The Role of Emerging Market Countries in a Changing International Monetary System: The Brazilian Perspective

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Abstract: In the current debate about the future of the Dollar, some researchers have pointed out that, besides the Dollar's main rival, the Euro, there would be space for new challengers, including most prominently the currencies of the five BRICS. This paper aims at contributing to this debate by posing the following question: is it possible for emerging market countries to defend or promote the internationalisation of their moneys? The analysis will be centred on the case of Brazil. In South America, the early 2000s marked a resumption of regional monetary and financial cooperation, revealing the desire of those countries in creating regional institutions alternatives to the traditional multilateral ones as well as in reducing the dependence on the Dollar. This scenario, in principle, would represent an opportunity for Brazil to promote the international use of its currency, the Real, in South America. However, this paper will argue that it is unlikely that Brazil could internationalise its currency in the near future. The argument lies both in the hierarchical nature of the international monetary system, where states that issue currencies that are not widely accepted internationally occupy an unprivileged position, and in the weak commercial and financial links between the Brazilian economy and the rest of South America.

Introduction

The global financial crisis and its aftermath brought to light the problems of configuration of the international monetary system (IMS) and renewed the debate about the future of the United States (US) Dollar. While the Dollar remains the world's leading international currency, some have speculated that in the near future the *exorbitant privilege*[1] of the US Dollar in the IMS could be shared with other contenders, giving rise to a world of multiple reserve currencies (Calleo 2009; The World Bank 2011; Maziad et al. 2011; Eichengreen 2011). The Chinese Renminbi (RMB) is clearly the leading candidate among emerging market currencies to assume a greater international role although some experts have emphasised that there may be space for other currencies. Maziad et al. (2011, 3) asserts that "there are signs that the system is evolving toward a greater role for emerging market (EM) currencies, reflecting both strong fundamentals in EMs and an appetite for diversification among investors", adding that "key EM currencies with potential for internationalisation are the Brazilian Real, Chinese Renminbi, Indian Rupee, Russian Ruble, and South African Rand" (Maziad et al. 2011, 10). Eichengreen (2011, 8) maintains that "where the Renminbi leads, other emerging market currencies, such as the Indian Rupee and Brazilian Real, could eventually follow". By the same token, Cohen (2009a, 21) claims "several states around the world today are thought to harbour ambitions to amplify their monetary power – including, most prominently, the four BRIC countries (Brazil, Russia, India, and above all China)".

This paper aims to contribute to this debate by posing the following question: is it possible for the governments of emerging market countries to defend or promote the internationalisation of their currency? The analysis will be centred on the case of Brazil. It begins by discussing the asymmetry between an increasingly multipolar global economy and a persistent unipolar IMS, centred on the US dollar. It then reviews the literature on money and power and the hierarchical nature of the IMS, highlighting the benefits associated with issuing an international currency and the disadvantages of issuing currencies that are not accepted internationally. It next considers the case of the Brazilian currency. It seems reasonable to assume that, if the Brazilian government wanted to promote the internationalisation of the Real, it would

[1] In the 1960s, Valéry Giscard d' Estaing, the then French Finance Minister, coined the expression *exorbitant privilege* to refer to the advantages of the Dollar being the international reserve currency.

start by broadening its use in South America. Therefore, the discussion in this section is structured considering the relation of Brazil with its South American peers. The first part looks at the institutions for monetary and financial cooperation in South America; the second analyses monetary and exchange rate policies in the region; and the third examines the commercial and financial links between the Brazilian economy and the rest of South America. The last section reflects on the challenges faced by emerging market economies in general and Brazil in particular in the context of international monetary relations.

The Role of Emerging Market Countries in a Changing International Monetary System

Over the past three decades, the shape of the world economy has changed significantly, with developing countries gaining an increased share and assuming a greater role as drivers of global economic growth (UNCTAD 2013, 21). Yet, despite increased economic weight and a significant rise in trade centrality, a large asymmetry still exists between economic size and role in the international monetary system. Until now, no emerging market economy has issued a currency that is widely used internationally. Therefore, these countries need to recognise the disadvantages of issuing currencies that are not accepted worldwide.

The contrast between the growing influence of emerging markets in the global economy and the limited role of their currencies in the IMS is a source of concern for the effective functioning of the system (Maziad et al. 2011, 3). Indeed, concentration on the Dollar does not reflect the increasingly polarised structure of the global economy and, as pointed out by Maziad et al. (2011, 19), "the shift to a multipolar IMS would be consistent with ongoing global adjustment". Likewise, Eichengreen (2011) has argued that as the international system becomes more multipolar, the international monetary system should be similarly multipolar. In general, there is an agreement among scholars that addressing this imbalance in the IMS is critical for managing the global system in which the IMF continues to play a central role, and to understand the forces that will influence the system in the long term (The World Bank 2011; UNCTAD 2011; Cohen 2009b; Cohen 2009a).

Developing economies have been reasonably successful in increasing their power in global governance institutions. Amidst the global financial crisis, the G20 was elevated from an unambitious finance ministers' meeting to a meeting of the heads of government in 2008, and replaced in September 2009 (during the G20 summit in Pittsburgh) with the G8 as the most prominent forum for discussions on the impacts and consequences of the crisis as well as for international economic cooperation. This change put at the table states like Brazil, Argentina and Mexico.

Following the reform of the IMF's quota system and positioning in 2008, by November 2010 the Fund agreed wide-ranging governance reforms to meet the rising importance of emerging market countries. When (or if) the US Congress approves the reform, Brazil, China, India and the Russian Federation will be among the top 10 IMF shareholders, together with the US, Japan, France, Germany, Italy and the United Kingdom. Furthermore, the Basel Committee on Banking Supervision (BCBS), coordinated by the Bank for International Settlements (BIS), was expanded in March 2009 to include emerging market members such as Australia, Brazil, China, India, Mexico, Russia and South Korea. Developing countries are seeking alternative forms of cooperation outside traditional institutions. The BRICS, for instance, have recently announced their own development bank and a US$ 100 billion emergency financing arrangement.

However, developing countries have been less successful in enlarging the role of their currencies in the IMS. To be sure, the same developing economies that have been increasingly conquering more voice and influence on global governance institutions still struggle with the disadvantages of issuing peripheral currencies. This is relevant because a central currency yields the issuing state a non-negligible power in both economic and political domains. Therefore, in principle, one would expect that as the balance of international power changes, the international monetary architecture should be adjusted to meet the interest of the new powers. Indeed, this is one of the arguments behind the debate around the future of the dollar, in which some scholars speculate about the emergence of a multi-currency international system (Helleiner 2008; Dailami and Masson 2009; Helleiner and Kirshner 2009; Eichengreen 2011; The World Bank 2011).

There is a general understanding among scholars that the next currencies that could have a larger role in the IMS are the Euro and the Renminbi. On the one hand, the

Euro is already an international currency. Therefore, the discussion about the Euro is if it will enlarge, sustain, or reduce the status that it has as an international currency. The Euro does not challenge the US Dollar for the top position in the IMS: it can compete for more space, but will not substitute the US Dollar as the top currency in the foreseeable future. On the other hand, the debate around the role to be played by the Renminbi in a potential multi-currency system encompasses the internationalisation of the Chinese currency as a first step. A relatively large literature about the Renminbi internationalisation has recently spring up, discussing for instance the challenges it will face and whether or not this is a good strategy for China (see for example Peng and Shu 2010 and Prasad and Ye 2012). However, both the cases of the Euro and the Renminbi are hardly useful as benchmarks to analyse the case of emerging market currencies in general. To put it simply, while emerging market states traditionally issue peripheral currencies, the Euro is already a central currency, and, as the world's second largest economy, China is a singular case among emerging market economies.

To that extent, whereas there is a clear interest in debating the future of the IMS and the role to be played by the rising powers, hitherto the debate has focused mainly on the internationalisation of the Renminbi, with less attention being paid by the cases of Brazil, Russia, India, South Africa and other emerging markets. This gap matters because scholars suggest that there could be space for other emerging market currencies in the IMS, as pointed out earlier in this paper. The case of Brazil and its currency, the Real, appears to be more analogous to the cases of other emerging markets economies.

Currency hierarchy: central versus peripheral currencies[2]

The broadly realist IPE literature recognises that the IMS is hierarchical (see for example Gilpin 1987; Strange 1994; Cohen 2004). As Cohen (2004, xii) makes clear "though seemingly technical in nature, the management of money in fact is anything but neutral in its implications for the distribution of wealth and power across the globe". Indeed, every monetary regime has both costs and benefits for its players, since it stipulates the nature of international money, the policy instruments that are

[2] Idea of central and peripheral currencies has been used by Cohen (2009a, 12). See also Conti (2011).

acceptable to adjust the balance of payments, and the legitimacy of national policy objectives (Gilpin 1987). Insofar as the architecture of the IMS generates asymmetric benefits for each actor, each state must use its power to influence the system if it wants to maintain the advantage (Strange 1994).

The hierarchy among currencies around the world is well illustrated by Cohen's currency pyramid, where he defines seven categories of currencies: Top, Patrician, Elite, Plebian, Permeated, Quasi and Pseudo currencies (2004; 1998). This seven categories can be arranged in two main groups: the first three have some degree of international use and the remaining four have little or no importance abroad. To be sure, while certain currencies are used beyond their domestic domains, others have little or no use at the international level. The first are the central or international currencies, and the latter are the peripheral or non-international currencies.

A central currency plays at the international level at least one of the three basic functions of money: medium of exchange, unit of account and store of value. The best example of a currency that presently fulfils this definition is the US dollar, which has been the *top* international currency since the post-1945 world order. Other central currencies are less used worldwide, having rather a strong regional use, such as the Euro and the Yen. Likewise, some central currencies serve more effectively as one of the functions of money, such as the British Sterling, the Swiss Franc, the Canadian and Australian dollars, among others. Despite having different levels of international use, central currencies work as currencies in the international level, i.e. they are use as a medium of exchange, as a unit of account and/or as a store of value.

As currencies come closer to the base of the pyramid, they have little or no use internationally and they gradually lose their basic functions also in the domestic context (first the store of value, then the unit of account, and finally the medium of exchange, when a foreign currency becomes the legal tender within national borders). Carneiro (2008), Prates (2005), Belluzzo and Carneiro (2004) and Conti (2011) argue that peripheral currencies are those that cannot fulfil any of the classical functions of money internationally. Even with the removal, de jure or de facto, of the domestic restrictions to convertibility, such currencies are not demanded as a store of value, but rather as a financial asset.

Not surprisingly, there are several benefits associated with issuing an international currency (see for example Cohen 2004; Eichengreen 2011; Maziad et al. 2011). The so-called *exorbitant privilege* is probably the most widely known and refers to the fact that the international use of a currency can diminish the constraint of the balance of payments on domestic and fiscal policy, easing macroeconomic management. Additionally, there is an advantage associated with the reduction of transaction costs; it allows companies to expand their business abroad at reduced cost and residents to use their own money when travelling overseas, for instance. International seigniorage constitutes a real-resource reward for the economy. Whenever non-nationals acquire national currency, either as hard cash (bank notes and coins) or financial claims denominated in the domestic money, this generates cross-border seigniorage for the issuing country of an international currency.[3] Furthermore, the international use of a currency can help to enhance a state's soft power. In other words, the widespread global use of a currency can endorse intangible forms of issuer influence, contributing to shaping the preferences of others.

Finally, once independence from external influence is achieved, the consequent dependence of other countries gives leverage to the issuer of an international currency. As explained by Cohen (2012), leverage can be exercised directly or indirectly. Jonathan Kirshner (1995) labelled such policies enforcement and entrapment. Direct leverage, or enforcement "is the manipulation of the rules of the system in order to sanction (or support) member states" (Kirshner 1995, 116). In contrast, indirect leverage (entrapment) works through systemic infrastructure to change material incentive structures. In one instance, as states accumulate foreign reserves, they acquire an interest in the stability and value of this currency, generating a certain affinity with interests of the country issuing the international currency.

Clearly, if some currencies expand their domains beyond the jurisdiction of the countries that issue them, less popular currencies suffer a direct invasion of their

[3] As Cohen explains, "since no interest is paid on the cash liabilities of a central bank, holdings of its notes and coins abroad represent the equivalent of an interest-free loan to the issuing country. […] The second component, rather more substantial, derives from foreign accumulations of financial claims denominated in the home money, an increase of effective demand for assets. Typically motivated by liquidity considerations, the added demand has the effect of driving the cost of borrowing below what it might be otherwise" (Cohen 2012, 16). Or in Eichengreen's words, "it costs only a few cents for the Bureau of Engraving and Printing to produce a $100 bill, but other countries have to pony up $100 of actual goods and services in order to obtain one" (Eichengreen 2011, 3).

traditional territorial domains, partially or totally, weakening their use and influence (Cohen 1998, 93). Up until now, the latter scenario has been generally the case of currencies issued by emerging market economies. While there are several advantages associated with issuing an international currency, there are disadvantages in issuing a currency that does not have foreign acceptance.

Firstly, unlike developed states, developing states are often not able to issue external debt denominated in their own currency, which has been described by some scholars as the "original sin" (Eichengreen, Hausmann, and Panizza 2003). Hence the capacity of domestic debtors to honour external obligations becomes fully linked to the variations of their exchange rates, which are potentially higher in the current context of volatile capital flows. Moreover, as most of the foreign debt is denominated in the key international currency – the US Dollar – changes in exchange and interest rates of this currency, according to the management of American monetary policy, have an immediate impact on the value of this debt (Prates 2005, 274).

Secondly, peripheral currencies are also associated with a higher risk premium because they are considered less safe than the key currency so investors expect a higher risk premium to compensate for the risk of holding the asset (see Maziad et al. 2011, 12). On the other hand, US interest rates tend to be the lowest in the system because the US remunerates the key currency, which investors consider to be the most safe, liquid and default-free.

Finally, while states that issue international currencies are policy *makers*, states that issue peripheral currencies are policy *takers* (Ocampo 2001). Ultimately, this reflects the fact that states that issue international currencies hold a higher degree of freedom to formulate macroeconomic policies and, in doing so, have more influence over the international economy. In contrast, states that issue peripheral currencies have to respond and adjust to the global shocks – of economic activity, financial flows, commodity prices, and of the exchange rates of major currencies – generated by the centre economies, being in this sense policy *takers*.

Therefore, assuming that it is advantageous to a state issue an international currency, in other words that issuing a peripheral currency has several disadvantages, it appears logical to expect states to be willing to internationalise their currencies, and enjoy the monetary power that comes with that. It is important to note that the project of

internationalising a currency may not aim to affect the entire globe (it can be a regional project) and it may be directed at only certain monetary functions such as broadening a certain currency's role in trade invoicing and settlement (Cohen 2009b; Maziad et al. 2011, 4).

Cohen (2009a, 21) suggests two paths for currency internationalisation. One is the commitment to a broader use in trade and invoicing settlement, in order to attract the interest of foreign central banks. The other is the commitment to broad financial market development, making the currency convertible for instance (so that it can be freely bought or sold by international investors without government restrictions), in order to attract the interest of private investors. The remainder of this paper will attempt to bring light to these suggestions considering the case of Brazil.

Currency internationalisation: the Brazilian perspective

This section addresses the political and economic relations among South American countries focusing on the role played by Brazil. It begins by considering the existent architecture for monetary and financial cooperation in South America. It then examines monetary and exchange rates policies on South America. It concludes by analysing trade and financial data of South America and Brazil. In theory, regional institutions could be a channel to support the internationalisation of the Real and to broader the monetary power of Brazil. In addition, better macroeconomic convergence among South American economies as well as having strong commercial and financial links with other South American economies would favour the internationalisation of the Brazilian currency.

Resumption of monetary and financial cooperation in South America

It is significant that Brazil is identified as a country with potential to internationalise its currency. Indeed, recent developments in Brazil and South America appear to align to theoretical prerequisites to internationalise the Brazilian currency. Particularly, the inauguration of a favourable economic and political environment in the early 2000s marked the resumption of regional integration in South America, with the creation of new arrangements and the revival of old systems. Being the major economy in the

region, this represented a unique opportunity for Brazil to defend and promote the international use of the Real in South America.

In a first moment, roughly from 2003 to 2007, regional cooperation in South America was fuelled not only by a greater political convergence, where several left-wing presidents were elected in the early 2000s, but also by a distinctive period of economic growth, driven mainly by Chinese demand on commodities and by the dynamism of large domestic markets. The favourable economic situation facilitated regional integration by alleviating the traditional financial vulnerabilities of the region. Here, the substantial accumulation of foreign exchange reserves and the reduced public sector external debts were particularly important (Ocampo 2009, 716). At the heart of this trend was the desire of several South American countries to create regional alternatives against the traditional multilateral institutions, controlled by developed countries, which included a widespread interest in reducing the dependence on the US Dollar (see for example Calixtre and Barros 2010, 21–22; Camara-Neto and Vernengo 2009, 200–202; Brazilian Ministry of External Relations 2008, 243).

Later on 2008, the global financial crisis hampered central economies (particularly the US) more than emerging market economies and revealed the obsolescence of traditional multilateral financial institutions to respond. This unveiled an opportunity for developing countries to embrace the creation and renewal of mechanisms for monetary and financial regional cooperation. Moreover, the absence of perspectives in the short- and medium-term for substantial reform in the international monetary architecture (inherited from the post-1945 world order and embodied by the Bretton Woods institutions) further supported the momentum to create regional alternatives.

Against this background, the analysis now turns to the existent regional monetary and financial architecture in South America and to the role played by Brazil in these institutions. It seems reasonable suppose that, if Brazil was going to internationalise its currency, it would start by broadening its influence in the region.

Brazil's economic prominence in South America is not only evident in its membership of regional financial institutions, but also in the fact that it is one of the main contributors. These institutions serve three main purposes: mechanisms to finance development; emergency funds to address liquidity and balance of payment problems; and clearance mechanisms for payments in local currency.

Looking first at the mechanisms to finance development, there are four major institutions in South America: the Andean Development Corporation (CAF), the Plata Basin Financial Development Fund (FONPLATA), the Structural Convergence Fund (FOCEM) and the Bank of the South. The latter is still at pre-operational stage and will be the largest institution in terms of resources under management, with an authorised capital of US$ 20 billion (compared to US$10 billion under CAF and US$ 1.6 billion under FONPLATA). FOCEM projects are financed through annual contributions made by its members totalling US$ 100 million. In terms of membership of partners or shareholders, CAF is the only institution that includes extra-regional partners.

Brazil participates and is a major contributor in all these institutions. It contributes 70 per cent of the total amount annually designated to FOCEM (by comparison Argentina gives 27 per cent, Uruguay gives 2 per cent, and Paraguay gives 1 per cent). Both Brazil and Argentina hold one-third of the quotas in FONPLATA with the remaining third equally divided between Bolivia, Paraguay and Uruguay. In the Bank of the South, just like Argentina and Venezuela, Brazil will contribute with US$ 2 billion of the US$ 7 billion of subscribed capital with the remaining US$ 1 billion divided among Ecuador, Uruguay (US$ 400 million each), Bolivia and Paraguay (US$ 100 million each). In CAF, Colombia, Peru and Venezuela are the main shareholders followed by Argentina and Brazil, which have been increasing their presence in the recent years.

Another important financial development institution in South America is the Inter-American Development Bank (IDB). The IDB is made up of forty-eight shareholders, of which 26[4] are 'borrowing' countries and 22[5] extra-regional 'non-borrowing' members. Since the Bank is not owned by developing countries[6] and its headquarters is in Washington DC, with the US holding the largest number of shares (30 per cent), the IDB cannot be viewed as a regional initiative in this context. Among the

[4] Argentina, The Bahamas, Barbados, Belize, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Guyana, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Dominican Republic, Suriname, Trinidad and Tobago, Uruguay and Venezuela.

[5] Extra-regional members are Germany, Austria, Belgium, Canada, China, Korea, Croatia, Denmark, Slovenia, Spain, United States, Finland, Greece, Israel, Italy, Japan, Norway, the Netherlands, Portugal, United Kingdom, Sweden and Switzerland.

[6] The expression "bank owned by developing countries" ("*bancos de propiedad de países en desarrollo"*) is used by Ocampo (2006, 15) to refer to multilateral development banks that do not have the capital of industrialised countries.

borrowing members, Brazil and Argentina hold the largest number of shares (10.75 per cent each) behind the US.

Finally, despite its name Brazilian Development Bank (BNDES in its Portuguese acronym) has been expanding its operations in South America. Since 2003, regional integration has officially become a mission of the BNDES (BNDES 2004, 1). Notwithstanding, the BNDES only funds Brazilian companies or branches of multinational companies established in Brazil, since its potential for regional integration is limited in comparison to multilateral institutions such as the IDB.

Regarding emergency funds available for liquidity and balance of payment problems, there are two relevant institutions: the Latin American Reserve Fund (FLAR) and the Regional Clearance Unitary System (SUCRE). Brazil is not a member of either of those institutions. FLAR is a joint reserve fund whose main shareholders are Venezuela, Colombia and Peru (20 per cent each), and the remaining 40 per cent is equally divided between Bolivia, Costa Rica, Ecuador and Uruguay. SUCRE, which was launched under the Bolivarian Alliance for the Peoples of the Americas (ALBA), is made up by a Regional Monetary Council, a Common Account Unit (the SUCRE), a Central Clearance Chamber and a Reserve and Trade Convergence Fund.

SUCRE also serves as a clearance mechanism for payments in local currency, the third category of regional arrangements for monetary and financial cooperation in South America, together with the Agreement on Reciprocal Payments and Credits of the Latin American Integration Association (CPCR) and the Brazil-Argentina Local Currency Payment System (SML). Brazil is part of both the CPCR and the SML. While the CPCR dates back from 1982 and comprises all ALADI economies (except Cuba) and the Dominican Republic, the Brazil-Argentina Local Currency Payment System (SML) is one of the most recent initiatives in financial cooperation and allows Argentinean and Brazilian importers and exporters to make and collect payments for trade operations in their respective local currencies. Figure 1 illustrates the regional monetary and financial architecture in South America.

Figure 1. Mechanisms of monetary and financial cooperation in South America

Member countries	Development financing				Liquidity and balance of payments problems		Clearance mechanisms		
	CAF[1]	FONPLATA	FOCEM	Bank of the South	FLAR[2]	SUCRE (Fund)[3]	SUCRE (Currency)[3]	CPCR	SML
Argentina	X	X	X	X				X	X
Bolivia	X	X		X	X	X	X	X	
Brazil	X	X	X	X				X	X
Chile	X							X	
Colombia	X				X			X	
Ecuador	X			X	X	X	X	X	
Paraguay	X	X	X	X				X	
Peru	X				X			X	
Uruguay	X	X	X	X	X			X	
Venezuela	X			X	X	X	X	X	

1. Costa Rica, Dominican Republic, Jamaica, Mexico, Panama, Portugal, Spain and Trinidad and Tobago are also members of CAF.
2. Costa Rica is also a member of FLAR.
3. Cuba and Nicaragua are members of SUCRE.
4. Mexico and Dominican Republic are also members of CPCR.

To conclude, Brazil has been a dominant player in regional monetary and financial cooperation, particularly in the areas of development financing and clearance mechanisms for payments in local currency. In 2003, South America integration was named as one of the pillars of the Brazilian foreign policy (Brazilian Ministry of External Relations 2008, 43) and Brazil has been a key actor in many of the new institutions that have been created since then, such as the FOCEM (created in 2004), the Bank of the South (whose establishment began in 2007), and the SML (entered into force in October 2008).

Monetary and exchange rate policies convergence

In addition to the renewal of monetary and financial cooperation, empirical evidence also suggests a greater macroeconomic convergence among South American countries in recent history. According to the theory of optimum currency areas (see for example Mundell 1961; McKinnon 1963; Frankel and Rose 1998; Rose and Engel 2002; Bayoumi, Eichengreen, and Mauro 2000; Alesina, Barro, and Tenreyro 2002; Kenen 1969), the adoption of a single currency by a group of countries symbolises the apex

of the integration process, which in theory requires a high degree of macroeconomic convergence and factor mobility. However, historical processes of integration, particularly in the European case, reveal that the adoption of a single currency can be the result of political decisions taken in spite of the non-compliance of the theoretical conditions. Therefore, it is possible to envisage the deepening of monetary and financial integration even if the prerequisites defined by the theory are not fulfilled. Nevertheless, we assume that the greater the asymmetries among countries, the harder it is to deepen monetary and financial integration. Thus, better macroeconomic convergence in South America theoretically also favours the internationalisation of the Brazilian currency.

Financial crises in the late twentieth century undermined potential monetary and financial cooperation in South America in a different way to what occurred in East Asia. For instance, South American countries chose to fight domestic imbalances caused by the crisis individually and so the start of the 21st century was marked by divergent macroeconomic strategies in the region. However, as external conditions began to improve (notably after 2003), there was a greater convergence of macroeconomic policies of South American economies.

To begin with, several South American economies implemented Inflation Targeting (IT) combined with flexibility in the exchange rate. Between 1999 and 2002, Brazil, Chile, Colombia, Peru and Uruguay adopted fully-fledged IT[7] and implemented dirty floating exchange rate regimes[8]. Since 2011, Paraguay has been completing the transition towards a fully-fledged IT regime while maintaining exchange rate flexibility (IMF 2014a). Argentina, Bolivia, Ecuador and Venezuela have not followed this trend.

Since late-2011, monetary policy in Bolivia has been anchored to a stable nominal exchange rate vis-à-vis the US Dollar. This has been accompanied by liquidity management through open market operations (IMF 2014b). In its latest annual report on Exchange Arrangements and Exchange Restrictions, the IMF has included Bolivia among the countries that do not have an "explicitly stated nominal anchor but rather monitor various indicators in conducing monetary policy" (IMF 2013, 5–6). In the

[7] Since the early 1990s, Chile and Colombia had pursued some looser form of IT, and Peru has done so since the mid 1990s.
[8] Except for Chile whose exchange rate arrangement is defined by the IMF as free floating (IMF 2013, 5–6).

same report, the IMF classified the Argentinean exchange rate arrangement as a *crawl-like arrangement*, meaning that the country maintains a de facto exchange rate anchor to the US Dollar (the same has been applied in Bolivia) (IMF 2013, 5–6). Besides, Argentina's monetary policy framework is classified as a monetary aggregate target.

Ecuador and Venezuela's monetary policy framework is an exchange rate anchor to the US Dollar (IMF 2013, 5–6). In Ecuador, formal dollarisation exists whereby the US Dollar circulates as the sole legal tender. In the case of Venezuela, the exchange rate arrangement is a conventional peg and the national currency, the Venezuelan Bolívar, is the legal tender.

The reduction in South America's average inflation rates compared to high inflation during the 1980s and 1990s is evidence of transformation in the region. From 2003 to 2013, the average inflation rate for South American countries was 7.7 per cent annually (IMF 2014c). Even so, there was a slight acceleration of South America average inflation rate in 2008 - 2013 in comparison with 2003 - 2007 (see Figure 2). In Peru and Chile average inflation rate rose from 2.6 and 2.9 per cent respectively (2003 - 2007) to 3.3 per cent (2008 - 2013), but they still stand out with the lowest averages. In Colombia, inflation decreased from 5.6 per cent (2003 - 2007) to 3.7 per cent (2008 - 2013), followed by Paraguay (8.6 to 5.3 per cent), Brazil (7.2 to 5.6 per cent) and Uruguay (9.6 to 7.7 per cent). On the other hand, inflation rates accelerated in Ecuador (3.7 to 4.9 per cent), Bolivia (4.8 to 6.7), and above all Venezuela (20.2 to 28.9 per cent). Finally, in Argentina, average inflation rates remained stable (9.4 per cent in 2003 - 2007, and 9.3 per cent in 2008 - 2013).

Furthermore, the proportion of gross public debt as a percentage of GDP in South America decreased from 52 per cent (2003 - 2007) to 35.5 per cent (2008 - 2013) (IMF 2014c) (see Figure 2). Chile has the lowest proportion of gross public debt as a percentage of GDP despite increasing from 7.8 per cent (2003 - 2007) to 9.1 (2008 - 2013). Between 2003 and 2013, Paraguay had the second lowest proportion of gross public debt as a percentage of GDP (23 per cent), followed by Ecuador (27 per cent), Peru (30.3 per cent), Colombia (36.3 per cent) and Venezuela (40.4 per cent). The highest proportions in the same period were in Uruguay (73.4 per cent), Argentina (73 per cent), Brazil (67.4 per cent) and Bolivia (50.6 per cent). Comparing 2003 with 2013, all South American economies decreased their ratio of gross public debt to GDP, particularly the four that accounted for the highest averages: Argentina went

down from 139.4 per cent in 2003 to 46.9 per cent in 2013; Uruguay from 111.5 per cent to 59.4 per cent; Brazil from 74.6 per cent to 66.3 per cent; and Bolivia from 74.1 per cent to 33.1 per cent.

Figure 2. Inflation rates and gross public debt as a percentage of GDP in South America, 2003-2013

	Inflation (%)			Gross Public Debt (% of GDP)		
	2003-2007	2008-2013	2003-2013	2003-2007	2008-2013	2003-2013
Argentina	9.4	9.3	9.4	99.5	51.0	73.0
Bolivia	4.8	6.7	5.8	67.9	36.1	50.6
Brazil	7.2	5.6	6.4	69.3	65.7	67.4
Chile	2.9	3.3	3.1	7.8	9.1	8.5
Colombia	5.6	3.7	4.5	39.4	33.7	36.3
Ecuador	3.7	4.9	4.3	35.1	20.3	27.0
Paraguay	8.6	5.3	6.8	32.1	15.4	23.0
Peru	2.3	3.3	2.9	38.5	23.5	30.3
Uruguay	9.6	7.7	8.6	86.5	62.4	73.4
Venezuela	20.2	28.9	25.0	43.5	37.9	40.4
South America	**7.4**	**7.9**	**7.7**	**52.0**	**35.5**	**43.0**

Source: World Economic Outlook Database, April 2014.

To sum up, it is significant that several South American countries have adopted IT combined with flexibility in the exchange rate, suggesting a greater convergence among monetary and exchange rate policies objectives. At the same time, while figures of gross public debt as a proportion of GDP have decreased substantially (except Chile that has the lowest proportion of gross public debt as a percentage of GDP), the average inflation rate in the region has accelerated. However, given the historical background of high and unstable inflation in the region, the figures of 2008 - 2013 are considered low for South America.

Brazil's trade and financial links with South America

International experience has shown that determinants of currency internationalisation include economic size and trade networks, helping a currency to be applied to invoicing and settling trades (Maziad et al. 2011, 11; Cohen 2009a, 13). Brazil is by far the largest South American economy, accounting for more than half of the

region's GDP. It is also South America's leading merchandise trader, responsible for some 37 per cent of the region's exports and for 39 per cent of its imports. Nonetheless, Brazil has the lowest trade to GDP ratio, a measure of a country's openness or integration in the world economy. Therefore, in spite of its economic size and volume of trade, Brazil is a closed economy to world trade flows, as Figure 3 illustrates.

Figure 3. South America's GDP and trade data, 2012

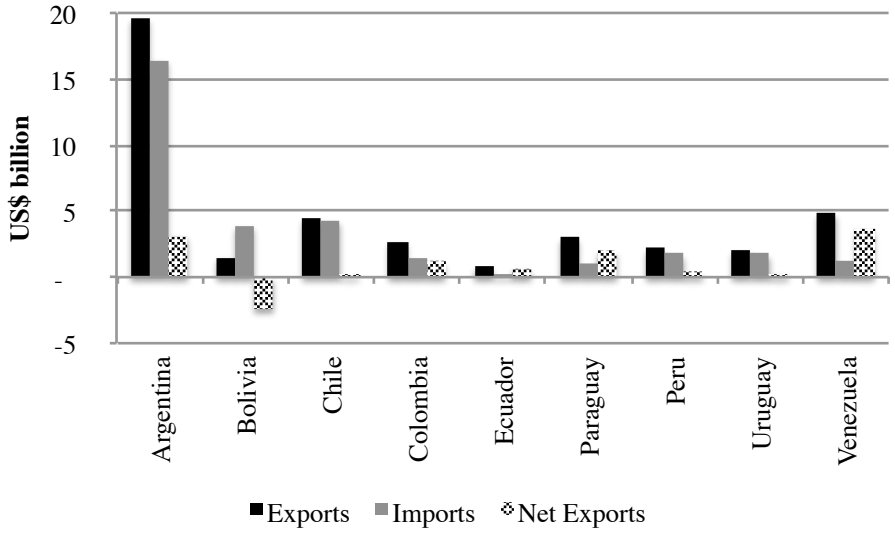
Countries	GDP (million current US$, 2012)	Trade to GDP ratio (2010-2012)	Merchandise Trade			
			Exports		Imports	
			Value (million US$)	Share in world total exports	Value (million US$)	Share in world total imports
Argentina	475 502	40.1	80 927	0.44	68 508	0.37
Bolivia	27 035	74.6	11 233	0.06	8 269	0.04
Brazil	2 252 664	24.0	242 580	1.32	233 388	1.25
Chile	269 869	69.2	78 277	0.43	79 468	0.43
Colombia	369 606	35.3	60 125	0.33	59 111	0.32
Ecuador	84 040	64.4	23 765	0.13	25 477	0.14
Paraguay	25 502	100.2	7 270	0.04	11 555	0.06
Peru	203 790	49.2	46 228	0.25	42 274	0.23
Uruguay	49 920	54.7	8 709	0.05	11 652	0.06
Venezuela	381 286	41.3	97 340	0.53	60 500	0.33

Source: WTO/World Trade Profiles. Accessed July 2014 (data updated in March 2014).

In addition, in 2013 Brazil had trade surpluses with every South American economy except Bolivia (see Figure 4). This is partially explained by the fact that Brazil has in regional markets a destination for its exports of manufactures (see for example Cunha et al. 2012, 154; Lélis, Cunha, and Lima 2012, 65–75)[9]. As a consequence, several less advanced and smaller South American economies hold systematic deficits in intra-regional trade (see Figure 5), indicating an uneven distribution of the gains of regional integration (UNCTAD 2007, 110–111; Fiori 2011, 22). In order to achieve sustainable integration in the long term, such intraregional structures of trade surpluses and deficits need to be addressed. In not doing this, disadvantaged participants will impose countermeasures, weakening the integration process. For instance, expanding initiatives such as the FOCEM to reduce the problem of economic asymmetries within South America would be advisable if Brazil desires to build a positive image among its regional peers.

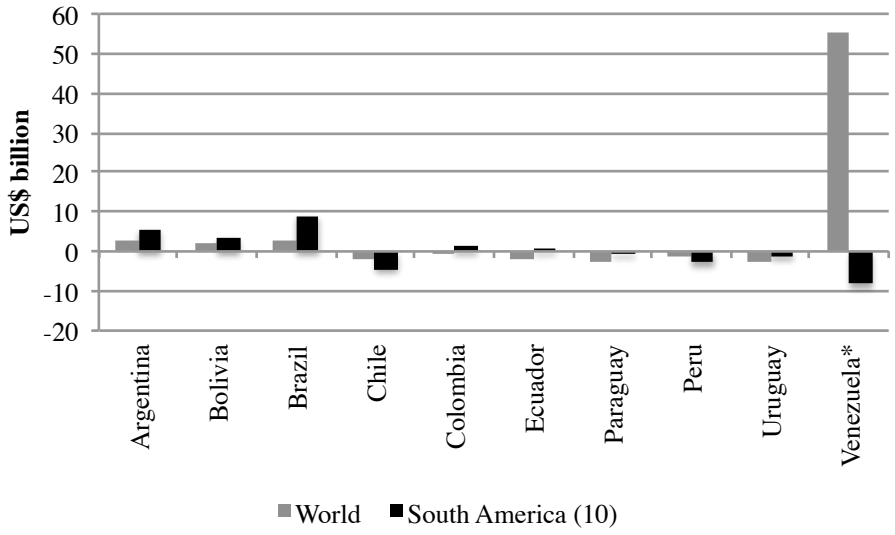
[9] Particularly after the global financial crisis, Chinese competition in South American markets has intensified, displacing Brazilian exports, especially manufacturing (Cunha et al. 2012, 154; Lélis, Cunha, and Lima 2012, 65–75).

Figure 4. Brazil exports, imports and net exports to South America, 2013



Source: Comtrade.

Figure 5. Net exports of South American Countries, 2013



* Venezuela's last data available is from 2011.

Source: Comtrade.

One reason behind the low trade integration in South America is the reliance on commodity exports (Adler and Sosa 2014, 456). On one hand, it makes the creation of regional value chains more difficult while on the other movements in commodity prices greatly influence the value of currencies of large exporters and importers of

commodities, as in the case of Brazil. As observed by Maziad et al. (2011, 11–14), this limits such currency's attractiveness as a unit of account and an international store of value, and can also hamper its potential use in trade settlement.

Apart from Brazil's weak trade connections with South America, there are also financial resource issues that limit its potential to lead the region's integration and to internationalise its currency. As noticed by Culpeper (2006), regional and monetary financial cooperation is more likely to succeed if member countries can provide financial resource. For example, Brazil accumulated an extraordinary volume of foreign reserves in recent years, escalating from US$ 33 billion in 2000 to more than US$ 358 billion in 2013, according to IMF data. Other South American countries hold much smaller amounts of foreign reserves – in 2013 Peru held US$ 65 billion, Colombia US$ 43 billion and Chile US$ 41 billion. To put this in perspective, China's foreign exchange reserves totalled US$ 3.8 trillion, followed by Japan, with US$ 1.2 trillion. Other Asian countries with elevated foreign reserves sums are Korea (US$ 345 billion), Hong Kong (US$ 311 billion) and Singapore (US$ 277 billion).

By the same token, Brazil is traditionally the main recipient of foreign direct investments (FDI) in South America (see Table 1 in Annex), mainly from the US. The US is also the principal investor of FDI in Argentina, Chile and Paraguay, contributing to weakening Brazil's position as a regional leader. According to ECLAC's data (2013, 53–54) Brazil is the second main source of FDI in Argentina and Paraguay, and the fourth in Colombia and Uruguay.

In sum, while the Brazilian economy has achieved some remarkable advances and its political leaders have exerted considerable political leadership in the regional arrangements for monetary and financial cooperation, Brazil's agenda remains dominated by domestic issues. To that extent, unlike China's assertive campaign in internationalising the Renminbi, Brazil is struggling to "regain growth momentum, restrained as it is by the significant structural problems unveiled by the worsening external environment" (Bolle 2013, 19). As Bolle describes, given Brazilian authorities are focused on growth and private domestic investment resumption, "in the midst of fiscal headwinds and monetary 'tsunamis' from developed countries", the project of currency internationalisation becomes secondary (Bolle 2013, 19).

Conclusion

This paper has attempted to contribute to the debate about the future of the IMS and the role reserved for developing economies by asking whether it is within a government's capacity to internationalise its currency. While several scholars have addressed currency hierarchy and the relationship between money and power,[10] much less attention has been paid to the problems faced by states that issue peripheral currencies. Moreover, the hierarchical structure of the IMS suggests that it will be difficult to developing countries to change the status of their currencies. To be sure, making the currency legally convertible does not mean that international public and private actors will demand it as a currency (it can be still demanded as an asset).

In this context, the case of Brazil is remarkable because it differs from the case of China, which is an actor with much higher economic and political power, and resembles more the challenges faced by other emerging market economies. By analysing the case of Brazil and its potential of internationalising the Real, it is possible to provide some evidences that the economic scenario in South America since the turn of the millennium has fulfilled some of the theoretical prerequisites for the internationalisation of the Brazilian currency. However, in addition to the weak commercial and financial links of Brazil with the rest of South America, the hierarchical and rigid nature of the IMS seems to be indeed the biggest challenge. Possibly, part of the explanation lies in the fact that internationalising an emerging market currency and expanding its influence over a region affects the current balance of power of the IMS.

At the same time, it is significant that making the Real a convertible currency would likely make it also more susceptible to volatile capital flows. In other words, maintaining capital controls is in part a response of emerging countries in general, and of Brazil in particular, to the absence of global monetary cooperation in an unstable international monetary and financial system.

[10] Topics include the power of states that issue international currencies (Kirshner 1995; Cohen 2000; Cohen 2009a; Cohen 2012), the transition between Great Britain and the US as the issuer of the key international currency (Chitu, Eichengreen, and Mehl 2012; Eichengreen and Flandreau 2010) and, more recently, the debate around the future of the Dollar and the possibility of an emerging a multi-currency international system in relation to China and the Euro (Helleiner 2008; Dailami and Masson 2009; Helleiner and Kirshner 2009; Eichengreen 2011; The World Bank 2011).

How to overcome the situation of being an unprivileged player in the IMS is an issue that commands further research. Moreover, if currency internationalisation is not a viable alternative to increase developing countries' monetary power, regional monetary and financial cooperation as well as other initiatives among developing countries, such as the Brics Bank, are welcome to reduce asymmetries within the IMS.

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Annex

Table 1. Inward foreign direct investment in South American countries, 2000-2012 (US$ million)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Argentina	10 418	2 166	2 149	1 652	4 125	5 265	5 537	6 473	9 726	4 017	7 848	9 882	12 551
Bolivia	736	706	677	197	85	-288	281	366	513	423	643	859	1 060
Brazil	32 779	22 457	16 590	10 144	18 146	15 066	18 822	34 585	45 058	25 949	48 506	66 660	65 272
Chile	4 860	4 200	2 550	4 334	7 241	7 097	7 426	12 572	15 518	12 887	15 373	22 931	30 323
Colombia	2 436	2 542	2 134	1 720	3 016	10 252	6 656	9 049	10 596	7 137	6 758	13 438	15 823
Ecuador	-23	539	783	872	837	493	271	194	1 058	306	163	641	587
Paraguay	104	84	10	27	38	54	95	202	209	95	228	215	273
Peru	810	1 144	2 156	1 335	1 599	2 579	3 467	5 491	6 924	6 431	8 455	8 233	12 240
Uruguay	273	297	194	416	332	847	1 493	1 329	2 106	1 529	2 289	2 505	2 710
Venezuela	4 701	3 683	782	2 040	1 483	2 589	-508	1 505	1 741	-2 169	1 849	3 778	3 216

Source: ECLAC 2013, p.50