Latin America Advisor

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Today's Top News

Advisor ANALYSIS

Q **U.S. bank FleetBoston Financial labeled as "incomprehensible" ruling issued last week by an Argentine judge charging the head of Fleet's local unit and 14 managers with refusing to return some customers' deposits during a run on the financial system in December. If found guilty of "fraudulent administration," the bank officials could face up to six years in jail. Where is this case headed and what are the broader implications for Argentina's banking system?**

A **Board Commentary: Geoffrey Milton:** "This is yet another example of 'blame the foreign banks' to cover up the real situation, when it is the political structure in Argentina which is responsible for the demise of the financial system. Because of the chaos last December, each bank had to make its own interpretation of the Central Bank regulations. Apparently, Fleet's country head has been quite vocal in his commentary on the factors behind Argentina's dire state. It was inevitable he would be a target in any campaign of retribution. Early on in the crisis, the Bank of Nova Scotia management faced a similar judicial process. Obviously, such behavior can only confirm the view that foreign investment in Argentina is extremely risky, subject to judicial vagaries, and without the benefit of the rule of law. Until a firm deal is concluded with the IMF, which includes unequivocal provisions on the status of domestic bank deposit accounts, the fate of the banking system remains very uncertain. In the meantime, the banks are trapped in the middle of the discord between the executive and judicial branches of government."

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>
> -- Steve Hanke

Guest Commentary: María Luisa Kun: "These cases (the court says they found another 15 involved in similar situations) are just more examples of bad customer service with really possible fraudulent implications. But at least four broader aspects are worth mentioning. First, in a completely destroyed financial system (for reasons other than the ones raised by this event), where one of the essentials -- trust -- has disappeared, this event fosters the critical picture. Second, crisis situations pave the way to relax controls in financial services, making dishonest

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events more plausible and achievable. Third, financial service providers (FSPs) should plan for exceptional circumstances, accidental or systemic, to preserve and retain the loyalty of customers -- particularly the most sophisticated and profitable -- because consistent, good service may attract new clients while the perception of unacceptably poor service will result in consistent churn. Fourth, FSPs in all geographies -- not only crashed countries -- should screen operational aspects for compliance and understand the needs for insurance coverage to face monetary penalties and even jail-time for officers when non-compliance is detected. (By the way, the U.S. Patriot Act and Office of Foreign Assets Control have the same implications)."

Guest Commentary: Steve Hanke: "That FleetBoston finds the ruling by an Argentine judge 'incomprehensible' is, well, incomprehensible. After all, we are talking about Argentina. As A.S.J. Baster noted in his 1935 classic, *The International Banks*, foreign banks operating in Argentina have a long history of attempting to seize business opportunities. However, he added that 'the degree of security offered was decidedly low, and at best uncertain.' Indeed, 'legal formalities were cumbersome, and the judges, in many cases, were either ignorant and overpaid political appointees, or underpaid, open to bribes, and liable to blackmail litigants.' One of the most dramatic acts of arbitrary injustice in the banking sphere occurred on May 19, 1876, when the Santa Fé Government decreed the compulsory liquidation of the London Bank in Rosario. The astounded manager of that solvent bank protested, but to no avail. The police forcibly removed the bank's gold from its vaults, and the hapless manager was imprisoned for impeding the liquidation. Thanks to gunboat diplomacy -- namely the H. M. S. Beacon -- restitution of the plunder ensued. That was then. Now, even though the Duhalde government has plundered the foreign banks for billions and the Argentine legal system remains as unpredictable as the shifting desert sands, the U.S. government is encouraging the IMF to cut a deal with the Argentine government. Turning a blind eye promises more, not less, mischief."

Geoffrey Milton is a member of the ADVISOR board and General Manager at the New York Branch of Arab Banking Corporation.

María Luisa Kun is Latin America Research Director at Gartner.

Steve Hanke is Professor of Applied Economics at The Johns Hopkins University.

Economic News

Brazil's Central Bank Refuses to Pay High Yields to Rollover Domestic Debt

Brazil's Central Bank failed Wednesday to sell $300 million in Dollar-linked domestic debt as it refused to pay yields of close to 40 percent, Bloomberg News reported. The securities are part of $1.8 billion in domestic debt coming due today. Brazil sold similar securities on Tuesday maturing next year at yields of around 36 percent. Investors are demanding higher yields on concerns the Central Bank's monetary policy committee (Copom) may raise interest rates to levels not seen in three years at its monthly meeting next week. The Copom raised interest rates 300 basis points last month to 21 percent to head off an upward inflationary trend. Earlier this week, Brazil reported October inflation of 1.31 percent, putting annual inflation at 6.98 percent, versus a Central Bank inflation target of 5.5 percent for this year. The country's Real currency weakened for a second straight day following the failed debt auction, edging down 0.55 percent to a buy/sell rate of 3.62/3.63 to the Dollar. In other Brazil news, President-elect Luiz Inácio "Lula" da Silva is