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# A step towards greater financial autonomy

## Argentina and Brazil are striving for a common currency. Such a union could boost regional trade and lead to more independence from the US

Even before Olaf Scholz met newly re-elected President Lula in Brasília last week, the latter had visited neighbouring Argentina, where he floated the idea of creating a common currency union for the two countries. The international response? Shaking heads. 'It's a terrible idea', tweeted Paul Krugman, Nobel laureate in economics. In the German weekly *Die Zeit*, Thomas Fischermann wrote about a 'dream money of the South'. So, was the announcement of a common currency for southern Latin America just talk?

A monetary union of *all* of Latin America would cover 5 per cent of global gross domestic product (GDP) – in comparison with the euro's 14 per cent, estimates the Financial Times. The idea has been debated since the early days of Mercosur, the Southern Common Market, which was founded in the early 1990s. A closer look at Brazil and Argentina, its largest member states by far, shows that that is indeed no simple matter. Both countries have long suffered from low and volatile growth and unstable currencies.

Argentina has repeatedly had to declare insolvency. It is not clear that it will be able to pay its May debt instalment to the International Monetary Fund. Inflation in the country of the football world champions is approaching triple digits. Does Brazil really want to team up with its financially unstable neighbour? And who would want to hold such a regional currency? The two countries' bilateral trade is minimal – barely 10 per cent of their foreign trade. The region is definitely not ready for the currency union Robert Mundell described in his standard theory of optimum currency areas.

## Advantages of a common currency

And yet, there are a few reasons why it would be *good* for Argentina and Brazil to move their currencies closer together. And a regional currency cooperation already underway shows what is possible.

For one thing, trade within Mercosur offers what Brazil and Argentina have recently been less and less successful in with partners such as the US, Europe and China: export manufactured goods. Even big Brazil, which until 10 years ago exported a respectable amount of finished and semi-finished goods, now mainly supplies the rest of the world with raw materials. In 2020, 90 per cent of its exports were products like soybeans and iron ore. However, 80 per cent of Brazil's trade with Argentina are *technological* goods – mainly passenger cars and automotive parts.

***For regional trade to rebound, currency coordination is urgently needed.***

That is exactly what Lula and Argentine President Fernández use to justify a future common currency. They want to revive Mercosur as an internally and externally strategic project and strengthen their negotiating positions in multilateral institutions and globally. Most importantly, as Brazilian economists explain, it is a way to re-industrialise the two countries and make their economies more resilient to global shocks. But such regional trade requires a certain kind of currency coordination.

The fact that the Argentinian *peso* and the Brazilian *real* fluctuate at different rates against theUS dollar makes the two neighbours' bilateral trade dicey. For regional trade to rebound, currency coordination is urgently needed. A theory of optimum currency areas for the Global South has to reverse the traditional order: it's not a matter of creating a currency union among countries that already have high trade volumes. Instead, greater monetary cooperation is needed to *boost* South-South trade integration.

## Against the weaponization of global finance

Eurozone countries know a thing or two about the challenges of coordinating the economic policies of neighbouring countries. However, regional trade in the Global South also has other problems, although the solution is not all that utopian. It's setting up regional payment systems

to allow for greater independence from the US dollar. That's because the dollar is so dominant in international payments that, outside the eurozone, even regional trading partners usually can't get by without using the US currency. A Brazilian exporter has to have his Argentinian importer pay him in dollars, which he then has to change into Brazilian *reals* – and vice versa. This triangular transaction is costly for companies.

Recent geopolitics have sharpened awareness of dollar dependency, with countries in the Global South observing the 'weaponization' of global finance with concern. The sweeping exclusion of Russian banks from the SWIFT global payments system – along with those of Iran, Cuba and Venezuela – shows that monetary policy has long been highly political. Dollar dependency thus also means being dependent on US foreign policy, as Brazilian Finance Minister Fernando Haddad argued last year when he called for a common currency with limited reach.

***The SML (Sistema de Pagos en Moneda Local) has played an important role in building trust between central banks.***

Ignoring the media uproar, a closer reading reveals that the South American proposal is not about copying the euro but rather about first creating a common cryptocurrency for their central banks to use as a unit of account so that local currencies can continue to be used in bilateral trade. Mercosur already has an institutional forerunner, the 'Local Currency Payment System' (*Sistema de Pagos en Moneda Local, SML*). Small-scale and little-known, the SML is the first cooperation by central banks in Mercosur.

And that's not all: While over the past decade, Mercosur either stagnated or regressed in almost all areas, the SML gradually also included the small member states of Uruguay and Paraguay. As we show in a new study, the SML has played an important role in building trust between central banks – which is what many past regional projects in Latin America have lacked, as Celso Amorim, Brazil's former foreign minister and brilliant authority on Latin American integration, recently noted.

Incidentally, after World War II, Western Europe jump-started its regional trade with a similar regional payments system. That was followed by the artificial 'European Currency Unit' (ECU), which later became the euro. Whether South America will choose to take a similar path or develop other forms of monetary cooperation – such as a regional digital central bank currency – and what the future holds for the *yuan,* which China is pushing to strengthen in international trade, are some of the uncertainties of the new multipolar world.



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