the Common South Market (MERCOSUR).\textsuperscript{64} Mr. Chávez has expressly criticized the use of food crops to develop ethanol-based fuels, a strategic keystone of Brazil's economy.\textsuperscript{65}

Even though both Mr. Lula da Silva and Mr. Chávez come from left-wing parties, the former has been moving towards a more pragmatic and market friendly government such as those of Chile and Peru.\textsuperscript{66} In fact, Mr. Lula da Silva has built a good relationship with U.S. President George W. Bush, motivated by their mutual strategic interest in developing ethanol-based energy projects and diversifying part of the Brazilian

\begin{thebibliography}{99}
\bibitem{55} Martinez, supra note 18.
\bibitem{56} Lanzan el Banco del Sur, supra note 3.
\bibitem{58} Martinez, supra note 18.
\bibitem{59} Bolivarian Finance, supra note 41.
\bibitem{60} Hugo Chávez Moves into Banking, supra note 12.
\bibitem{61} Id.
\bibitem{63} The RCTV arose after Brazil's Senate issued a declaration criticizing Mr. Chavez's decision not to renew the broadcast license held by RCTV (a private company). Mr. Chavez immediately contested such declaration linking Brazil's Senate's position with the United State's interests in the region. To get more information about this verbal exchange, see Chris Carlson, RCTV Case Causes Tensions Between Brazil and Venezuela, VENEZUELANALYSIS, June 4, 2007, http://www.venezuelanalysis.com/news/2427.
\bibitem{65} Romero, supra note 63.
\bibitem{66} Hugo Chávez Moves into Banking, supra note 12; Romero, supra note 63.
\end{thebibliography}
and American energy matrix into such a source of energy. From another viewpoint, Brazil already has its own development bank, the National Bank of Economic and Social Development of Brazil ("BNDES"), "whose lending of 62.5 billion reais ($37 billion) in the 12 months to September [2007] was 50% greater than that of the World Bank in the same period." The BNDES president declared that he would propose creation of a fund through his bank, whose purpose would be to finance integration projects in Brazil and South America with the World Bank and the Inter-American Development Bank, which raises the question of whether the Bank of the South would duplicate the BNDES's mission and whether the lending power of the BNDES makes any other regional alternative obsolete.

Finally, Brazilian diplomats are afraid that the Bank of the South will make soft, politically driven loans that will go unpaid. "Brazil wants to avoid showing that it is somehow part of a Chávez-led institution that is making loans for projects that are being judged more for their political ideology than for their economic viability", said Peter Hakim, president of the Inter-American Dialogue, a policy group in Washington D.C. that focuses on Latin America. In this regard, whereas Mr. Chávez's conception of the Bank of the South excludes any participation of its technical staff in the decision process, Brazil's position is that such technocrats are precisely the people who should staff the bank, and that the Bank of the South should adopt conventional banking standards.

So, even though the Venezuelan Minister of Finance has said that the very first element necessary to found the Bank of the South has been successfully achieved, namely, the political will of the South American Governments to create this institution, doubts have been raised about the extent to which Brazil is truly and actually committed to the creation of the Bank of the South. Eric Toussaint, who has actively participated in the new bank's negotiation process, clearly illustrates the extent to which Brazil is actually committed to the new bank:

Brazil has joined the Bank of the South because it cannot be absent from it: if the foundations of the Bank of the South had not been laid on the initiative of Venezuela and Argentina, Brazil would never have given it any thought. But to maintain its regional economic

67. Hugo Chávez Moves into Banking, supra note 12.
68. Bolivarian Finance, supra note 41.
70. Bolivarian Finance, supra note 41.
71. Barriónuevo, supra note 11.
72. Bolivarian Finance, supra note 41.
73. More Equal Power Distribution in Banco del Sur Demanded by Venezuela, supra note 17.
75. Martínez, supra note 18.
dominance Brazil cannot stay away from the Bank of the South. If we look at it from the viewpoint of Ecuador, Venezuela and Bolivia, it is easy to understand why these governments are interested in having Brazil in the Bank of the South, because it is an important economic power and because a series of progressive governments in the region wish to maintain good relations with Brazil so that it does not strengthen its ties with the United States, which would weaken the region vis-à-vis American aggressivity [sic]. A truly diplomatic and geo-strategic game is being played. In a more ideal world, the Brazilian government would adopt a truly leftist policy - an alternative to its alliance with the US and its support for the agro-exporting industry and for an export-based policy which is set on conquering the markets of the region. But that is a far cry from reality.76

Although Brazil's commitment to the Bank of the South might be weak, the fact is that Brazil has joined the proposal. Two reasons have been given to explain Brazil's participation. First, as noted by Mr. Toussaint's comments, Brazilian diplomats realized that Brazil could never have remained outside a South American institution, especially a wealthy one.77 "[T]he impression is that its decision [to participate in the Bank of the South] results from the perception that Brazil cannot remain aside of irreversible political events, rather than from an option politically inspired in favor of a sovereign and supportive integration process of the South American peoples."78 Instead of rejecting the idea of creating a regional institution, Brazil's diplomats have worked to limit the new bank's remit and to slow its creation process.79 Second, Brazil's adherence to the Bank of the South is explained by its business interests in the economy of Venezuela.80 Brazilian Finance Minister Mr. Guido Mantenga said in 2007 that although Brazil had shown less interest in creation of the bank because Brazil has the greatest credit capacity, "we continue to support the project because it will benefit our commercial partners and Brazilian businesses."81 Brazilian companies currently have substantial interests in the Venezuelan economy.82 Brazil's exports to Venezuela rose by 60 percent last year.83 Odebrecht, a Brazilian construction company, has built a new metro line in Caracas and a bridge over the Orinoco, and is building a $2.5 billion hydroelectric dam.84 Braskem, Odebrecht's petrochemicals arm, has a three billion dollar partnership with state-owned Pevquen that includes building two plants to produce plastic resins. Companhia Vale do Rio Doce is eyeing Venezuela's min-

77. Bolivarian Finance, supra note 41.
78. Martinez, supra note 18.
79. Bolivarian Finance, supra note 41.
80. Hugo Chavez Moves into Banking, supra note 12.
81. Barrionuevo, supra note 11.
82. Bolivarian Finance, supra note 41.
83. Hugo Chavez Moves into Banking, supra note 12.
84. Id.
eral riches.\textsuperscript{85}

To sum up, the absence of Chile in the Bank of the South is evidence that not all of the most competitive economies of the region are participating in the project and, consequently, doubts exist as to the soundness of the Bank of the South. More importantly, Brazil's conduct to date suggests that its commitment to the Bank of the South is actually weak, and that its interest is designed to counterbalance Mr. Chavez's influence in the region. Without a strong commitment from Brazil, the strongest economy in Latin America, the Bank of the South existence would be precarious.

The obstacles that Brazil's position can introduce to the creation of the new bank, as conceived by the other members, first showed up when they had to decide whether or not the Bank of the South would comply with a monetary function. As early as the presidential elections of 1998-1999, Mr. Chávez proposed creation of a regional organization in which all South American reserves could be pooled. The goal of the regional organization would be to replace the IMF in South America, playing a central role in regional monetary policy\textsuperscript{86} and to provide a balance of payments support in crisis situations.\textsuperscript{87}

Ecuador's Rafael Correa supported Mr. Chávez's ideas for the new bank, arguing that it should combine the emergency-aid functions of the IMF with the project lending of the World Bank and the IBD.\textsuperscript{88} Moreover, Ecuador's Minister of Economy and Finances, Mr. Ricardo Patiño, declared that the collection of international reserves that Argentina, Bolivia, Brazil, Ecuador, Paraguay, and Venezuela deposited in American and European banks added up to approximately $164 billion, which should be used for the regional monetary stabilization fund.\textsuperscript{89}

The idea of creating a monetary institution was expressed in the documents prepared at the beginning of the negotiation process. The Second Provision of the Declaration of Quito states that the parties agreed to analyze the possibility of continuing to strengthen the Latin American Reserve Fund by integrating new partners and/or creating new instruments.\textsuperscript{90} Similarly, the Declaration of Paraguay stated the parties agreed

\begin{itemize}
\item \textsuperscript{85} \textit{Id.}
\item \textsuperscript{86} \textit{More Equal Power Distribution in Banco del Sur Demanded by Venezuela, supra note 17.}
\item \textsuperscript{88} Hugo Chavez Moves into Banking, supra note 12.
\item \textsuperscript{90} Declaration of Quito, supra note 36 (stating the members' agreement to analyze the potential for advancing the stabilization fund by strengthening the Latin American Reserve Fund (LARF) by integrating new partners and/or creating new instruments).}
\end{itemize}
to "move forward" in relation to such idea. Nonetheless, Brazil, however, rejected the idea of the Bank of the South becoming a lender of last resort. Brazil's Finance Minister Mr. Guido Mantenga had already rejected the idea that the new bank could provide financial first-aid without the tough conditions the IMF imposes, calling for "modesty and parsimony" in any new body. Because of Brazil's lack of support for a regional bank supplying monetary functions, no consensus was possible between the members on this issue. Under the Declaration of Rio de Janeiro, signed by the Ministers of Economy, Finances and Treasury of the current seven members of the Bank of the South, on October 8, 2007, the parties agreed that the new institution would be only a "development bank".

Venezuela's Minister of Finances has declared that the debate as to whether or not the Bank of the South must act as regional monetary fund might be taken up again in four or five years, although a commitment to continue evaluating monetary fund functionality was not included in the Declaration of Rio de Janeiro or in the Foundational Act. Certainly, the limited scope of the Bank of the South has, to some extent, destroyed its innovative content and eliminated a function that none of the other banks operating in the region comply with.

Venezuela's Minister of Finance has said that the Bank of the South would provide the region with its own development bank, which it does not have at the moment. The Bank of the South may also help tackle the "neoliberal paradigm," whereby capital generated in South America allegedly migrate to developed economies in the way of dividends, payments of interests and/or patents, instead of remaining in the region, supporting regional development. However, other South American development institutions are improving their performance fairly well and pursuing the same purposes that the Bank of South would pursue in the region. The Andean Development Bank ("CAF") has lent over half of its total portfolio (three billion dollars) in South America, which represents 50 percent of all MDB lending. Even Venezuela, which virtually ceased borrowing from the Inter-American Development Bank, the World Bank, and the International Monetary Fund in 2000, has maintained an annual flow of $650 million coming from the CAF. Brazil's own development bank, the BNDES, has also become a force in the re-

91. Declaration of Asunción, supra note 36 (stating the members' agreement to make progress towards a stabilization and guaranty fund by integrating new existing funds and/or creating new instruments).
92. Hugo Chavez Moves into Banking, supra note 12.
93. Declaration of Rio de Janeiro (Oct. 8, 2007) (stating that the Ministers agreed the new institution would be a development bank with South American character being the central feature of new financial architecture in the region).
94. Cabezas, supra note 75.
95. Id.
96. Martinez, supra note 18.
98. Id.
gion and lent thirty-four billion dollars in 2006 for Brazilian projects. Furthermore, Venezuela's president declared that he would propose creating a fund through his bank, with a purpose that seems to duplicate those of the Bank of the South.

Being just a development bank, it would be hard for the Bank of the South to compete against other institutions, due to its relative inexperience and lack of expertise. Mark Shifter, Vice President for Policy at the Inter-American Dialogue in Washington, an entity focused on Latin America, stated that "There's the concern that [the Bank of the South] will be a sham if its lending policies are driven by politics and personal loyalty, particularly when there are institutions indigenous to the region that are functioning well."

To conclude, an issue that has not been raised is what actions the Bank of the South is planning to carry out in order to counterbalance a competitive alternative to the signaling function to international markets that the IMF continues to perform today. Many lenders still base their decisions on the IMF’s blessing, usually in the form of a stand-by agreement in compliance or a clean Article IV report. Balancing the IMF’s influence upon the region requires not only creation of a regional monetary fund, but also an alternative source of economic advice and risk assessment that diminishes the IMF hegemony upon development finance gate keeping.

It is worth considering the Chiang Mai Initiative ("CMI"), an experiment in 2000 in which the Finance Ministers of ASEAN countries and China, Japan, and South Korea ("ASEAN +3") agreed to provide liquidity support for the member countries that experienced balance of payment difficulties in order to prevent an extreme crisis or systemic failure in a country and subsequent regional contagion, as occurred in the 1997 Asian financial crisis. The CMI involves an expanded ASEAN Swap Arrangement (from five members to ten) and a network of bilateral swap arrangements among ASEAN +3 countries. Paradoxically, drawing most funds through swaps is conditioned on the achievement of an agreement with the IMF, which conditions financing upon the implementation of policy reforms by the borrower, some of which are fairly strict. In response to objections raised to what is called "the IMF link" by the Malaysian Prime Minister Mahathir Mohamad, the members further agreed that borrowing up to 10 percent of the available swaps would not require

99. Barrionuevo, supra note 11.
100. Id.
103. Id.
104. Id.
IMF approval.\textsuperscript{107} It has been argued that most of the Asian countries do not feel they have the economic surveillance capacity that the IMF has provided and, even more important, that the conditionality upon the International Monetary Fund's supervision was intended to prevent lax economic policies.\textsuperscript{108}

B. CAPITALIZATION AND VOTING STRUCTURE

The Bank of the South is projected to raise seven billion U.S. dollars from its current seven members as initial capital.\textsuperscript{109} Although this contribution exceeds Latin American contributions to the IDB by two billion dollars, it is still a small fraction of the latter's 100 billion dollar operating "callable" capital that could be raised through non-regional member contributions and frequent bond issues on international markets.\textsuperscript{110} Moreover, the Bank of the South's initial proposed capital is more than the CAF's five billion dollar callable capital and three billion dollar paid-in capital\textsuperscript{111} and not much less than the almost eight billion dollar BNDES' callable capital.\textsuperscript{112}

Beyond the initial capital on which the new bank will be based, the most difficult issue its members have been debating, which contribution system should be adopted, illustrates, once again, how distant the positions among some members are. According to the Sixth Provision of the Foundational Act signed in Buenos Aires in December 2007, the Finance Minister of each country-member will carry out, within sixty days as from the signing date, all the measures necessary to finish drafting the bank's organizational agreement.\textsuperscript{113} An Argentine Government representative said that the "document will establish a series of details, including the system of contributions and, if they are different, how will the weight [sic] of each nation in decision-making."\textsuperscript{114} However, two positions exist among members of the new bank as to how contributions ought to be: some support an equal-contribution system while others prefer a non-equal contribution system.\textsuperscript{115}

The debate as to each country's contribution is directly related to the voting system that has been adopted for the new bank. The fifth provision of the Foundational Act states that each member of the Bank of the South will have "equal representation" within the board "under a demo-

\begin{itemize}
  \item \textsuperscript{107} Id.
  \item \textsuperscript{108} McElhinny, \textit{supra} note 88.
  \item \textsuperscript{109} Barrionuevo, \textit{supra} note 11.
  \item \textsuperscript{110} McElhinny, \textit{supra} note 88.
  \item \textsuperscript{112} BYLAWS OF \textit{Banco Nacional de Desenvolvimento Econômico e Social - BNDES}, Article 6, http://www.bndes.gov.br/english/bndes/bylaws.pdf ("BNDES's equity capital is composed of R$ 13,879,407,032.73 . . . divided into 6,273,711,452 . . . registered shares with no face value.").
  \item \textsuperscript{113} FOUNDATIONAL ACT OF THE BANK OF THE SOUTH, \textit{supra} note 4.
  \item \textsuperscript{114} Seis Presidentes Firman Acta Fundacional de Banco del Sur, \textit{PAlS}, Dec. 9, 2007.
  \item \textsuperscript{115} Id.
\end{itemize}
Before the launching meeting in Buenos Aires, the Venezuelan Finance Minister Mr. Cabezas declared that each member would have one vote in both the political and administrative management boards of the bank. The rationale of such a rule was explained by Mr. Cabezas in a conference held in Washington D.C., in October, 2007: "No one, by themselves, will be the owner of Bank of the South", he said.

It is worth of mentioning that such a voting structure presents an important difference in relation to the Washington-oriented IFIs, where votes are awarded in proportion to the contributions of each member, thus favoring U.S. and European non-borrowing members. Whereas the U.S. controls 30 percent of the Inter-American Development Bank’s Board vote share and about 17 percent of World Bank and International Monetary Fund shares, the eight countries forming the Bank of the South control less than four percent of IMF Board, less than 6 percent at the World Bank, and 33 percent at the IDB.

However, despite such advantages, a one country, one vote system gives few incentives to larger economies, such as that of Brazil, to contribute more funds than the weaker economies. Different proposals defining the contribution system were presented during the negotiations of the Bank of the South, but again, no consensus was possible among the members. First, Brazil and Argentina proposed that each member contribute the same amount of funds, because they have the same voting rights as all the other members. So, if the projected initial capital was seven billion dollars, each of the seven members would have to contribute one billion dollars. Such amount would be higher than the amount that Bolivia, Ecuador, and Paraguay currently contribute to the Inter-American Development Bank as ordinary capital ($920.4 million, $556.8 million, and $435.8 million respectively), though lower than the amount contributed by the remaining members of the Bank of the South (Uruguay: $1,164.2 million; Argentina: $10,858.9 million; Brazil:

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116. Foundational Act of the Bank of the South, supra note 4, provision five.
117. Cabezas, supra note 75.
118. Id.
120. Id.
123. Id.
124. Id.
zil: $10,858.9 million\(^{127}\); Venezuela: $5,817.8 million\(^{128}\)). Ecuador, Bolivia, Paraguay, and Uruguay opposed the foregoing criteria.\(^{129}\)

Second, Argentina and Brazil came up with a second proposal whereby the major economies would contribute more to the Bank of the South more than the smaller economies\(^{130}\) and have more voting rights in the administrative management board, which is supposed to manage the bank on a day-to-day basis, but not on the political management board.\(^{131}\) This proposal was fervently criticized for jeopardizing the “democratic principle” adopted in the Quito Declaration and reproducing the unequal system adopted by the IFIs, whereby the most powerful economies dominate the policies and main decisions of the financial institutions.\(^{132}\) The proposal was again refused by Ecuador, Bolivia, Paraguay, Uruguay, and Venezuela.\(^{133}\)

Third, Ecuador, Bolivia, Paraguay, and Uruguay proposed the contributions be proportional to the size of the economy of each country-member, without affecting its voting rights.\(^{134}\) Each country would have to put in 10 percent of its respective international reserves, although it has not been reported if such reserves would be considered either as paid in capital or callable capital.\(^{135}\) Not without reason, Brazil resisted equal voting rights even with unequal contributions.\(^{136}\) Were 10 percent of reserves to be designated as callable capital, Brazil would allocate far more than other smaller economies such as Bolivia or Ecuador ($16 million versus $400 million), not to mention the fact that the new bank’s total capital would be at least ten times higher than the seven billion dollar figure initially proposed.\(^{137}\)

In addition, Ecuador proposed that each member should not contribute less than the respective contribution each country has in the International Monetary Fund, the World Bank, or the Inter-American Development Bank.\(^{138}\) However, little has been reported as to whether such criteria refers to contributions to a single institution or combined contributions. Moreover, even if the Bank of the South is capitalized through the total funds that each member actually contributes to the fore-

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129. REDEBRASIL, supra note 122.
131. REDEBRASIL, supra note 122.
132. Id.; Ugarteche, supra note 132.
133. REDEBRASIL, supra note 122.
134. Id.
136. Id.
137. Id.
138. Cabezas, supra note 75.
going IFIs (in the case of the Inter-American Development Bank, as paid-in capital), the new bank’s capital would be $403 million, pretty much less than the seven billion dollar projected capital mentioned above. Brazil and Argentina, under this hypo, would still be the major contributors followed by Venezuela, Ecuador, Uruguay, Bolivia, and Paraguay. No information was released as to the adoption of these criteria, so it is reasonable to assume that it did not receive support from all of the members.

Finally, Venezuela came up with a set of all-encompassing criteria: contributions should be (i) proportional to the countries’ relative share of the regional economy or regional population, (ii) voluntary, and (iii) no less than that made to the IFIs. It was not clarified whether the denominator that would be used when defining the first criteria would be the economy or population of all South American countries or only that of all the members of the Bank of the South. Again, little information was released to the public as to how those three criteria should be defined and mixed, but whatever the denominator is, Brazil would be required to contribute over half of all initial contributions and as much as 120 times more than the smallest member would contribute.

Therefore, the contribution system is another line dividing Brazil’s interests on the one hand, and other smaller economies such as that of Bolivia or Ecuador on the other hand, the latter of which can count on the support of Venezuela. There is no reason for Brazil to accept a system in which it will have to contribute more funds than the other economies without gaining more control of the bank as a result. However, were Brazil’s position accepted, tying voting power and contribution, the “democratic principle” on which the Bank of the South must be based, according to Venezuela, Bolivia, and Ecuador, would be undermined. Moreover, were the contributions reduced according to the contributing capacity of each member, the new bank might not be able to raise seven billion dollars as initial capital, thereby losing competitiveness against other institutions operating in the region. Hence, the debate as to the contribution system that ought to be adopted shows once again the considerable distance among the positions of the parties involved in the Bank of the South and the difficulty of bringing such positions together.

C. No Conditionality

An important characteristic of the Bank of the South pointed out by some of its supporters is that unlike the IMF, World Bank, and Inter-American Development Bank, the new bank will not condition its loans upon the implementation of neoliberal policy reforms like the ones involved in the foregoing IFIs’ programs, such as privatization of state enterprises, government deregulation, deep cuts in social spending, wage

139. McElhinny, supra note 15.
140. Id.
141. Id.
freezes or cuts, unrestricted free market access for foreign corporations, corporate-friendly tax cuts, and/or crackdowns on trade unions. However, what “no conditionality” actually means remains unclear. The Venezuelan Minister of Finance Mr. Rodrigo Cabezas pointed out in an October, 2007 conference in Washington D.C. that whereas IFIs have conditioned their loans upon the implementation of structural programs that derived in higher leverage, poverty, and inflation rates in the region, the Bank of the South will be the “antithesis” of such a manner of financing, not only because its loans will not be conditioned by any “hegemonic” policy, but also because all of its members will have the same voting rights. In February, 2007, Argentina’s former President Mr. Nestor Kirchner declared that the Bank of the South would adopt a different philosophy from that adopted by both the private lenders and the multilateral banks. Brazil’s Finance Minister, however, adopted a more cautious position and called for “modesty and parsimony,” and insisted that the Bank of the South would not bailout unwise borrowers.

If the premise of no conditionality meant that the Bank of the South would not place any restrictions on repayment other than those established under the terms of each loan, the new bank would face significant obstacles in raising capital. So long as its members do not achieve investment grade credit rating, the Bank of the South will not be able to access international credit markets independently or inexpensively. This will therefore increase the real cost of its loans that the Bank of the South may choose to subsidize, not to mention whether the members would be willing to subsidize loans made by the bank.

Furthermore, the no conditionality premise that has been raised as a cornerstone of the Bank of the South also governs transactions performed by other multilateral banks operating in Latin America. The CAF and the BNDES impose almost no policy condition upon the granting of its loans and, more importantly, have a high credit rating allowing them to raise funds in the international markets at competitive rates. The CAF is among the debt issuers with the highest credit ratings in Latin America and, during the last seven years, has had annual growth of 7.3 percent in its loan and equity investments portfolio, reaching a record of U.S. $8.2 billion in 2006—96 percent of which was invested in South America. The BNDES, on the other hand, has a relatively non-trans-
parent and unaccounted-for lending process, and its annual disbursements of financial resources in the region have been increasing for the last ten years.

In addition, the IDB is also working to improve its competitiveness in the region, especially against CAF and BNDES. In his speech at the IDB Annual Meeting in April, 2008, IDB's President Mr. Luis Alberto Moreno affirmed that all the seniors managers and division chiefs of the IDB were “attracted by the opportunity to help create a new paradigm for development finance” that is enabling the IDB “to offer new financial products, faster service, expert advice and flexible solutions tailored to the changing needs of individual governments and companies.” On May 10, 2007, Mr. Moreno declared that in order to be competitive, “we have to reinvent ourselves.” During 2007, the IDB undertook an unprecedented expansion of lending to the private sector in Latin America, approving $2.3 billion for twenty-nine projects, up from $920 million for twenty projects in 2006. Considering this data, one might argue that the no conditionality premise will not only affect the new bank’s ability to borrow money in the international markets, but also has relative importance given the flexible terms under which other institutions operating in the region grant their loans.

Certainly, in order to successfully compete against the other financial institutions mentioned above, the Bank of the South will need to offer a more specific and competitive advantage, other than the lack of conditionality. To date, the advantage has not been offered.

V. CONCLUSION

Latin America is going through a favorable macroeconomic growth trend and its main challenge consists of transforming the trend into sustainable equity growth. In order to achieve this goal, new investment, at competitive financing rates, needs to be made in various sectors of the economy, such as energy, roads, and health. The Bank of South is an attractive proposal that might perform an active role in such a process. Indeed, the idea of a regional financing institution has not only been poorly criticized, but also has received support from various sectors.

Although Brazil does not support the idea of creating a regional bank as conceived by Mr. Chavez and his supporters, it has adhered to the


152. Moreno, supra note 7.


154. Moreno, supra note 7.
proposal simply to protect its economic interests in the Venezuelaan economy and ease Mr. Chavez’s influence in the region. It seems unlikely that Brazil is actually committed to the creation of the Bank of South. Brazil’s lack of commitment, and the absence of Chile, would likely block successful implementation of the Bank of the South, just as Brazil blocked the creation of a monetary institution by stripping it of its vital, and innovative, monetary function. Furthermore, a one country, one vote system introduces a serious obstacle that makes it difficult to bring Brazilian and other economies’ position together with regard to what the contributions of the members should be.

Finally, the no conditionality premise raised as one the core characteristics of the new bank would not only affect its ability to borrow funds inexpensively or independently in the global markets, but would also eventually add little competitive value to the loans of the Bank of the South due to the light conditionality imposed by other financial institutions operating in the region. For these reasons, therefore, I believe that there are not enough conditions favorable to the Bank of the South in order to implement it in a successful and competitive manner.