

IS IT POSSIBLE TO ACHIEVE A MONETARY UNION IN MERCOSUR? A Post Keynesian Alternative Proposal*

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Introduction

In 1991, the Asunción Treaty, signed by the presidents of Argentina, Brazil, Paraguay and Uruguay, created *The Common Market of the South* (hereafter MERCOSUR). At that time, MERCOSUR was created to be *only* a Customs Union. However, instead of having motives to celebrate this treaty, the MERCOSUR experience has been characterized, at least in the last three years, by economic turbulences: in January 1999, the Brazilian currency was devaluated and, as a result, it brought some spillover effects in the MERCOSUR area, more specifically in Argentina; since the end of 2001, the socio-economic, political and institutional crisis in Argentina¹ has caused further macroeconomic instability among the MERCOSUR countries, particularly in Brazil. Considering these turbulences, a question arises: what is the future of MERCOSUR? Some of the answers go in the direction that the future of the MERCOSUR is only the establishment of a free trade area; in this context, the final step of MERCOSUR is just to join the *Free Trade Area of the Americas*. Other answers argue that only a monetary unification among the MERCOSUR countries is able to (1) create a new framework for economic management to change the style of fiscal policies among governments of MERCOSUR and modify the financial and monetary system of the member countries, as well as (2) prevent new currency crises in the region.

Until recently, the evidences had shown that the economic integration process in MERCOSUR was going in the direction of having a monetary union in this area: in 1997 the former President of Argentina, Carlos Menen, proposed the “dollarization” of MERCOSUR economies²; in 1998 the annual regional summit of MERCOSUR indicated the possibility of having, in the future, a single currency for the MERCOSUR countries; and in December 2000 the presidents of the MERCOSUR countries declared their approval to macroeconomic convergence targets, in which the member countries of MERCOSUR have to harmonize objectives for inflation rate, interest rate, fiscal deficit and net public sector debt³ – as is well-known, macroeconomic coordination policy and, as a result,

* This article is a revised and updated version of our article that was published in the last issue of the Journal of Post Keynesian Economics (JPKE), Winter 2002-2002. We revised and updated our JPKE article to account for the recent turbulence in Argentina.

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¹ This crisis is characterized by the collapse of the Convertibility Plan – that is to say, the devaluation of Argentine currency –, the default of Argentine foreign debt and tensions among governments and socio-economic actors. Considering the last characteristic, it is important to say that, from December 2001 to January 2002, after the former president Fernando de la Rúa was forced to resign due to his own mistakes, Argentina had three different presidents.

² Carlos Menen’s proposal was based on the Argentine currency board system in which Argentina ties its monetary policy to dollar by constitution. In other words, the Convertibility Plan, implemented in April 1991, established a one-to-one parity between the Argentine currency, *peso*, and the U.S.dollar. It also required that the currency in circulation would be equal to the available gold and currency reserves. It is important to say that, at that time, Argentina was interesting in having a single currency to MERCOSUR as a strategy to maintain the Convertibility Plan.

³ By the way, it was called a “Little Maastricht” for the MERCOSUR

macroeconomic convergence targets are *sine qua non* conditions to create a monetary union. However, in 2001/2002 the Argentine crisis put in check the survival of the MERCOSUR, and, as a consequence, the idea of having a monetary union in MERCOSUR.

Taking into consideration that the final step of economic integration process in MERCOSUR⁴ could be the monetary union, a theoretical and practical question arises: is it possible to achieve a monetary union in MERCOSUR?

Basically, the proposal of creating a single currency among the MERCOSUR countries is based on the theory of Optimum Currency Areas (OCA) and on the experience of the European Monetary Union (EMU).

In general, the analysis of OCA shows that fixed exchange rates are more appropriate for countries which are completely integrated. In this context, a country's decision to join a currency area is determined by the weight of the advantages and disadvantages of having (or not) fiscal and monetary policies centralized to promote economic integration and co-operation policy.

Keynesian critique of the theory of OCA focuses on the ability of member countries to manage fiscal and monetary policies. Thus, for example, countries joining a monetary union lose their ability to implement economic policies to stimulate effective demand and solve unemployment problems.

We begin by presenting the theoretical approach on OCA. We intend to show how inconsistent the proposal of creating a currency union among the countries of MERCOSUR is, as the final step of an integration process in this region. Moreover, we argue that only a Post Keynesian alternative proposal of (i) managing fiscal and monetary policies and (ii) requiring appropriate institutional arrangements can reconcile full employment with external equilibrium to the MERCOSUR countries in a global world.

The article proceeds as follows: Section 1 briefly presents a survey of the literature on OCA. Based on the original work of Mundell (1961) and the contributions of Mckinnon (1963) and Kenen (1969), this section explores the arguments for and against countries adopting a single currency. Section 2, given that the academic debate in South America favors a MERCOSUR monetary union based on the EMU experience and inspired by the theory of OCA (Edwards, 1998, Giambiagi, 1999, Giambiagi and Riogolon, 1999, is a representative sample), shows that there is no evidence of having macroeconomic convergence in MERCOSUR. Besides, it argues that since MERCOSUR has not even reached the stage of a common market yet, it is premature to think of the countries composing it as being ready to form a monetary union. Section 3 presents a Post Keynesian proposal for MERCOSUR arrangement, in which aims at preventing currency crises and promoting full employment and economic growth in this region. The final section summarizes and concludes.

The theory of optimum currency areas: a brief review

In the beginning of the 1960s, the debate on optimal exchange rate arrangements was concentrated over the choice between fixed or flexible exchange rates. At that time, Mundell formulated a new conceptual framework for analyzing optimal exchange rate arrangements, whereby OCA was seen as an international monetary arrangement. Arguing that "periodic balance-of-payment crises will remain an integral feature of the international economic system as long as fixed exchange rates and rigid wage and price levels prevent the terms of trade from fulfilling a natural role in the adjustment process" (Mundell, 1961, p657), Mundell rejected the idea that flexible exchange rates were an efficient system for stabilizing the economies – it means, to maintain, at the same time, the external balance and full employment – and concentrated attention on defining the structural characteristics in favor of an optimal exchange

⁴ In general, an economic integration process has a natural sequence as follows: it begins with the establishment of a free trade area to aim at introducing a common external tariff and finishes with the creation of a common market in which countries have to harmonize their macroeconomic policies and allow the free circulation of production factors.

rate system in which two (or more) countries could fix the exchange rates between (among) their currencies, as a condition to maintaining the stability of relative prices and to promoting economic integration. Thus, the theory of OCA emerged.

Starting from the assumption that the main goal of economic policy is to maintain external balance and full employment, Mundell's analysis argues that the degree of factor mobility – capital and/or labor – is an important issue to determine the optimal choice of exchange rate regime. In this context, Mundell concludes that the limit of an OCA would have to analyze the trade-off between factor mobility and the size of the area.

Since then, the idea of establishing a single currency for two or more countries, considering that they have identical characteristics, has been part of the international academic debate. McKinnon (1963) and Kenen (1969), for instance, presented important extensions to Mundell's theory.

McKinnon (1963) emphasized the relevance of size and openness of the economy – that is to say, the relation between tradable production and non-tradable goods production of a country – to determine the efficiency of the exchange rate system. According to him, the greater the size and openness of an economy, the greater the internal wage and price level change in response to an exchange rate change. Based on this premise, McKinnon concluded that the greater the size and openness of an economy, a fixed exchange rate to restore the external balance and maintain internal stability would be more efficient. In his own words, “if we move across the spectrum from closed to open economies, flexible exchange rates become both less effective as a control device for external balance and more damaging to internal price-level stability” (Ibid., p.719).

Kenen (1969), arguing in favor of a fixed exchange rate regime, emphasized Mundell's idea related to the degree of geographic factor mobility as an important condition to the optimal choice of exchange arrangements. According to him, the optimal exchange arrangement would depend on the degree of interindustry factor mobility. Kenen argued that the greater the diversity of an economy's production, the less persistent the unemployment or inflationary costs to the economy would be.

To sum up, according to the literature on OCA, the economic conditions to determine a monetary union depend on: (i) the openness and size of the economy involved to trade; (ii) the free movements of capital and labor factors; (iii) the high level of intra-regional trade and the diversity of production; and (iv) the susceptibility of the economy to asymmetric shocks and the flexibility of the economy to adjust itself to such shocks. In other words, the introduction of a single currency in a specific region depends on what kind of integrated regional market is. Eichengreen (1998, p.14), for instance, points out that “optimum currency area theory predicts that exchange rate variability should rise with the asymmetric of output movements, the dissimilarity of exports and country size ... while falling with trade linkages”.

In general, the analysis of OCA shows that fixed exchange rates are more appropriate for countries which are completely integrated. In this context, a country's decision to join a currency area is determined by the weight of the advantages and disadvantages of having (or not) fiscal and monetary policies centralized to promote economic integration and co-operation policy.

Under these circumstances, what are the advantages and disadvantages to a specific country when it decides to join a monetary union, according to the theory of OCA? The economic benefits from monetary union are related to the microeconomic efficiency, such as: (i) the inflation rate in the monetary union would be significantly lowest; (ii) the transaction costs and hedging costs of economic agents related with the risks of exchange rate changes would decrease or be eliminated; (iii) the purchasing power parity of the country would be stable; (iv) the elimination of the board taxes would standardize the products of the economy; (v) the exchange control barriers to factor mobility would be removed; and (vi) regional integration would be stimulated. On the other hand, the main reason a country might avoid joining the monetary union is the following: the country prefers to operate its independent economic policy for promoting economic growth, payments balance and full employment having the exchange

rate as an instrument of economic policy⁵. At this point, it is important to say that Post Keynesians critique of the theory of OCA focuses on the ability of member countries to manage fiscal and monetary policies. Thus, for example, countries joining a monetary union lose their ability to implement economic policies to stimulate effective demand and solve unemployment problems⁶.

To summarize the main idea presented above, the discussion shows that, before deciding to enter (or not) a monetary union, countries have to analyze the pros and cons of economic policy consequences. In other words, a country's decision to join a monetary union creates the following trade-off: microeconomic gains resulting from co-ordination policy *vis-à-vis* macroeconomic loss as a consequence of not operating independent monetary and fiscal policies.

Is MERCOSUR an OCA? Do the MERCOSUR macroeconomic variables converge?

Is it possible to create a monetary union in MERCOSUR? When? Giambiagi (1999), for instance, believe that, between 2010 and 2015, MERCOSUR will be ready to adopt a single currency. According to him, "the answer to the question 'Does monetary union in Mercosur make sense?' is Yes. However, the answer to the question 'Is this a viable option in the short term?' is obviously No" (Ibid., p.31).

Going in this direction, Giambiagi presents a proposal, based on the theory of OCA and on the experience of the EMU, for a working agenda to establish a single currency in the MERCOSUR. According to his working agenda, "the aim is that ... the four Mercosur countries would: first, have an inflation rate close to international levels; second, respect the some public sector deficit *established in Maastricht* for the euro countries; and, third, have certain ... external disequilibria goals" (Ibid., p.30, emphasis added).

Before analyzing, specifically, Giambiagi's proposal of working agenda, the literature concerning the OCA argues that, as it was shown in the previous section, there are at least three preconditions that countries have to meet before entering a monetary union: (i) trade and financial integration process among countries must be intensified; (ii) factor mobility – labor and capital mobility – must also be intensified; and (iii) the macroeconomic magnitudes of the member countries must be satisfied.

Considering these preconditions, Eichengreen (1998, p.30), for instance, pointed out that MERCOSUR countries are so far away of satisfying the preconditions for a monetary union. Let us check this statement by looking at some figures.

First, the evidence shows that trade and financial integration process among the MERCOSUR countries is still so incipient. Looking at the intra-regional export figures of Argentina, Brazil, Paraguay and Uruguay – despite the fact that the intra-regional trade among the MERCOSUR countries increased more than three times between 1991 and 2000 – it is possible to observe that the total volume of intra-regional trade in this region represents less than 2.0% of GDP⁷. Moreover the degree of openness of the MERCOSUR countries is still low as well as the size of the economies involved to trade since their relative share in the world economy is only around 4.0%.

⁵ It is necessary to emphasize that, under monetary union, governments are not able to manage independent monetary policy and, as a result, they cannot monetize their fiscal deficits. Thus, fiscal and monetary policies are completely tied.

⁶ In a monetary union, the adjustment mechanism occurs on factor mobility. Then, fiscal constraints are designed to counter budgetary indiscipline as well as the monetary authorities lose control over monetary policy. In other words, under monetary union there is a single policy: central banks operate monetary policy just to keep inflation low and under control.

⁷ In 2000, the relation between total "fob exports" of Argentina, Brazil, Paraguay and Uruguay related to the MERCOSUR area and total GDP of these countries was 1.92% (US\$ 17.6 billion over US\$ 914.9 billion); in 1991, this relation was 0.81% (US\$ 5.0 billion over US\$ 613.6 billion). Moreover, the intra-regional exports of MERCOSUR countries, in 2000, represented 20.3% of the total exports of MERCOSUR countries to the world (US\$ 17.6 billion over US\$ 86.6 billion); in 1991, it was 10.80%

Second, factor mobility in MERCOSUR area is very low and asymmetric. On one hand, labor mobility in MERCOSUR is low because there are different technical and professional qualifications among the workers, as well as the labor markets in the MERCOSUR countries are so regulated. On the other hand, the capital mobility in MERCOSUR is quite asymmetric. In the 1980s, Uruguay adopted a financial market completely open to external capital as part of its strategy of development. During the 1990s, Argentina did not have any restrictions on external capital considering that this policy was part of its strategy to obtain international credibility for the maintenance of the currency board system. However, since the end of 2001, Argentina has “controlled” international capital due to its foreign debt crisis. Brazil, in a context of flexible exchange rate regime, is able to implement some sort of capital controls. Paraguay, recently, has liberalized its financial market.

Third, the statistical data of the member countries of MERCOSUR show that the rates of inflation, nominal interest, economic growth and unemployment are moving a little bit in different ways⁸.

Bringing back the Giambiagi’s proposal of working agenda (1999, pp.27-31), as well as taking into consideration the macroeconomic convergence targets approved, in December 2000, by the presidents of the MERCOSUR countries, the conditions required by the member countries of MERCOSUR to be able to join a monetary union and the entry of any other South American country in the MERCOSUR must be the following: (i) a free trade area has to be created; (ii) the countries have to harmonize their criteria for defining and measuring the principal macroeconomic variables; (iii) the countries should not devalue their exchange rate as well as they have to maintain their exchange rate within the normal margins determined by, for instance, a regional central bank; (iv) the annual inflation rate in a specific country should not be superior of 3.0%; (v) any country should not have an excessive fiscal deficit – more specifically, the budget deficit should not exceed 3.0% of GDP; (vi) the net public sector debt of any country of MERCOSUR cannot exceed 40.0% of GDP; and (vii) the countries cannot have an excessive current account deficit – a maximum of 3.0% of GDP is set.

Once again, let us check if the MERCOSUR countries satisfy the conditions proposed by Giambiagi and established, in December 2000, by the annual regional summit of MERCOSUR.

Focusing on the first point, the MERCOSUR is far away of creating a free trade area due to some trade conflicts, basically, between Argentina and Brazil. Giambiagi (Ibid., p.20), for instance, recognized that there is a deterioration in relations within the MERCOSUR area: “problems such as those that affected the sugar sector in Argentina, or the protest against Brazilian phytosanitary controls ... [A]fter the devaluation of the real, Argentine producers made ... demands, such as the introduction of a specific tariff against Brazilian goods, safeguard measures, and the establishment of quotas”. Moreover, since the devaluation of the *peso*, Argentina has moved tariffs upwards for some specific sectors and, as a result, it has caused further trade instabilities among Argentina, Brazil and Uruguay.

Looking at points two and three, despite the attempts to harmonize the main macroeconomic variables, it is possible to observe that the exchange rate regimes of the MERCOSUR countries differ among them. Uruguay has adopted, since the beginning of the 1990s, a crawling-peg system in which its currency can float according to the price stabilization objectives. During the 1990s, Argentina adopted a classical currency board system, pegging the

(US\$ 5.0 billion over US\$ 46.3 billion). These relations were elaborated by the author, according to Table 1, Table 2, Table 3 and Table 4.

⁸ Observing the period between 1995 and 2000, the figures about inflation rate, nominal interest rate, economic growth rate and unemployment rate show how divergent are these economic variables in Argentina, Brazil, Paraguay and Uruguay. According to the figures, the average rates of inflation (p), nominal interest (i), GDP (y) and unemployment (u), from 1995 to 2000, for the MERCOSUR countries are the following: Argentina = - 0.01% a.a. (p), 8.3% a.a. (i), 1.7% a.a. (y) and 15.3% a.a. (u); Brazil = 10.3% a.a. (p), 28.3% a.a. (i), 2.5% a.a. (y) and 6.3% a.a. (u); Paraguay = 8.9% a.a. (p), 28.3% a.a. (i), 1.2% a.a. (y) and 7.9% a.a. (u); and Uruguay = 14.9% a.a. (p), 20.1% a.a. (i), 1.5% a.a. (y) and 11.4% a.a. (u). These average rates were calculated by the author based on Table 1, Table 2, Table 3 and Table 4.

peso to the U.S. dollar on a one-to-one basis, with clear stabilization objectives. Recently, Argentine currency was devaluated and the Central Bank began to operate a floating exchange rate regime. Brazil, since the beginning of 1999, after adopting a crawling-peg system, has managed a floating exchange rate regime. Paraguay, in the last few years, has devaluated its nominal currency. In other words, since the exchange rate regimes of MERCOSUR countries still differ among them, it will be difficult to adopt some plan of macroeconomic-coordination and eventually a monetary union. Moreover, the different monetary and exchange rate regimes in these countries can be very disruptive. As Fanelli (2000, p.3) pointed out, “[e]s prácticamente imposible que dos países avancen en la coordinación de sus políticas macroeconómicas ignorando el tipo de régimen cambiario que cada uno posee”⁹.

Concerning the inflation rate target, despite the substantial reduction in the inflation rates in Argentina, Brazil, Paraguay and Uruguay, especially since the middle of the 1990s, these countries still have inflation rates above the 3.0 % threshold, with the exception of Argentina which has had an inflation rate under 3.0 % since 1995, but, as is well-known, this was only possible with the adoption of an extremely rigid currency board regime. However, the ceiling of 3.0% of inflation for each country may be too ambitious if one considers the high past inflation rates in the countries of the region (see Table 1, Table 2, Table 3 and Table 4).

The figures for the fiscal deficits in MERCOSUR countries, from 1991 to 2000, show that, (a) the fiscal deficit in Brazil, since 1995, has been greater than 3.0% of GDP; (b) Argentina’s budget deficit was always less than the target established; and (c) fiscal deficits in Paraguay and Uruguay have been less than 3.0% of GDP throughout except for 2000 and 1999 and 2000, respectively. In terms of the ratio of government debt to GDP we may observe that, between 1991 and 2000: in the case of Paraguay, it has been less than 40.0%; in Uruguay it has been satisfied; in Argentina, since 1996 it has been greater than 40.0% and, moreover, it has been increasing; and in Brazil during the last three years, from 1998 to 2000, it has been greater than 40.0 %, and it has been increasing (see Table 1, Table 2, Table 3 and Table 4).

Finally, looking at the figures relating to the current account deficits (see Table 1, Table 2, Table 3 and Table 4), it may be noted that the average ratios of current account deficit to GDP, from 1998 to 2000, for Argentina, Brazil, Uruguay and Paraguay are 4.1%, 4.3%, 1.6% and 2.7%, respectively. It is also important to note that since 1996 there has been a clear deterioration in the current account deficit of Argentina, Brazil and Uruguay, and this tendency has been followed, mainly in the case of Argentina and Brazil, by an increase in the foreign debt/GDP ratio.

To summarize this section, the attempt to create a MERCOSUR regional monetary union is open to a number of objections: first, the MERCOSUR’s factor markets are not sufficiently unified to make it an OCA; second, the volume of intra-regional trade among the MERCOSUR countries is still low; and third, the macroeconomic variables in the proposed union show that there is a long way to go before convergence is achieved. Thus, we agree with Eichengreen (1998) that MERCOSUR countries do not appear to satisfy the preconditions for a monetary union.

A Post Keynesian alternative to economic integration in MERCOSUR¹⁰

As is well-known, since the collapse of the Bretton Woods system in the early 1970s, intense and extensive international mobility of capital and financial liberalization – *i.e.* the globalization process – has substantially altered the dynamic process of international economy. Macroeconomic policies, with the specific aims to stimulate effective demand and, as a consequence, increase the level of employment, have been limited¹¹. Moreover, in the absence

⁹ Translating to English: “[i]t is almost impossible to imagine that countries can adopt macroeconomic coordination ignoring the existing type of exchange rate regime” (Fanelli, 2000, p.3).

¹⁰ This section is based on Ferrari-Filho (2000).

¹¹ Davidson (1999-2000, p.201), for instance, shows that after the breakdown of the Bretton Woods system, in 1973, the world real growth rate is practically half of what it was during the period from 1950 to 1973.

of government macroeconomic policies to limit the movements of capital flows, international speculative capital flows have created serious monetary problems, such as the European monetary crisis in 1992/1993, the Mexican peso crisis in 1994/1995, the Asian crisis in 1997, the Russian crisis in 1998, the 1999 Brazilian crisis, the Turkish crisis in 2001, and, recently, the 2001/2002 Argentine crisis, provoking high rates of unemployment, exchange rates disequilibria, persistent balance of payments imbalances, severe liquidity crises in the banking system in the industrialized countries, and so on. To sum up, instead of producing stability and economic growth in the global economy, the globalization process has caused global economic problems, such as: exchange rate instabilities, low growth rates and high unemployment rates, and balance of payments imbalances, among others.

To avoid new currency crises in the MERCOSUR area – recently, the evidence has shown that these crises can be explained by a mix of contagion crises arising from any international crisis and the perception by market operators that the countries have serious macroeconomic imbalances¹² – the annual regional summit of MERCOSUR decided to approve, in December 2000, some macroeconomic convergence targets, in terms of inflation rates, interest rates and fiscal deficits and net public sector debts. Assuming that these macroeconomic convergence targets represent another stage of the creation of a single currency in MERCOSUR, a question arises: in a global world, can a single currency solve the economic problems in MERCOSUR?

Looking at the EMU experience, Arestis, McCauley and Sawyer (2001), for instance, argue that the project of a single European currency has brought to the EMU countries deflationary and destabilizing policies. Considering that MERCOSUR countries have more social problems than the EMU countries, probably the costs of creating a monetary union in MERCOSUR would be rather dramatic.

The Keynesian economic analysis concerning the financial and currency crises in a global world shows that the real disruptive outcomes derived from speculative attacks in liberalized financial markets and they will be *only* reduced (or eliminated) if there is a market maker institution able to (i) prevent the capital volatility, (ii) assure market price stability and (iii) promote full employment economic growth.

Taking into consideration this idea, instead of adopting a deflationary economic policy to MERCOSUR area, characterized by, implicitly, Giambiagi's working agenda and, explicitly, the macroeconomic convergence targets approved, in December 2000, by the regional summit of MERCOSUR, we propose an alternative arrangement to MERCOSUR to assure economic growth and stability. To address this objective, it is necessary to create a MERCOSUR Supraregional Board (MSB) with political power to establish some rules to (i) regulate the foreign reserves, (ii) maintain stable the exchange rate system, (iii) eliminate the external imbalances and (iv) monitor and prevent the market failures. Our inspiration is Keynes's revolutionary analysis presented in his *International Clearing Union*, during the Bretton Woods Conference in 1944.

At that time, the main idea of Keynes's *International Clearing Union* was “the substitution of an expansionist, in place of a contractionist, pressure on world trade” (Keynes, 1980, p.176). Thus, Keynes suggested a scheme set out in a new international monetary system, based on an international currency, *bancor*, able to resolve the current financial crises and at the same time to promote full employment and economic growth in global economy. Keynes clearly demonstrated what the world economy needed when he wrote that,

“We need an instrument of international currency having general acceptability between nations (...) We need an orderly and agreed method of determining the relative exchange values of national currency units (...) We need a quantum of international currency, which is neither determined in an unpredictable and irrelevant manner (...) nor subject to large variations depending on the gold reserve policies of individual countries; but is governed by the actual current requirements of world commerce, and is also

¹² This idea is clearly developed in Alves et al. (1999-2000)

capable of deliberate expansion and contraction to offset deflationary and inflationary tendencies in effective demand world. We need a system possessed of an internal stabilising mechanism, by which pressure is exercised on any country whose balance of payments with the rest of the world is departing from equilibrium in either position, so as to prevent movements which must create for its neighbours an equal but opposite want of balance (...) We need a *central institution* (...) to aid and support other international institutions” (Ibid., pp.168-9, emphasis added).

This central institution proposed by Keynes would have the functions of (i) preventing a lack of global effective demand, (ii) providing an automatic mechanism for restoring the balance of payments of the countries, (iii) providing each country with the ability to control movements of capital, and (iv) expanding the quantity of the liquid asset.

Interpreting and adapting Keynes’s international proposal to MERCOSUR, we think that a proposal must be drawn based on the creation of a MSB to delegate power to the regional central banks for (i) operating fiscal and monetary policies as instruments to promote full employment and economic growth, (ii) equilibrating the balance of payments by using trade and stable exchange rate policies and adopting “an automatic mechanism for placing a major burden of payments adjustments on the surplus nations” (Davidson, 1994, p.268), (iii) disciplining the banking and financial system and (iv) providing an anti-speculative mechanism to control movements of capital.

On the contrary to Keynes’ proposal, we think that the MSB does not require the establishment of a single currency to MERCOSUR. What is required is to design some rules for the governments and central banks of the MERCOSUR countries able to substitute the process of expanding effective demand for the current dynamic of speculation activity in the MERCOSUR area. In order to realize this objective, the rules must be designed as follows: (i) the monetary policy, instead of controlling the stock of money to keep inflation under control, has to be operated in a sense of changing the nominal interest rates and, as a result, affecting the rate of investment; (ii) the fiscal policy has to be managed to support aggregate demand, as well as the budget deficit could be used by the governments as a discretionary policy for reducing the economic and social differences among the countries; (iii) to avoid the adjustment problems caused by the susceptibilities of their economies to asymmetric shocks and to equilibrate the balance of payments, it is necessary to consolidate a common external tariff for the MERCOSUR’s products, the exchange rate regime – based on a fixed, but adjustable exchange rate system – has to be harmonized, and a “trigger mechanism” – to aim at putting more pressure of balance payments adjustments on the creditor countries than on the debtor countries – has to be created¹³; and (iv) the central banks must act as lender of last resort, provide long-term lending, and establish some sort of control on capital flows to mitigate instability and fragility in the region.

Our proposal removes the restraints on national-level fiscal and monetary policies, reduces the entrepreneurial uncertainties and develops an institutional arrangement to assure full employment economic growth and to reduce the regional inequality among the MERCOSUR countries. To finalize this section, paraphrasing Keynes, we believe that a proposal to MERCOSUR built like that “could use its influence and its power to maintain stability of prices and to control the trade cycle [in the MERCOSUR area]” (1980, pp.190-191).

Conclusion

We have argued in the paper that the attempt of creating a regional monetary union in MERCOSUR is open to a range of objections, such as: first, the use of EMU model of monetary union implies to adopt a deflationary policy; second, according to the OCA literature

¹³ According to Davidson, the “trigger mechanism” is the main instrument to guarantee that “export-import imbalance is eliminated without unleashing significant recessionary forces” (Davidson, 1994, p.272).

and the academic proposals favor a MERCOSUR monetary union, the figures showed that (i) the factor markets are not sufficiently unified, (ii) the volume of intra-regional trade among the MERCOSUR countries is still low and (iii) the macroeconomic variables of the MERCOSUR failed in addressing the convergence criteria.

Considering these arguments, we have concluded that it is thus premature to discuss a MERCOSUR monetary union. Above all, however, even if the stage were reached for such a union, we would suggest that the EMU model is not appropriate for this area. In other words, the MERCOSUR cannot accept an integration process in which the member countries have to replace their “structuralist process”, constructed decades ago, by a “monetarism” view of the economy.

Moreover, we proposed, based on a Post Keynesian analysis, a new regional arrangement to MERCOSUR to promote “full employment, growth and stability” and to reduce the real disruptive outcomes derived from the speculative activity in financial markets in this region. This is one of the principal legacies of Keynes’s ideas. This is our challenge for MERCOSUR.

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Government Budget/GDP	(0.1)	(1.8)	(0.7)	1.1	(7.2)	(5.9)	(6.1)	(7.9)
	(10.0)	(4.6)						
Government Debt/GDP	36.9	38.2	32.8	28.5	31.6	33.3	34.5	42.4
	47.7							46.9
Current Account/GDP	(0.3)	1.6	(0.1)	(0.3)	(2.6)	(3.0)	(3.8)	(4.3)
	(4.1)							(4.6)

Source: CEPAL (www.cepal.org) and INFORME MERCOSUL (www.mercosul.org).

Notes: (1) Percentages based on values at 1995 prices; (2) Consumer Price Index; and (3) Average nominal interest rate determined by the Central Bank of Brazil.

TABLE 3
Macroeconomic indicators of Paraguay

	1991	1992	1993	1994	1995	1996	1997	1998
1999								
2000								
Exports to MERCOSUR	0.2	0.2	0.3	0.4	0.5	0.6	0.8	0.7
	0.5	0.5						
(US\$ Billion)								
Exports (US\$ Billion)	1.1	2.0	2.8	3.4	4.3	3.9	4.0	3.8
	2.7	2.9						
Nominal GDP (US\$ Billion)	6.2	6.4	6.9	7.8	9.0	9.6	9.5	8.5
	7.7	7.4						
GDP Rate (%) ¹	2.5	1.8	4.1	3.1	4.7	1.3	2.6	(0.4)
	(0.1)	(0.6)						
Inflation Rate (%)	11.8	17.8	20.4	18.3	10.5	8.2	6.2	14.6
	5.4	9.0						
Interest Rate (%) ³	34.9	28.0	30.1	35.5	33.9	31.9	27.8	30.5
	30.2	16.4						
Unemployment Rate (%)	5.1	5.3	5.1	4.4	5.3	8.2	7.1	6.6
	9.4	10.7						
Government Budget/GDP	(0.2)	(0.6)	(0.5)	1.1	(0.3)	(0.8)	(0.2)	(1.3)
	(1.0)	(3.6)						
Government Debt/GDP	26.2	19.4	17.7	15.9	17.6	16.8	17.4	21.4
	30.7	33.1						
Current Account/GDP	(5.2)	(0.9)	(0.9)	(3.5)	(3.1)	(5.2)	(2.5)	(1.7)
	(1.8)	(1.4)						

Source: CEPAL (www.cepal.org) and INFORME MERCOSUL (www.mercosul.org).

Notes: (1) Percentages based on values at 1995 prices; (2) Consumer Price Index; and (3) Average nominal interest rate determined by the Central Bank of Paraguay.

TABLE 4

Macroeconomic indicators of Uruguay

	1991	1992	1993	1994	1995	1996	1997	1998
1999	2000							
<hr/>								
Exports to								
MERCOSUR	0.5	0.5	0.7	0.9	1.0	1.1	1.3	1.5
1.0	1.0							
(US\$ Billion)								
Exports								
(US\$ Billion)	1.6	1.8	1.7	1.9	2.1	2.4	2.8	2.8
2.3	2.3							
Nominal								
GDP								
(US\$ Billion)	10.4	12.9	15.0	17.5	19.3	20.5	21.7	22.5
21.1	20.2							
GDP Rate (%) ¹								
(3.2)	(1.0)	3.5	7.9	2.7	7.3	(1.4)	5.6	4.9
								4.6
Inflation								
Rate (%) ²	81.3	59.0	52.9	44.1	35.4	24.3	15.2	8.6
4.2	4.8							
Interest								
Rate (%) ³	75.2	54.5	39.4	37.0	38.2	28.1	19.6	15.1
14.2	8.1							
Unemployment								
Rate (%)	8.9	9.0	8.3	9.2	10.3	11.9	11.5	10.1
11.3	13.4							
Government								
Budget/GDP	1.2	0.3	(1.0)	(2.2)	(1.9)	(1.8)	(1.6)	(1.0)
(3.8)	(4.1)							
Government								
Debt/GDP	41.2	34.9	31.1	30.5	28.8	28.1	28.4	26.9
27.5	28.7							
Current								
Account/GDP	(0.1)	(1.9)	(2.9)	(2.3)	(1.1)	(1.1)	(1.3)	(2.1)
(2.9)	(3.0)							

Source: CEPAL (www.cepal.org) and INFORME MERCOSUL (www.mercosul.org).

Notes: (1) Percentages based on values at 1995 prices; (2) Consumer Price Index; and (3) Average nominal interest rate determined by the Central Bank of Uruguay.