

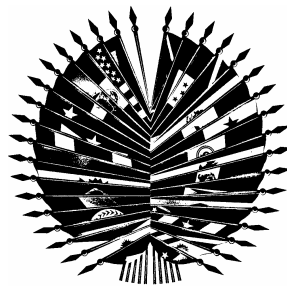
OAS TRADE UNIT STUDIES

Analyses on trade and integration in the Americas

Towards Financial Integration in the Hemisphere

Sylvia Saborío

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OAS TRADE UNIT STUDIES

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**Towards Financial Integration
in the Hemisphere**

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A Publication of the
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TOWARDS FINANCIAL INTEGRATION IN THE HEMISPHERE

The present report documents and analyzes the activities carried out to date under the "Capital Markets Development and Liberalization Initiative" entrusted by hemispheric Heads of State and Government to Ministers of Finance at the Miami Summit.

The Evolving Mandate

1. Whereas the Miami Summit Declaration contained very clear directives regarding trade -effectively calling for the negotiation of the "Free Trade of the Americas" to be concluded no later than 2005, with concrete progress toward that goal by the end of the century- it was rather vague concerning finance. It merely called for the creation of strengthened mechanisms to foster and protect the flow of productive investment in the hemisphere and promote the development and progressive integration of capital markets.
2. Noting that "the availability of capital at competitive rates is essential to finance private sector investment' and that 'developing, liberalizing and integrating financial markets domestically and internationally, increasing transparency and establishing sound, comparable supervision and regulation of banking and securities markets will help to reduce the cost of capital by enhancing investor and depositor confidence", the **Miami Plan of Action** called on regional governments to:
 - ✍ "Form a Committee on Hemispheric Financial Issues to examine steps to promote the liberalization of capital movements and the progressive integration of capital markets, including, if deemed appropriate, the negotiation of common guidelines on capital movements that would provide for their progressive liberalization.
 - ✍ Prepare, in cooperation with the Inter-American Development Bank, a comprehensive list of national capital regulations in order to promote transparency and support the discussions in the Committee on Hemispheric Financial Issues.
 - ✍ Support the cooperative endeavors of the Association of Latin American and Caribbean Bank Supervisors and Council of Securities Regulators of the Americas to provide sound supervision and regulation that support the development and progressive integration of markets."

The Plan also directed the Committee on Hemispheric Financial Issues to "review problems of debt in the Hemisphere, taking account of ongoing work and drawing, as appropriate, on a broad range of expertise".

3. The Committee on Hemispheric Financial Issues (CHFI) held its first meeting at the Deputy Finance Minister level in July 1995. In that and subsequent meetings, the CHFI discussed ongoing financial developments along with steps to strengthen hemispheric financial markets, reviewed debt problems in the region and developed a proposal for future work. The expanded mandate, endorsed at the First Meeting of Western Hemisphere Finance Ministers (New Orleans, May 1996), directed the CHFI to:
 - ✍ Examine issues that affect economic and financial market performance, such as improved analysis and dissemination of information and the conduct of monetary policy in the context of globalized markets.
 - ✍ Ensure implementation of IMF national disclosure standards and encourage adoption and application of rigorous accounting and disclosure standards by enterprises.
 - ✍ Explore ways to increase private sector savings, including pension reform.
 - ✍ Examine the overall debt situation in the hemisphere and mechanisms to deal with it.
 - ✍ Develop recommendations in such areas as privatization, infrastructure investment and micro-enterprise development.
 - ✍ Develop new programs to strengthen and integrate regional financial markets, where needed.
 - ✍ Identify specific initiatives that Finance Ministries can pursue to combat money laundering and corruption to complement the ongoing work of the OAS.
4. The Ministers also called for the creation of a Technical Working Group on National Financial Market Regulation, whose main task was to complete (in conjunction with the IDB), the compilation of a comprehensive list of national financial market regulations and promote its dissemination and update. More broadly, the Working Group was envisioned as "a dynamic vehicle to promote the development, liberalization and integration of financial markets".

In addition, the Ministers launched four initiatives:

- ✍ A technical training program (to be developed in conjunction with the Association of Latin American and Caribbean Bank Supervisors and the Council of Securities

Regulators of the Americas and funded by the IDB) to help develop and train more highly skilled bank and securities supervisors and examiners in order to enhance the safety and soundness of regional financial systems.

- ✍ A series of meetings between policy-makers, regulators and market participants to be hosted by the IDB, focusing on practical ways to facilitate greater participation by retail investors in financial markets, improving the financial, legal and regulatory environments, and improving financial market infrastructure and financial disclosure and transparency on an internationally comparable basis.
 - ✍ The review, by relevant national private sector organizations, of national laws and institutions affecting the financing of the private sector, with emphasis on protection of private property rights, bankruptcy regimes, commercial dispute resolution and competition policy.
 - ✍ A comprehensive training and technical assistance program to support nations in the implementation of their commitments under the December 1995 Buenos Aires Ministerial Communiqué on Money Laundering. The program, to be developed by the IDB in conjunction with the OAS, would focus on three core areas: legislation/regulation, investigation/prosecution and financial intelligence support.
5. At their **Second Western Hemisphere Finance Ministers' Meeting** (Santiago, December 1997), ministers acknowledged that recent financial and exchange market volatility lent greater urgency to their common agenda of pursuing sound macroeconomic policies and strengthening and modernizing financial markets, and reaffirmed their commitment to deeper integration in the western hemisphere. Accordingly, they endorsed the adoption of the Special Data Dissemination Standard by the IMF, expressed support for the financial services negotiations in the World Trade Organization, and noted that financial services warranted special attention in the FTAA. In addition, they issued a declaration of [*Principles for Strengthening, Modernizing and Integrating Financial Markets*](#), in which they, inter alia:
- ✍ Endorse the [report of the working party on financial stability in emerging market economies](#) entitled Financial Stability in Emerging Market Economies: A strategy for the formulation, adoption and implementation of sound principles and practices to strengthen financial systems.
 - ✍ Endorse the [Basle Committee's Core Principles for Effective Banking Supervision](#).
 - ✍ Endorse the Council of Securities Regulators of the Americas (COSRA) *1997 Principles for Oversight of Independent Auditors* and welcome COSRA's decision to implement an investor education and protection campaign.

- ✍ Encourage the development of an organizational structure for over-the-counter (OTC) transactions to inform investors of market developments and help prevent hazardous financial practices.
 - ✍ Support the ongoing efforts by the International Organization of Securities Commissions (IOSCO) to develop core principles for the supervision of securities markets, as well as efforts by securities regulators and the accounting profession to develop high quality standards and greater harmonization of accounting procedures and consistency of information disclosure by firms.
 - ✍ Encourage the deepening of cooperation among regulators in the region, including the Association of Latin American and Caribbean Bank Supervisors, COSRA, the Central American Monetary Council, the Central American Council of Supervisors of Bank, Insurance and Other Financial Institutions, the Caribbean Supervisors Group and the Offshore Group of Banking Supervisors, noting the special role they can play in fostering sub-regional as well as regional financial integration.
 - ✍ Endorse the report on [Supervision of Cross-border Banking](#) issued by a joint working group of the Basle Committee and members of the Offshore Group of Banking Supervisors.
 - ✍ Support bilateral arrangements for on site inspection of branches and subsidiaries of financial institutions and information exchanges, as well as increased cooperation among supervisors within and across sectors, domestically and across borders to address issues raised by international conglomerates.
 - ✍ Acknowledge the role of bilateral treaties on double taxation in promoting cross-border investments and encourage their subscription both within and outside the region.
 - ✍ Reaffirm their commitment to combat money laundering and urge governments to implement the anti-money laundering provisions of the [1988 United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances](#), as well as the [40 Recommendations of the Financial Action Task Force](#), the additional 19 Recommendations of the [Caribbean Financial Task Force](#), the [OAS/CICAD Model Regulations](#) and the [Communiqué and Plan of Action adopted at the 1995 Ministerial Meeting on Money Laundering held in Buenos Aires](#).
6. Consistent with these *Principles*, the Finance Ministers also launched the following initiatives at their Santiago meeting:

- ✍ A three-prong effort to assist in the adoption and implementation of Basle Core Principles for Effective Banking Supervision, that calls for: (1) national banking supervisory authorities to prepare (by June 1998) an assessment of each country's implementation of the Core Principles to date, along with an identification of the main obstacles to compliance; (2) the Association of Latin American and Caribbean Bank Supervisors to report annually to the CHFI on the region's progress and recommendations to advance the process; and (3) the establishment of a Working Group on Transparency and Disclosure to prepare national assessments of current bank reporting and disclosure requirements and propose for each country specific targets for compliance with internationally accepted standards and a timetable for attaining them. The Working Group, chaired by Chile, is to submit its recommendations to the CHFI by mid-1999.

- ✍ A two-step effort to facilitate the transparency, efficiency and security of cross-border transactions, that calls for: (1) the World Bank, in conjunction with IOSCO, the IDB and others, to compare the existing clearance and settlement systems of countries in the region to the standards of the Bank for International Settlements and the framework outlined in IOSCO's *Clearing and Settlement in Emerging Markets: A Blueprint*, and (2) national and regional authorities to implement the necessary changes to meet those standards.

- ✍ A call on national, regional and sub-regional banking supervisory authorities, with the support of multilateral institutions, to implement bold supervisory training programs to achieve the highest levels of instruction in the most relevant issues of supervision and to report annually to the CHFI on their progress.

- ✍ A call for the establishment of financial intelligence units (FIUs), or the strengthening of existing procedures, to combat financial crimes and develop mechanisms of coordination to facilitate the timely sharing of information among governments.¹

- ✍ A call for the establishment of a separate negotiating group on financial services within the Free Trade Area of the Americas (FTAA) process.

- ✍ A call for the IDB, in conjunction with the World Bank and the Consultative Group to Assist the Poorest (CGAP), to develop guidelines for: (1) legal, supervisory and regulatory reforms to increase credit availability to small and micro-enterprises; and (2) a legal, supervisory and regulatory framework for specialized micro-finance institutions.

¹ This effort is being supported by the U.S. Financial Crimes Enforcement Network (FinCEN) and the Egmont Group, a international coalition formed in Belgium to combat concealment of profits from drug trafficking.

7. Echoing the Finance Ministers' pronouncements, the **Santiago Plan of Action** subsequently called on regional governments to:
 - ✍ "Strengthen banking supervision in the Hemisphere through: implementation of the Basle Core Principles for Effective Banking Supervision; training programs to strengthen supervisory capacity; and the establishment of sound, high-quality reporting and disclosure standards for banks, and creation of a Working Group to assist countries in this process.
 - ✍ Improve banking and securities market clearance and settlement systems in the Hemisphere, in order to facilitate the transparency, efficiency and security of internal and cross-border transactions."
8. The Committee on Hemispheric Financial Issues last met on October 5, 1998 to discuss recent economic developments and appropriate policy responses to the increasingly difficult external environment, as well as to take stock of the progress made in the implementation of the Santiago agenda ([see the full memorandum recounting the meeting](#)). Their next meeting is scheduled to take place in the context of the IDB Annual Meetings next March in Paris.

Parallel Agendas, Contrasting Styles

9. In contrast to the very structured, time-bound and goal-oriented nature of the task entrusted to Trade Ministers and their deputies, Finance Ministers have a more diffused agenda. In fact, the CHFI has evolved mainly as a mechanism to strengthen the network of finance officials in the hemisphere, facilitating discussions on key economic issues; as a vehicle to provide mutual support and cross-validation of individual countries' reform efforts; and as a means of giving impetus to further the work of other organizations, including central banks, multilateral development banks and banking and security regulators in areas of particular interest to countries in the region. Accordingly, its *modus operandi* is looser, the pace of work less hurried and the results of its endeavors less tangible than those of its counterparts in the trade area.
10. Another striking difference between the two camps is that whereas on the trade side the focus is clearly hemispheric, on the finance side the main concerns tend to be local and global, rather than hemispheric in scope. This is very much in keeping with the nature of the problems that most countries in the region are facing: increased volatility in international financial markets and the threat of contagion derived thereof, compounded by great weaknesses and vulnerabilities in their domestic banking and financial sectors. To some extent, it may also reflect the fact that

finance ministers regularly meet in other venues (i.e. as governors to the World Bank, IMF and IDB) where the issues at hand are clearly global in nature, and there is a natural spill-over from those encounters onto the hemispheric dialogue.

11. Indeed, aside from the periodic monitoring and surveillance of prevailing international financial developments, much of the work done to date in the context of the CHFI, has entailed actions to assess weaknesses in the legal, regulatory and supervisory environment at the national level, and devise mechanisms to help countries redress those shortcomings and bring their systems in conformity with international norms. To wit:

- ✍ The *Survey of Financial Systems of the Americas*, compiled by the IDB at the request of Finance Ministers at the Miami Summit. This database includes information on the distribution and structure of markets and financial institutions in each country, as well as the laws, regulations and governing authorities of each country's banking and non-banking financial markets.²
- ✍ The annual reports by the Association of Latin American and Caribbean Bank Supervisors on countries' implementation of Basle Core Principles.³
- ✍ The task of the Working Group on Transparency and Disclosure, seeking to upgrade national reporting and disclosure practices in line with international standards.⁴
- ✍ The work program on Clearance and Settlement, which aims to conclude the first ten in-depth country studies by October 1999 and thereafter seeks to establish an on-going institutional mechanism for addressing clearance and settlement issues in the hemisphere, possibly in association with CEMLA.⁵
- ✍ The various training programs for bank and securities regulators, supervisors and examiners, including those conducted by: the Association of Latin American and Caribbean Bank Supervisors in conjunction with the Council of Securities Regulators of the Americas (with IDB funding); the Toronto International

² The Survey, which contains information as of the end of 1996, can be accessed through the IDB's homepage at www.iadb.org.

³ The first Report (December 1998) is currently under review by national authorities, prior to distribution.

⁴ The working Group expects to have concluded the first 3 or 4 cases by the end of 1999.

⁵ See The World Bank project proposal in this area: [Payments and Securities. Clearance and Settlement Systems Project](#), September 23, 1998. The initial 10 countries selected are: Argentina, Brazil, Chile, Colombia, Costa Rica, El Salvador, Mexico, Peru, Trinidad & Tobago and the Eastern Caribbean Central Bank (which comprises Antigua and Barbuda, Dominica, Grenada, Montserrat, St. Kitts & Nevis, St. Lucia and St. Vincent & the Grenadines).

Leadership Center for Financial Sector Supervision (sponsored by the World Bank and the Government of Canada, in cooperation with the IMF, the BIS and the University of York); the OAS/CICAD with IDB support in the area of money laundering; IOSCO and others.

12. While such efforts to deepen, modernize and liberalize domestic financial markets and develop an adequate information, regulatory and supervisory infrastructure in keeping with international standards and practices have the broader objective of improving the interface with the international financial system at large, clearly they also help to promote financial integration in the region. Likewise, the regional and sub-regional focus of training programs and institutional strengthening measures at the national and regional level aimed at enhancing prudential regulation, supervision and surveillance of cross-border transactions can be expected to contribute to the eventual harmonization of norms and procedures region-wide.
13. Financial developments over the last year or so have also sharpened the focus on regional concerns. Thus, at recent meetings of the CHFI and elsewhere, Finance Ministers and Deputies have begun to contemplate the possibility of joint action -at the sub-regional or regional level- to better counter the threat of financial market volatility and contagion. While still at a very tentative and preliminary stage, discussions have centered largely around two possible alternative lines of action: 1) The pooling of a portion of countries' reserves supplemented by funds from other sources (such as multilateral financial institutions and even private entities) into a contingent "mutual liquidity fund", to fend off speculative attacks on member countries' currencies; and 2) "Dollarization" schemes to try to forestall the exchange risk altogether. While it is too early to tell where these discussions might lead, the development of a regional financial payments mechanism or a radical change in the prevailing foreign exchange regime would likely have important implications for the workings and architecture of the FTAA that need to be taken into account.

OAS TRADE UNIT STUDIES SERIES

- 1*. *Small and Relatively Less Developed Economies and Western Hemisphere Integration. / Economías Pequeñas y Relativamente Menos Desarrolladas e Integración del Hemisferio Occidental.* April /Abril 1997.
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- 5.* *Constructing an Effective Dispute Settlement System: Relevant Experiences in the GATT and WTO. / Creación de un Sistema Eficaz de Solución de Controversias: Experiencias Pertinentes en el GATT y la OMC.* Rosine M. Plank-Brumback. March / Marzo 1998.
6. *Approaches to Services Liberalization by Developing Countries.* Sherry Stephenson. February 1999. OEA/Ser.D/XXII, SG/TU/TUS-6; ISBN: 0-8270-3991-3
7. *Towards Financial Integration in the Hemisphere.* Sylvia Saborío. September 1999. OEA/Ser.D/XXII, SG/TU/TUS-7; ISBN: 0-8270-3990-5

* These publications were not officially numbered.

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