Governance, transparency and accountability in Latin America

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I will refer to Latin America, the region from where I come and know. Latin America is, in financial matters as well as in other matters, of a complex diversity. The large and medium-sized countries of Latin America are emerging market economies, that is, countries with middle incomes and close links to the international financial market. Some of them have very sophisticated domestic financial markets. Securitization and derivatives had however limited reach and often met the skepticism of the domestic regulators of financial markets.

The smaller, low income countries have financial sectors confined to their domestic banking sector. They have very limited connections with the international financial market. Despite the shallowness of the financial markets some interesting innovations have been taking place like thriving microfinance institutions.

Commodity exports loom large in the export basket of both types of countries and the sharp fall in commodity prices is having far-reaching repercussions on the current account of their balances of payment and on their fiscal budgets. These real shocks may impact the financial sector over time.

Virtually all countries in LA reformed the legislation of their central banks in the 1990s (Chile did in the 1980s) and of the regulatory and supervisory institutions of their financial markets as well. With legal central bank independence or without, central banks were strengthened as monetary authorities. The monetary authority of central banks should not be taken as granted: in fact, it was laboriously established. Lessening the fiscal grip on central banks was not always easy and gaining independence from the private banks and bankers was a long battle.

With more power and authority of the central banks came responsibilities in terms of governance, transparency and accountability. Starting with governance, the role of the Governing Boards and of the Monetary Operations Committees was greatly reinforced by the legislation and the regulation. Most decisions are taken collectively in boards and committees with a small number of members, usually between six and twelve. The members of the governing board and other top officials of central banks are

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collectively responsible for the decisions taken except when they mark openly their disagreement and this is shown in the minutes. The responsibility is legal and political.

In a few countries the central bank's governing board formally consults with the executive branch and the Minister of Finance sits in it. This is done at some expense of central bank independence but it has the merit of coordinating fiscal and monetary policies. More frequently, the president (governor) of the bank is a *primus inter pares* member of the governing board; sometimes she has a defining vote should a stalemate arise when voting a decision. She is also the chief executive officer. The duality of roles, chairman of the board and CEO is, on occasion, a source of governance difficulties.

In practice, in all central banks reviewed, decisions are taken unanimously. But this practice leads to mute dissent, when it may contribute to take better decisions.. There is also a high frequency of group thinking and the chairmen exert, in fact, more power than what is contemplated in the legislation.

The Latin American central banks have been traditionally repositories of technical competence. In the past fifteen years a further strengthening has happened and the technical bodies of central banks are up to international standards.

As part of their modernization, the Latin American central banks have invested very much in communication. They issue reports regularly on the state of the economy and on monetary conditions. Five Latin American countries (Chile, Brazil, Peru, Colombia and Mexico) have inflation targeting as their monetary framework. As is well known, Inflation Reports have a major role in inflation targeting. But even in countries that do not follow inflation targeting, their central banks produce regularly very detailed reports on monetary conditions.

The supervisory authorities also publish regularly reports on the financial conditions of the banks under their supervision. The public receives disaggregated accounting information on the main items of the balance sheet and of the profit and losses statements, as well as on their liquidity and solvency (solvency is measured in relation to the Cook ratios).

The information provided to the markets and the public is indeed very valuable but it does not bridge the understanding gap of the public. Worse, often little effort is put into the explanation to the public at large and to political elites on what is the scope and which the implications of the policies adopted are. The markets, the political elites and the public are overwhelmed by the amount of information that is published. This provides an argument for less information, with more selection of the topics that really matter. The political elites and the public pay little attention to financial information except when there are allegations of misconduct of the top official of the central bank or of the commercial banks.

The legislation obliges the central bank and the supervisory authorities to inform to the executive power and to Congress on a regular basis. They oblige also to issue a detailed annual report and to publish their financial statements in the newspapers.

Abundant as it is, the information given by the central bank is sometimes short on specifics. The motivations of the most important decisions like changes in the interest rate, or in the exchange rate, are rarely explained or when they are explained, they are in vague and oblique terms. Very few countries in Latin America publish the minutes of their governing boards or monetary operations committees on a timely basis. If they publish at all, it will be after a long delay. There is also a deficit in the explanation on the procedures of decision-making.

The Latin American countries were plagued in the past by financial crises, mainly banking crises. The latter were accompanied by foreign exchange crises in the emerging economies. These crises have tested to the limit the function of lender of last resort of the central banks. By dearth of adequate legislation, of deposit insurance institutions of sufficient financial strength and of mechanisms for the prompt resolution of failing banks, central banks had to assume responsibilities that went well beyond liquidity assistance as lenders of last resort. The challenge was the greater the more underdeveloped were the safety net and the regulations. The actions of the central banks to rescue the commercial banks or their depositors were often surrounded by a high degree of opacity with regard to the amounts, the conditions and the banks that had recourse to it. The nature of the operations made some degree of secrecy unavoidable. Transparency and accountability are more likely when lending of last resort is rules based. The shortcoming of this approach is, of course, the loss of flexibility.

The painful experience of the 1980 and 1990s with banking crises left important lessons. The Latin American countries are more prepared than in the past in terms of regulation and supervision. More important, the banks are well capitalized and hold sufficient liquidity to withstand, at least for a while, the current crisis. In fact, banks in virtually all Latin American countries are showing great resilience during the current international crises.

There should not be however complacency. The institutional consolidation is far away of being achieved. In some countries, particularly in the smaller ones, governments continue exerting great pressure on their central banks and their supervisory authorities. There, the turnover rate of the central bank boards (including the governor) and of the supervisors of the financial sector has been very high. Rapid turnovers shows that the domestic official financial institutions continue to be under political influence and, sometimes, under the influence of the banking establishments.