COMMENTS ON LEFORT-WALKER

Arturo C. Porzecanski
ABN AMRO Securities LLC

The version of this interesting paper that was available for review at the time of the conference dealt almost exclusively with the development of capital markets in Latin America during the 1990s. Contrary to its title, the paper did not, in fact, advance many ideas of how said markets might (or should) develop further in this new decade. The authors quantified the growth of the region's equity and bond markets during the past decade and discussed how equity markets tended to shrivel up after the Asian crisis of 1997–98—possibly temporarily, according to the authors—while the markets for government and corporate bonds continued to grow unabated.

This mostly retrospective look at the region's financial markets missed highlighting, however, some of the key factors that drove the process forward during the 1990s. One of them was the decline of inflation everywhere in Latin America—from four-digit to three-digit to two-digit and by now to single-digit annual inflation in virtually all countries. Had hyperinflation not been vanquished in Latin America, surely the financial markets would have remained as small, repressed, unpredictable and uninteresting as they were in decades prior. High and variable inflation increases the variability of everything that matters—company costs, sales and earnings, the business climate, economic policies, and exchange rate fluctuations. Another driver was the appearance of local institutional investors, mainly pension funds and insurance companies, as country after country allowed for privately run pension alternatives and demonopolized essential financial services such as insurance. The rise of institutional investors brought with it a demand for securities—be they stocks or bonds—that did not exist when governments ran pension and insurance liabilities on a pay-as-you-go, rather than increasingly fully funded, basis.

Yet another important factor was the introduction of various reforms to enhance the workings of the capital markets—to improve transparency via accounting standards and disclosure rules and curb abuses such as insider trading. In the months prior to the conference, indeed, the legislature in Brazil passed a badly needed bill enhancing minority shareholders' rights. The congress in Chile approved a bill allowing for a modernization of that country's domestic capital markets. And politicians in Mexico agreed to a sweeping reform of antiquated laws on bankruptcy and the use of collateral and guarantees. These and various previously adopted new laws, regulations, and standards throughout the region surely encouraged the widening and deepening of Latin American capital markets.

The paper likewise did not mention some of the developments that have blurred the line between domestic and international capital markets, namely, the ways that globalization has affected the past, and surely will influence the future, of these markets. And yet the growing correlation between Latin American and U.S. bourses has been instrumental in reducing the appeal of the former as diversification plays vis-à-vis the latter. The trading of Latin America's benchmark shares in ADR form in the NYSE and the Nasdaq, moreover, has surely enhanced their liquidity but, at the same time, has facilitated herdlike behavior. For example, regional and outside investors bid up the region's tech stocks when investing in technology was very popular (1996–99)—only to subject them to massive dumping when technology all of a sudden became a dirty word (in 2000–2001). In addition, the arrival in Latin America of numerous foreign financial institutions—from Spanish commercial banks, which gained a commanding market share in many countries, to Dutch insurance companies and U.S. pension fund managers—has made it quite difficult to draw a line between domestic and global financial markets. When you keep your savings in a bank owned by HSBC, get a mortgage from a subsidiary of Citibank, buy your insurance from an affiliate of ING, and have your mutual funds managed locally by a broker working for Merrill Lynch, are you operating in the domestic or global financial markets?

With regard to what the future holds, surely a great deal depends on how countries treat domestic and foreign capital going forward. The Greek tragedy unfolding in Argentina—the country that had privatized, liberalized, and deregulated its capital markets the most—may well lead to new risk-averse attitudes among Latin American policymakers and investors, both domestic and foreign, generating changes in regulations and in the scale and nature of fund flows. Lower world oil prices, if sustained throughout 2002, may well bring great fiscal and financial pressures to bear on Ecuador and Venezuela, with possibly dire consequences for the business climate and the fledgling financial markets in those countries. And the policy direction of the next government in Brazil, to be elected later this year, will certainly have a major impact on the future of that capital market—the largest of them all.

One conclusion I have reached is that, until junk bonds and venture capital finally develop in Latin America, the fruits of financial innovations and liquid markets will not trickle down and benefit the overwhelming majority of small enterprises that hold the key to the region's economic development.