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EMU and Latin America

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Participating in a panel at the end of a conference poses the risk of either repeating something that has already been widely discussed and accepted or sounding too controversial. In any case, I will try to deal with the following two issues: what are the pros and cons of EMU; and what are the prospects for monetary union in Latin America.

Concerning the desirability of EMU, I want to emphasize that traditional economic analyses of the pros and cons of monetary unions are likely to be at least incomplete and, in any case, very complex. On the one hand, since we economists lack a sound microeconomic theory of money we are at best capable of providing a very rough and somewhat inaccurate approximation to the costs and benefits of monetary unions. On the other, since economic systems are not static but rather evolve over time, an appropriate analysis should adopt a dynamic view where not just past or current but also prospective costs and benefits are assessed.

The above notwithstanding, I will still say that the creation of EMU was very appropriate. Indeed, after having established a single market in the European Union, going forward towards a monetary union was a natural development. EMU certainly helps fully reap all the potential benefits deriving from the free circulation of goods, services and capital within the euro area. Furthermore, we should not forget that many European countries were for sometime already importing their monetary policy from the Bundesbank in a sort of 'de facto asymmetric monetary union'. The creation of EMU allowed in this way for a '*de iure*' symmetric monetary union where monetary policy decisions are made taking into account the interests of the euro area as a whole and not just of the "anchor country", as it was previously the case.

I should also add that in its first three and a half years of life, EMU has functioned very well in the presence of a number of complications. These stem from the differences in cyclical conditions among member countries as well as from the occurrence of several external shocks, like the US recession, the crises in Brazil in 1999 and Argentina at present or the bursting of the IT bubble.

Finally, I would like to mention that the main problems observed in the economic performance of the euro area are not those that many observers envisaged. In particular, before the creation of EMU it was feared that the participation of the so-called "peripheral" countries -like Spain or Italy- would be a source of tensions given their different economic structures relative to the "core" countries. Nevertheless, what has been observed is that countries like Spain or Italy have significantly increased their economic flexibility so as to cope with the requirements posed by their participation in the euro area. In contrast, the two largest countries have not shown the degree of economic flexibility and dynamism that is required to support a higher rate of potential output growth in the euro area as a whole. Consequently, it is of great importance that structural reforms are vigorously pursued in the single currency area and, in particular, in the largest economies.

Turning now towards the issue of monetary union in Latin America, it is important to ask if there are any lessons that can be drawn from the European experience.

A key lesson is that the road towards European monetary integration has been long, uneven and sometimes with dangerous turns. EMU represents the culmination of an integration process that started nearly fifty years ago and which evolved gradually. In Europe, the process started fostering trade integration, then went on to pursue deeper financial integration in an environment of closer monetary cooperation, and then achieved a significant degree of economic convergence prior to the creation of monetary union.

Of course, there have been naturally reinforcing interactions among the various steps of the European integration process. In this regard, it is also worth recalling that for many years achieving monetary union was not even on the agenda of European policymakers, which shows that the goals of integration became increasingly ambitious as time went on and previously set objectives were realized.

We shouldn't forget however that there was a failed attempt to establish a monetary union in Europe in 1970 -the so-called Werner Plan-. With hindsight, the reason why this earlier attempt failed is that the economic and political conditions for it to succeed were not there. Or, in other words, the time was not ripe.

Another useful lesson from the European experience is that monetary union cannot be regarded as a purely technical process but as part of a regional integration project which has wide economic, institutional and ultimately political dimensions. While, as I have mentioned, EMU represents the culmination of the European integration process set in motion in the fifties, it should not be forgotten that such process started with an important political motivation after the painful experiences of two world wars.

So, what are, in my view, the main differences between Europe and Latin America in the path towards monetary unification?

A first difference has to do with the lack of a unique, well defined regional economic integration project in Latin America in contrast with the single, open-to-all with clean entry conditions European project. In Latin America, the juxtaposition of several sub-regional integration projects often with different levels of ambition -Nafta, Mercosur, Andes region, Central America, etc.- has not, in spite of the attempts made, been very effective in promoting economic integration in the region as a whole. In fact, according to a number of estimates, the degree of effective regional economic integration existing nowadays in Latin America is like that of Europe about thirty years ago. Thus if, as I have tried to emphasize earlier on, regional monetary integration needs to be preceded by a significant degree of regional economic integration, the time doesn't seem to be at all ripe for the establishment of a monetary union in Latin America.

A second difference with Europe, closely related to the first, is the lack of a supra-national institutional framework in Latin America. In the European case, the existence of a clean, well defined supra-national institutional framework, like that embedded in the Union Treaty after Maastricht was critical for the success of the monetary unification process. Such a framework interacted in a virtuous way with national policies, reinforcing macroeconomic stability and convergence. Specifically, the determination of national policymakers in carrying out the appropriate policies was strengthened by the existence of the supra-national framework and, in particular, by the incentives for EMU participation. For instance, it would be difficult to explain why countries like Spain, Italy or Portugal undertook decisive policies aimed at structural reforms, fiscal consolidation and low inflation in the nineties without taking into account the drive to become members of EMU.

Taking all of the above into account, what prospects are there for a Latin American monetary union? I think it is clear that it remains a very distant goal. Indeed, there seems to be no social or political demand for it except in some very small countries and there is not even demand for other less ambitious forms of monetary cooperation.

The main reason for this lack of demand is that Latin American countries are confronted with such intense domestic economic problems that regional integration processes -and in particular monetary integration- are not at the top of the policy agendas. As a result, significant advances will need to be made in the domestic economic front before monetary cooperation makes some progress in the region.

To conclude, before asking about the prospects for monetary union in Latin America it is critical that countries in the region significantly improve their domestic economic institutions, increase macroeconomic stability and significantly advance along the road of regional economic integration. If so, maybe sometime in the future we may once again gather in this wonderful place to discuss with more realism than today what are the prospects for monetary integration in Latin America.