

# Foreign Exchange Reserves Accumulation in Latin America during the Current Crisis

*Acumulación de Reservas de divisas en América Latina durante la actual crisis*

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## Resumen

A pesar del mínimo crecimiento económico en los países de América Latina de 2006 en adelante, muchos de ellos han acumulado reservas internacionales. En la literatura se pueden encontrar tres causas por las cuales se acumulan reservas: (1) el pago de la deuda a corto plazo, (2) el pago de por lo menos tres meses de importaciones, y (3) la protección de una eventual salida de capitales y problemas en el tipo de cambio. No obstante, la mayoría de los países de América Latina cumple los tres criterios. ¿Por qué entonces algunos países latinoamericanos siguen acumulando reservas? Nuestra respuesta es que para algunos gobiernos, el atesoramiento podría representar una expresión social de la riqueza en el corto plazo, distinción que hizo Marx para economías no consideradas capitalistas.

### Palabras clave:

- Finanzas internacionales
- Bancos centrales y sus políticas
- Prestamos Internacionales

## Abstract

Even though several Latin American countries have shown recently poor economic performance, many of them have accumulated foreign exchange reserves from 2006 onwards. Conventionally, three reasons are given for international reserves accumulation: (1) payment of short-term debt, (2) payment of at least three months of imports, and (3) protection for an outflow of capital. However, the majority of the Latin American countries meet all three criteria. Why then do some Latin American countries continue to accumulate reserves? Our answer is that for some governments, hoarding might represent a social expression of wealth, following Marx's ideas

### Keywords:

- International Finances
- Central Banks and their Policies
- International Lending and Debt Problems

JEL: F3, E58, F34

## Introduction

Even though several Latin American countries have shown recently poor economic performance, many of them have accumulated foreign exchange reserves from 2006 onwards. Conventionally, three reasons are given for international reserves accumulation: (1) payment of short-term debt, (2) payment of at least three months of imports, and (3) protection for an outflow of capital. However, the majority of the Latin American countries meet all three criteria. Why then do some Latin American countries continue to accumulate reserves? Our answer is that for some governments, hoarding might represent a social expression of wealth, following Marx's ideas. After this introduction, Section 2 describes the economic performance of Latin America, the US, Germany, and Japan. In Section 3, we highlight the increasing amount

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only option to grow would be to increase interregional cooperation through trade in underdeveloped countries.

(5) Neoliberalism, has fueled the shift in Latin American economies to attempt to increase exports (Williamson 1990), mainly commodities. Domestic markets have not gotten wider, real wages have not increased, income distribution has not improved, and interregional cooperation among underdeveloped countries has not succeeded. It would seem that economic growth in Latin America depends on external factors. However, Latin American GDP in several countries has been stagnant.

(6) Finally, China has grown consistently from 1981 onwards.

**Table I**  
**Growth in Countries around the World**

Countries	1981-1990	1991-1995	1996-2000	2001-2005	2006-2010	2011-2013
Argentina	-1.4	6.7	2.7	2.4	5.7	4.1
Brazil	1.6	3.1	2.0	2.8	4.5	2.1
Colombia	3.6	4.1	1.3	3.6	4.6	5.1
Chile	3.9	8.7	4.2	4.2	3.5	5.1
Mexico	1.9	2.2	5.1	1.7	2.0	3.0
Peru	-0.7	5.3	2.6	4.3	6.9	6.1
Uruguay	0.2	4.0	3.0	0.3	5.7	5.1
Venezuela	0.9	3.5	0.8	3.1	3.8	3.7
Latin America	1.4	3.4	3.1	2.5	3.8	3.2
US	3.4	2.6	4.3	2.5	0.8	2.0
Germany	2.3	2.0	1.9	0.6	1.3	1.4
Japan	4.6	1.4	0.9	1.2	0.4	1.0
Adv. Countries	3.5	2.2	3.1	1.9	0.8	1.7
China	9.3	12.3	8.6	9.8	11.2	8.2

Source: World Bank

### Foreign exchange reserve accumulation

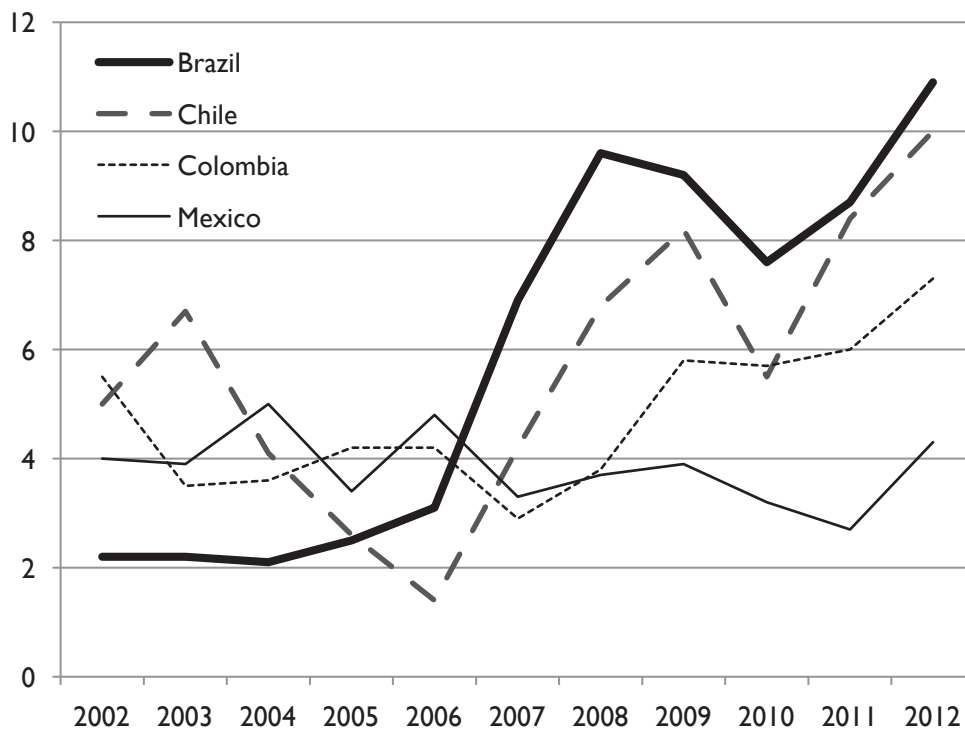
From 2008 through 2009, several countries had abrupt declines in gdp, along with problems in other economic variables such as unemployment, current account deficits, and the evolution of the profit rate. In 2008, the us gdp declined -0.3 percent, and Japan saw a decline of -1.0 percent. Meanwhile, in 2009, the growth rate in Germany was -5.6 percent, -in Japan -5.5 percent,



## A theoretical explanation

Brazil, Mexico, Colombia, Chile, Uruguay, and Peru have increased their foreign exchange reserves as a percent of GDP from 2006 onwards, but Brazil and Mexico have produced minimal economic growth. With the hoarding carried out by Latin American countries, these countries have bought T-bills and other financial assets, resulting in a situation in which underdeveloped countries might finance developed ones, particularly the US. In 2012, among the biggest buyers of T-bills worldwide, Brazil was number 5, Mexico was number 14, and Colombia and Chile were numbers 28 and 30, respectively (see Figure 1). Beginning in 2005, all four countries have increased their purchases of treasury bonds. Why have some countries of Latin America pursued a policy of international reserves accumulation with a minimal growth rate?

**Figure 1**  
Latin America's T-Bills accumulation as a percent of GDP

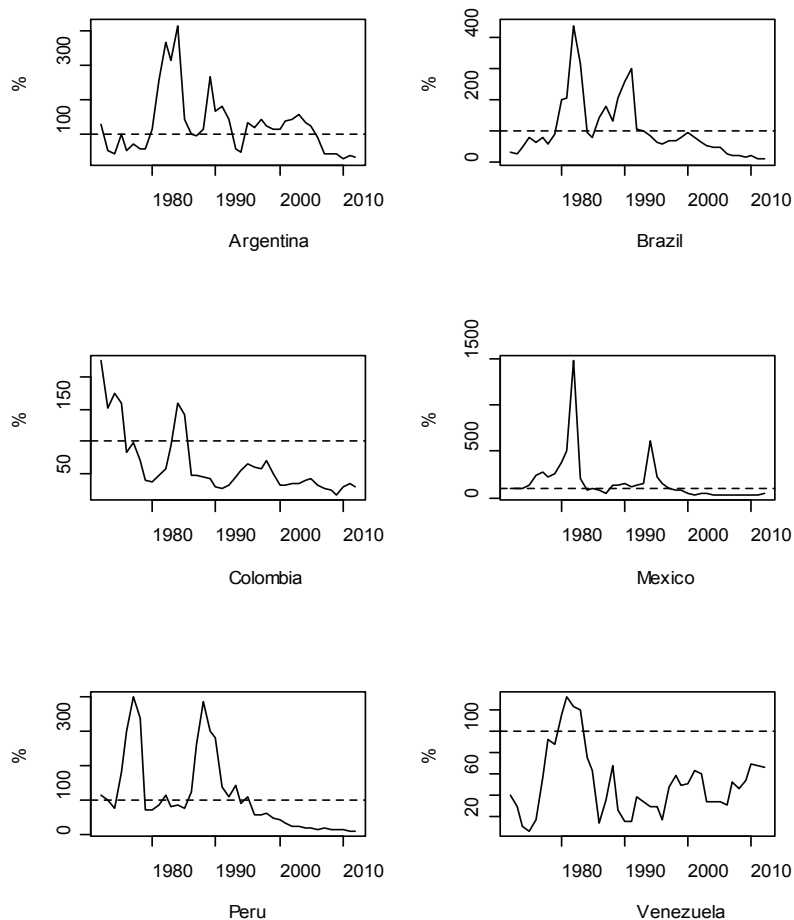


Source: U.S. Department of the Treasury 2014



The economic literature conventionally identifies three reasons countries hoard (See Bird and Rajan 2003; Rodrik 2006; Lanteri 2014). The first is to ensure payment of short-term debt (usually one year), which is the so-called Guidotti-Greenspan rule. As shown in Figure 2, all Latin American countries, except Argentina, have reduced their short-term debt level with respect to their foreign exchange reserve from the late 1990s to the present day. This fact, according to Rodrik (2014), helps countries to borrow more easily and avert a crisis.

**Figure 2**  
**Ratio of short-debt to foreign exchange reserves**



Source: Author's elaboration with data from WorldBank (2014).

A second reason for international reserves accumulation takes into account each country's participation in international trade. Payment of three months of imports is considered an appropriate level (Rodrik 2006; Bird and Rajan 2003). According to Rodrik (2006), this ratio had fluctuated around 3 during the 1990s in almost all the underdeveloped countries. Currently, countries such as Brazil, Peru, and Uruguay have ratios higher than 10. Colombia, Mexico, and Chile have ratios between 3 and 4, and in Argentina and Venezuela the ratio has deteriorated but is still above the level that is considered appropriate (See Table 3).

**Table 3**  
**Ratio of Foreign Exchange Reserves to Imports**

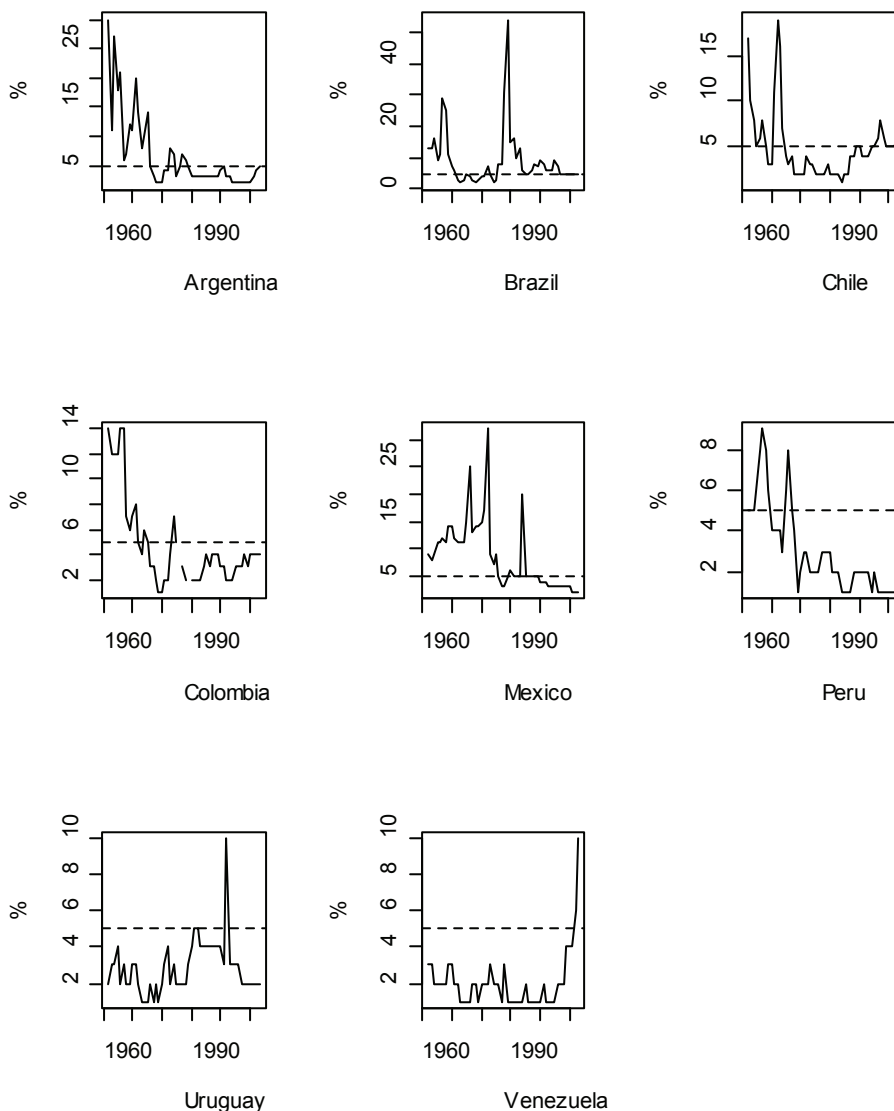
Countries	2005	2006	2007	2008	2009	2010	2011	2012
Argentina	7.3	7.3	8.4	6.9	9.3	7.6	5.3	5.3
Brazil	5.1	6.7	10.9	8.5	13.2	11.9	11.7	12.8
Chile	4	3.5	2.6	3.1	4.4	3.6	4.6	4.5
Colombia	5.7	4.9	5.3	5	6.1	5.6	4.8	5.1
Mexico	3.3	3	3.1	3.1	4.3	4.1	4.4	4.6
Peru	8.2	7.9	9.9	8.4	11.3	11.0	10.2	12.5
Uruguay	6.4	5.3	6	6.4	9.9	7.6	8.3	10
Venezuela	9.9	9	6.2	7.1	6.9	5.9	4.7	3.9

Source: Authors' elaboration with data from World Bank 2014

A further indicator aims at the financial sector with regard to the ratio of M2 to foreign exchange reserves; the rule of thumb is considered to be 5. The indicator shows whether countries could solve sudden capital outflows and subsequent problems in exchange rate. Then, this argument would be the reason for the outstanding accumulation of foreign exchange reserves in underdeveloped countries. However, no country in Latin America (except Chile and Venezuela for short periods of time) has exceeded that level on average in the 2000s (see Figure 2).



**Figure 3**  
**Ratio of M2 to foreign exchange reserves. Dotted line = 5**



Source: Author's elaboration with data from WorldBank (2014).

Why do Brazil and Mexico, especially, keep up a policy of accumulation of foreign exchange accumulation? According to Aizeman and Lee (2006), accumulation of foreign exchange is a neomercantilist policy that was practiced in Japan and Korea. Two types of neomercantilism are distinguished: (1) mo-



netary mercantilism and (2) financial mercantilism. The first is compounded on competitive depreciations among underdeveloped countries, which produces an economic policy beggar-thy-neighbor with negative externalities for other countries. The second is based on supporting export sectors increasing their productivity. The two measures seek a positive trade balance, to hoard and promote economic growth. However, except for Chile, Peru, and Venezuela, no country in Latin America has had persistent trade surpluses and none of them has had persistent economic growth. It is well known that Latin American countries benefited from the early 2000's boom in commodities. Neither trade surpluses during that period because of competitive depreciations, nor increases in neither productivity, nor hoarding were used to spark an industrialization process.

As already mentioned, Rodrik (2006) provides an explanation called self-insurance protection against the capital outflows or changes in the exchange rate that may lead to a crisis. He also notes two types of costs involved in hoarding international reserves: (1) the spread between “the private sector’s cost of short-term borrowing abroad and the yield that the Central Bank earns on its liquid foreign assets” (Rodrik 2006, 7) such as T-bills; and (2) the loss of buying T-bills instead of increasing the stock of capital or social spending (antipoverty programs).

Some post-Keynesian scholars argue in the same vein considering the last point: As long as international reserves go beyond 5 or 6 percent of GDP, the surplus can be used to increase the stock of capital (Cruz 2006). Post-Keynesian scholars also comment that capital controls and not the increase of foreign exchange reserve prevent outflow of capital and exchange rate problems (Grabel 2003; Cruz 2006). Of course, increases in the stock of capital as well as capital controls may be desirable, but this position neglects the fact that institutions in each underdeveloped country are embedded, and that to establish capital controls in all the countries as in the Golden Age is not possible right now, given the correlation of forces among the elite and between the elite and working class. Also, post-Keynesian scholars forget the evolution of the profit rate.

Some Marxists (Lapavitsas 2013; Labrinidis 2014) notes that accumulation of foreign exchange is due to the function of money as world money. Certain currencies, therefore, go beyond their national space and serve as an international means of payment and hoarding. Advanced countries with quasi-world money, such as the US, Germany, and Japan have to keep a certain amount of foreign exchange reserves. Meanwhile, underdeveloped countries that intend



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