

Optimal capital of central banks and profits distribution criteria

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ABSTRACT

Capital of central banks has many roles, among them, to support policy actions, and to absorb possible losses for the operations that do or risks that confront; to generate trust and credibility in the public, and to contribute to the financial independence and institutional transparency. In this sense, the objective of this document is to explore the roles of capital of MERCOSUR and associated countries central banks (henceforth MERCOSUR-A), the factors that determine its behavior and inherent risks of tenure of certain assets, liabilities and the execution of determined operations, with the purpose of find criteria to contribute to the establishment of an optimal level of capital, or at least adequate, for central banks. Likewise this work seeks to analyze the policies of profits distribution and recapitalization nowadays used by the issuing entities.¹

The levels and composition of the capital amongst central banks of the MERCOSUR-A countries, are diverse: central banks of Uruguay and Chile register negative capital balances; Brazil shows a null capital; and the central banks of Argentina, Bolivia, Peru and Paraguay have positive capital levels. These situations may have diverse effects on the efficacy of monetary policy and, in general, are the outcome of distinct circumstances by which these institutions went through in the past, and the effects of which still persist nowadays.

The more important roles, that central banks' capital plays, according to the results of this document are: i) to provide support to the decisions in the policy making process, justified from the point of view of the main goals of central banks, and ii) to strengthen financial independence and central banks' governance process in front to government. These roles are not perceived as determinants when it has been adequately advanced in other aspects, as the central bank institutionalism, a good fiscal and financial system performance, on the main strands. However, considering that advances in these dimensions are not uniform among MERCOSUR-A countries, central bank capital can exert an important independent influence, at least in some countries.

Regarding the determination of an optimal capital level, Chile uses a broad range of methodologies for its calculation; Uruguay partially uses some of them. In Brazil is not applied the described methodologies in this document, although there it is studying the need of its application in the future. In the case of Peru, the adequate level of capital is evaluated taking into account that is necessary to have patrimonial and financial soundness that allow doing the necessary monetary operations to reach the target of the central bank, although it has also been evaluating the applicability of the methodologies described later in this document. Bolivia and Paraguay do not have a calculation of optimal capital level. Nevertheless, despite limited advance in the definition of optimal or adequate capital level, due to different complexities that its analysis imply, it seems to be certain consensus among MERCOSUR-A countries about the importance of maintaining positive levels of capital.

Amongst quantifiable risks, the most important ones that face central banks are currencies risk, and interest rates risk. Credit and operative risks, are of minor importance, and liquidity risk is not perceived as relevant. Nowadays, central banks do not identify the existence of non-quantifiable risks, in contrast to the BIS document, in which they are catalogued into higher weights category. Central banks of MERCOSUR-A have different experiences regarding the adoption of accounting norms. Brazil uses international norms; Paraguay, Peru, Uruguay and Bolivia, besides international standards, use specific norms of their central banks. Paraguay also uses government norms. Argentina uses national norms for commercial banks, and in parallel, applies international norms. Chile contemplates the use of its own norms according to those established in the National College of Accountants or the Banks Superintendence. IMF promotes the adoption of international

¹ The document is based on the provided answers to a questionnaire that was sent to the central banks of the countries of MERCOSUR-A. Published results correspond to the central banks of Argentina, Bolivia, Brazil, Chile, Peru, Uruguay, and Paraguay. The BIS made commentaries about a preliminary version of the questionnaire, and provided bibliographic references, including a non-published specialized document: Report of a study group on central bank capital (2005), prepared by representatives of ten central banks of different regions of the world.

accounting norms; however, there are several challenges for central banks, to completely adopt aforementioned standards. Greater independence of central banks have led to important changes in applied accounting norms, thus generating clarity and transparency about accountability processes, which in turn determine the necessity of important changes in the profits distribution policy.

The code of good transparency practices in monetary and financial policies of IMF establishes that it has to be disclosed to the public the way in which central banks' profits are distributed and how their capital is preserved. Other recommendations point out that profits must guarantee the non-negativity of capital, it must be avoided the transference of unrealized profits, transference must be neutral respect of monetary policy and it must be supported with liquid assets. The distribution of profits in MERCOSUR-A countries is determined through a norm of high government level that only can be modified in the senates of the countries. Most countries do not distribute unrealized profits and have numerical rules for their distribution. Nevertheless the establishment of these norms has contributed in all of cases to diminish the pressures that government could exert on central bank.

The results show that, most central banks of MERCOSUR-A, absorb losses that happen in every year. The recapitalization, in most cases, is a complex process that requires the intervention of legislative or executive instances of the countries.

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