LATIN AMERICA: SUCRE system may expand regionally

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Abstract

The Unified Regional Compensation System (SUCRE).

Six months before its fifth anniversary, the SUCRE virtual currency utilised to channel trade between members of the Bolivarian Alliance for the Peoples of Our America (ALBA) has entered a phase of consolidation. Venezuelan President Nicolas Maduro’s reversal of his predecessor’s decision to limit participation to ALBA has opened the door to Uruguayan involvement, raising the prospect of the system’s further expansion. Overall, despite having been used mainly as a means of exporting to Venezuela more cheaply and easily, the SUCRE’s stability, coherence, and provision of cost advantages to SUCRE-zone producers continue to make it an attractive alternative to trade in dollars.

Full text

SUBJECT:The Unified Regional Compensation System (SUCRE).

SIGNIFICANCE:Six months before its fifth anniversary, the SUCRE virtual currency utilised to channel trade between members of the Bolivarian Alliance for the Peoples of Our America (ALBA) has entered a phase of consolidation. Venezuelan President Nicolas Maduro’s reversal of his predecessor’s decision to limit participation to ALBA has opened the door to Uruguayan involvement, raising the prospect of the system’s further expansion. Overall, despite having been used mainly as a means of exporting to Venezuela more cheaply and easily, the SUCRE’s stability, coherence, and provision of cost advantages to SUCRE-zone producers continue to make it an attractive alternative to trade in dollars.

ANALYSIS: Impacts.

The SUCRE's opening to the wider region weakens ALBA; participation was one of the few concrete benefits of full membership.

Perceived success and expansion into Uruguay raises the possibility of convergence with Mercosur's existing currency-swap arrangements.

Consolidation validates Ecuador's New Regional Financial Architecture proposal, along with the stop-start Bank of the South project.

As with so many recent initiatives in Latin America and the Caribbean (LAC), the idea for a regional virtual currency came in 2008 from then Venezuelan President Hugo Chavez, though the mechanism itself was designed by a commission answering to Ecuador's Rafael Correa. Chavez insisted that its use be restricted only to ALBA states, and eventually all five -- Venezuela, Cuba, Bolivia, Ecuador and Nicaragua -- ratified the agreement.

The SUCRE has several interrelated purposes:

reducing reliance on the dollar for international trade within LAC;

saving foreign-exchange for participating states;

promoting diversification of trade relations towards LAC and away from traditional partners (especially the United States) by improving local producers' cost competitiveness;

facilitating participation of small and medium-sized enterprises (SMEs) in foreign trade; and

achieving balanced trade by using a Reserves and Commercial Convergence Fund to develop export-capable industries in participating states with trade deficits.

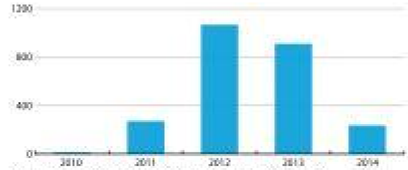
Where international trade usually requires that all individual transactions be converted into dollars, the SUCRE system allows states to compensate each other in their own currencies up to a pre-defined limit, with any variation either side of that limit cleared every six months in dollars. Thus, where via normal means a payment worth 10,000 dollars from Ecuador to Venezuela followed by another of 20,000 dollars from Venezuela to Ecuador would require 30,000 dollars, via SUCRE the same transactions would require only that the balance of 10,000 be compensated in dollars.

For businesses engaged in foreign trade, meanwhile, the use of local currency reduces transaction costs associated with currency conversion and the margins of middlemen. The saving can be as much as 5% of total cost, thereby promoting intra-regional trade by improving the competitiveness of SUCRE-zone producers vis-a-vis the rest of the world. Freedom from the cost of holding accounts in foreign currencies also allows for participation of smaller firms.

SUCRE's rapid rise (2010-12).

Uptake of the SUCRE was initially meteoric, rising from 12.6 million dollars in 2010 to around 1.1 billion by 2012.

The system was heavily promoted within participating countries, winning over even hostile private actors. Unlike most ALBA initiatives it is a genuine treaty agreement and therefore requires ratification by national parliaments, mitigating the risk of

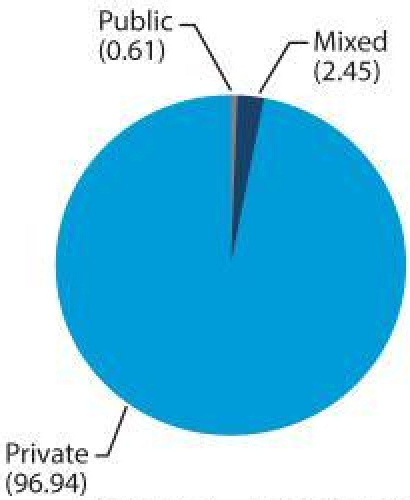


Value of SUCRE transactions since establishment (millions dollars)
Source: SUCRE Regional Monetary Council
annual report 2013; Venezuelan News Agency

collapse. Moreover, it reduces costs and thereby improves competitiveness within SUCRE-zone markets. In the Venezuelan case, it also provided a new channel through which to pay for imports at a time when foreign exchange commission CADIVI had become unsustainably corrupt and bureaucratic (though this body did maintain a role in approving SUCRE transactions).

Accordingly, early use purely by state enterprises was soon outpaced by private participation, involving even firms like Venezuelan food giant Empresas Polar, generally seen as an opponent of the Chavez and Maduro governments.

Tackling corruption.



Shares of SUCRE trade 2010-13 (%)
Source: SUCRE Regional Monetary Council
annual report 2013

However, alongside these successes Ecuadorian officials deduced in 2011 that as much as a third of exports to Venezuela were fictitious. Payments received in dollars by shell companies in dollarised Ecuador would simply be circulated back into Venezuela and sold at great profit on the currency black market. Though part of a wider problem estimated to have cost the Venezuelan state 20-25 billion dollars between 2010 and 2013 alone, the SUCRE provided a new channel for this practice. By early 2013 the Venezuelan Central Bank and finance minister jointly warned that it was becoming a serious threat to foreign reserves.

This threat has been reduced by a crackdown in both countries:

In Venezuela Maduro has ordered a wide-ranging investigation into the few institutions empowered to allocate foreign exchange. This has already led to the closure of CADIVI and stiff prison sentences for some of those involved (see VENEZUELA: Socialist swing worsens investment outlook - January 22, 2014).

In Ecuador, Correa has targeted operators of shell companies like Coopera, recently convicted of fraud in relation to 75 million dollars in SUCRE transactions.

With Venezuela also reforming its currency controls and effectively devaluing, the incentive to abuse the SUCRE has been reduced just as disincentives have increased.

Problems and potential.

The main limitation on the SUCRE's utility has been low trade levels between ALBA members. Participation of ALBA's five Latin American members means that virtually all intra-ALBA trade could potentially be channelled via the SUCRE, but many of their main regional trade partners remain outside of ALBA. Since other dysfunctional ALBA initiatives like the People's Trade Agreement and state multinationals ("grandnationals") have failed to increase intra-ALBA trade (see LATIN AMERICA: ALBA alliance faces doubtful future - June 27, 2014), the SUCRE's utility has been restricted. Accordingly, it has served mainly as a conduit for exports from Ecuador to Venezuela, accounting for nearly 96% of SUCRE trade in 2013. Since imbalances are ultimately cleared in dollars, this reduces the SUCRE's utility to states, though not to firms, yet the Reserves and Commercial Convergence Fund designed to help rebalance trade has not been implemented.

Much hinges on the successful adhesion of Uruguay, approved in March 2013; this is expected if, as anticipated, Tabare Vazquez is re-elected later this year. Expansion beyond ALBA's borders opens the door to other interested governments with high levels of trade with existing SUCRE-zone countries. The admission of Colombia and Peru, for example, would create a contiguous zone stretching from Venezuela to Bolivia via Colombia, Ecuador and Peru. Beyond the Andes, the Venezuelan Foreign Ministry and the Venezuelan chapter of the Mercosur Chamber of Commerce are already pressing for adoption of the SUCRE within Mercosur. As Mercosur already boasts a less-developed currency-swap arrangement, the ground is well prepared for any eventual convergence.

CONCLUSION: Although SUCRE trade will continue to fall in 2014, this should be seen as consolidation rather than rejection, since much of this reduction relates to the current crackdown on currency arbitrage in Venezuela and Ecuador. Reform of Venezuelan currency controls will further reduce incentives to this kind of corruption. Uruguayan membership will mean two of Mercosur's five full members are using the system, increasing the long-term probability of convergence. Expansion beyond ALBA's borders will also signal openness to other interested governments such as Colombia and Peru.

Details

Subject	Economic conditions; International relations; Politics; Corruption; Foreign exchange rates; Financial institutions; International trade; Monetary policy; Regions
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