HIGH SCHOOL EDITION
Journal of Student Research

Volume 14 Issue 1 (2025)

Towards a Latin American Currency: Why a Currency Union Would Benefit the Region's Monetary Policy

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ABSTRACT

Currency devaluation and volatility of currencies in Latin America have consistently been a problem for economies in this region, resulting in systemic inflation and hindered foreign trade. There has been much debate recently about what a currency union would look like in Latin America, conceived by the countries there as an effort to help resolve currency devaluation and promote economic growth. This prompts the question, would Latin America benefit from a currency union? People in the past have spoken about how a currency union might not be the best policy for Latin America at the moment. They talk about how Latin America is a highly volatile region that is vulnerable to macroeconomic disturbances and has a limited fiscal capacity to respond to shocks. This paper shows what a currency union would look like in Latin America if we were to imagine a way to go beyond the political and policy roadblocks. I comment on the many advantages and disadvantages associated with dollarization, the creation of a dollar bloc, limited currency unions, and other prominent currency union's around the world. Based on the examples of other unions from around the world, I speculate that a proper, overarching currency union might be the best method of instituting a common currency in Latin America–that is, if at all we can see beyond the political contingencies of the present.

Introduction

Currency unions are defined as collaborations between countries to share the same currency or participate in a union to share monetary policy. In a currency union, the participating countries are not integrated into one central government. They may share the same currency and have different governments but have one central system that manages the monetary policy. Monetary policy in a currency union is often decided by member states together, and the union's central bank. Nowadays, there are many countries with currency unions all over the world. This would mean the different countries and cultures involved share one currency, and typically, currency unions have free-floating exchange rates. A free-floating exchange rate is when the exchange rate is determined by global market conditions. Countries with strong currencies that are free-floating exchange rates are the U.S, the European Union, Japan, and Australia, to name a few. With a free floating exchange rate, countries compare their supply and demand to the supply and demand of other countries and their currencies, such as the United States dollar. It has been shown to be successful in many countries that have implemented this system (Pillay, 2020). However, there are many advantages and disadvantages that come with currency unions.

Another type of monetary union is a dollar bloc. A currency bloc is when a group of countries, in agreement with each other, swap their currencies for another currency, such as the euro or the Dollar. Countries that use the United States dollar create the dollar bloc. These blocs are used in many countries around the world, such as Ecuador, El Salvador, the British Virgin Islands, the Turks and Caicos, and Democratic Republic of Timor-Leste to name a few. These countries use the United States dollar. In Western Africa, a bloc that is pegged the European Union's Euro entails Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal and Togo. The currency is called the Western African CFA Franc. The Central CFA Franc, also pegged to the Euro, is used by Cameroon, Central African Republic, Chad, Republic of the Congo, Equatorial Guinea and Gabon. The two currencies that tend to be pegged the most are the United States Dollar, and the Euro (Pillay, 2020). Many different countries have chosen these currencies because of their durability and strength in international markets. Not only that, but some dollar bloc countries have their own currencies, with fixed exchange rates. Fixed exchange rates are when a government ties its official currency to another country's, or perhaps even to the price of gold. Countries have done this in the past, and continue to do so now for multiple reasons. There are benefits, but also disadvantages for countries in systems like these, and I will elucidate these in greater detail in the sections to come.

In recent times, there have been many economic crises in the world that have reached many countries, affecting, for the purposes of this essay, South America as well (Blanco, 2009). In the past, some South American countries have faced economic crises that have resulted in high inflation, forcing these countries to adopt or create another stronger currency. An example of this is Ecuador, where they faced a financial crisis in the late 1990's, and adopted the U.S dollar (Cueva, Díaz, 2019). Countries adopt the currencies of others with the hope that their inflation rate declines. In Ecuador's situation, they were facing an average inflation rate of 39% per year from 1982-1999, reaching a rate of 67% by the end of 1999. Since the adoption of the dollar in 2000, their inflation rate steadily declined to single-digit inflation by 2003, averaging 3.8% from 2007-2017.

Latin American countries have economies that range from least-developed, lesser-known countries to large well-known developing ones. Latin American countries are all part of the same geographical region but they do not all share similar cultural traits. For example, the majority of Latin American countries speak Spanish, whereas Brazil speaks Portuguese. Brazil is the largest economy in South America in terms of GDP (World Bank, nd). Brazil is a country that has its economic products in a number of categories such as agriculture, manufacturing, and natural resources to name a few. Its sheer size, which is 3.2 million square miles, allows Brazil to be one of the strongest performing economies not only in Latin America but also in the world (AGI Global Logistics, 2024). Currently, South America's economically weakest performing country is Venezuela (Maloney et al, 2024). Venezuela has the world's largest oil reserves at 303 billion barrels (U.S. Energy Information Administration, 2024). However, in the last 20 years Venezuela has seen a tremendous economic collapse. The country has been in a dictatorship since 1998, and the government carried on its vision for national socialism. Recent economic troubles in Venezuela have led to an exodus of nearly 8 million Venezuelans since 2014 (UNHCR, 2024). The other strong performing economies in Latin America are Brazil, Chile, Colombia, and Mexico (Cristina Del Campo, 2021). These countries make up the bulk of the South American economy (U.N. ECLAC, 2024), the majority of which have free-floating exchange rates. Latin American countries mostly export agricultural items, and commodities such as sugar, bananas, coffee, raw materials, plants, and fuel (Inter-American development Bank, 2019). These countries also differ in their political climates and outlook. South America's politics has been influenced by ideals ranging from socialism to capitalism, from welfarism to state-controlled capitalism (Pérez-Liñán, 2007). In terms of governmental control, countries in South America range from dictatorships, like Venezuela, to democracies that have emerged from a history of authoritarianism, like Chile. South America's troubled past and any possibility of its recurrence in the future hold far-reaching implications for humanity and the global order. For instance, as many as 442 million people live in the continent and it boasts of vast natural resources. South America contains one-fifth of the world's iron ore reserves (Avila and Griffin, 2024), 25% of the world's most strategic metals, and is home to 20% of the world's oil and natural gas reserves (ECLAC, 2023). Copper, a highly conductive material, and rare earth minerals are plentiful in South America. Chile is home to the world's largest lithium reserves (Gúzman et al, 2023). These minerals matter for the transition of the world going toward the goal of sustainable energy. Why is a continent with so much potential in the world so underdeveloped? It should not be. South America has enough resources to be a self-sustaining continent. However, that aspiration is far from being materialized. All South American nations have differing economic situations, but perhaps a shared currency would integrate these diverse economies and help them leverage their potential more robustly while negotiating with other actors. The first section of this paper contemplates the benefits and historical examples of currency unions, as well as the obstacles hindering their creation. Then, I demonstrate four possible models of currency unions and conclude by arguing that an overarching currency union would be the best for Latin America..

Benefits and Historical Vantages

There are many benefits to a currency union. These can include lower transaction costs, and greater foreign investment (Lacina et al, 2011). Currency Unions are seen as a more reliable option for investing in countries with volatile exchange rates. In South America, a currency union would have many very important effects that would help create a stable economy for the whole continent. One action is increased trade amongst the countries in the South American currency union. In a currency union, there are rarely any borders for economic trade amongst the countries (Tchatchouang, 2015). In fact, in a currency union, there would be free trade between the countries. This would lower the transaction costs for each country, and lead to greater commercial trade (Lacina et al, 2011). All of the items produced in the union would have their price protected by trade in between the continent, and by the strength of a currency. This is very good for South America because transaction costs for items produced would be at a more fair price for small producers as well as big ones. Many South American farmers continue to be underpaid for the amount of work they do (Melvin and Ladman, 1991). A currency union would help mitigate this. This would also generate a drop in interest rates for the economies in the union through a central bank and mutual monetary policy (Lacina et al, 2011).

In a Latin American currency union, oil markets are likely going to be more accessible to the world, leading to greater foreign savings as one economic option (Gutiérrez, 2007).The currency would prove effective for the oil market in Latin America by being a trade option for countries not wanting to risk trading in unsteady foreign currency instead. Presuming a country outside the union exports something to one within it and receives the Latin American currency in exchange, then it can buy oil from Latin America in that new common currency. Further, Latin American countries would have a high stockpile of the currency with themselves, which they can then use to trade in oil among themselves relatively freely. Conversely, fledgling trade would strengthen the currency and cause it to become more accessible, in turn bringing oil prices down in Latin America (Jameson, 2001). The Latin countries would be trading in their own currency, on their own terms. If the oil producing nations in South America agreed to sell their oil with terms and prices that favor them, then there would be greater economic purchasing power. Investment would also increase in countries in the currency union (Rose and Engel, 2002). The strength of a currency with strong backing would lead to more investment and belief that the currency can remain stable (Rose and Engel, 2002). Countries would be able to invest and trade currencies with the union because there is less risk of a devaluation, as there is strength in numbers (Jameson, 2001).

A currency union would also create more competition against the international trading giants such as China, the European Union, and the United States (Rose and Engel, 2002). This currency bloc would create more leverage to negotiate more favorable terms with public and private entities from these areas. South America historically has had to rely on these countries for assistance, often facing disadvantageous outcomes. An example of this is how China made up 60% of the external debt of Ecuador and Venezuela (Parisot, 2017). China as of late has been able to offer Latin American countries great interest rates for contracts that benefit their country and gaining a large business presence in the region (Lafargue, 2006). Latin America has repeatedly borrowed money from the IMF, and relies heavily upon each investment (Shadlen, 2007). Currency Unions in this system also may use exchange rates as a means to obtain policy credibility for governments and central banks that lacked reputations for monetary discipline.

However bringing about a currency union for a region as volatile as Latin America would also bring about doubts. If there were to be a brand new currency, this could bring skepticism with the stability in the market. Some member states will not like the fact they are losing their own monetary policy. They might not also agree with the decisions they may enforce. Countries with more developing economies may also interfere with the economic development of the currency union as a whole. Disruption in export sectors could lead to market crashes. The same could be said for many countries, but a currency union may always remain vulnerable.

Bringing about a Currency Union would require countries willing to participate in a union as a whole. Countries participating in the union would have to elect a central bank government, and where it would be held (Jameson, 2001).

Possible Models of a Currency Union

Now, I will explain four different possibilities that Latin America can pursue to create a stronger currency for the countries as a whole. The four possibilities are dollarisation, pegging with the dollar bloc, a currency union involving the economically self–sustainable states, and a full–fledged currency union. The first of many possibilities Latin America can choose is dollarization. Dollarization is when a country adopts the United States dollar in order to create a more stable currency (Jameson, 2001).

One benefit to dollarization is that it can create stable investment opportunities in the country (Jameson, 2001). This is because investors will see that the currency is stable, and will most likely not take a dive for the worst in case of market shocks. Their currency can peg the dollar which is one of the world's strongest currencies, and is heavily relied upon for that reason(Thalassinos and Politis, 2012). Countries that adopt the U.S dollar have the backing of the U.S federal reserve and dollar strength, which is one of the worlds strongest currencies (Jameson, 2001). The value rarely fluctuates as a sign of its stability, and is widely traded in the international market as a stable asset (Todorova, 2020). Another benefit is the free capital movement within the dollarized countries (Jameson, 2001). This is when trade and currency is closely shared with both countries, so they may be able to trade easily and at less cost (Jameson, 2001). American and Latin American businesses would be able to conduct more business. This would lead to large economic benefits for not only Latin America and America, but the world (Hufbauer and Schott, 2005). More companies would be able to become multinational and help local economies (Yue, 2015). Free capital movement allows there to be free trade agreements. In a free trade agreement, besides tariffs and other trade barriers being removed, there is the ability to have more people in the workforces (Saggi et al, 2018). There would be a greater exchange of skilled and unskilled laborers between the U.S and Latin America. This would help create more opportunities for Latin Americans to gain more skills, and help with labor in the U.S. Special economic zones (Hinojosa-Ojeda et al,1992). These economic zones could create great opportunities for American businesses to get more affordable labor with less shipping costs, and conduct business with more friendly governments (Cheong and Cho, 2009). This would give Latin American companies more exclusive chances to work with the world's largest economy (Thalassinos and Politis, 2012) as well as create more businesses for Latin Americans (Click, 2007). This could help with the gap of doing business with a more demanding government, such as China, to whom many Latin American countries owe a significant amount of debt. Latin American countries would still use the dollar which creates greater compensation for workers, but is more expensive for the American business, however there is a compromise to this (Hinojosa-Ojeda et al,1992). More resources would be available to both areas of the world, and capital for businesses (Jameson, 2001). Another benefit of countries adopting the dollar would be lower interest rates (Jameson, 2001). Countries that adopt a currency as strong as the U.S dollar face fewer risks than with other currencies (Todorova, 2020). This in return would help lower interest rates from other countries seeing much smaller risk in countries that adopted such a currency. This might also assist in Latin American countries gaining more access to foreign loans with more desired objectives, or the opportunity to borrow money (Click, 2007). Countries adopting the dollar can also expect a safer and organized balance of payments (Jameson, 2001). There is a much safer concern for exchange rate risk, and debt in countries that accept the dollar (Click, 2007). These countries will have less of a worry with the currency value fluctuating when in trade with the exchange rate (Click, 2007). Debt that these countries would be able to pay back in a currency that is stable.

While dollarization seems to create nothing but benefits for the countries that adopt it, there are also strong disadvantages that countries must need to be aware of. One issue that is important for multinational companies in international trade would be how dollarization could make multinational countries lose interest (Molano, 2000). This would be because countries that have cheaper sources for labor in areas such as Asia, would not want to do labor business in those dollarized countries since it has become more expensive (Beckerman and Solimano, 2002). There can be different valuations for assets in some Latin American countries with the dollar, however, companies would end up paying more money at the end of the day (Slivinski, 2008). This could make some countries lose their appeal and lose to competition in areas where labor is less expensive. In a free trade agreement, there is no mandatory obligation for any country to do a certain amount of business with another (Saggi et al, 2018). However, in a free trade agreement with a nation or multiple in Latin America, there may be an imperative for the amount of trade that must be done between countries. This could possibly be due to trade being in the favor of one country, or a smaller developing country might need more trade to help increase its national revenue or trade (Michaely and Papageorgiou, 1998). The larger concern with dollarization among countries is the economic dependance it might create (Galindo and Leiderman, 2005). The U.S is considered a trustworthy trade partner, however, there may be a time when the U.S will have to look after its best interests, which could involve creating terms that are more favorable to them. While the U.S dollar is considered one of the worlds strongest currencies, there is always the possibility of being affected by problems the dollar is facing (Powell et al, 2000). If there is a economic downturn or recession that is being sharply felt in the U.S, the countries that adopted the dollar will have a similar issue (Powell et al, 2000). Another issue that is related to losing monetary independence is not having control of a country's own monetary policy and beliefs. While countries maintain their own economic policy, a dollarized country is forced to follow the adopted country's currency policies, whether they agree with them or not (Click, 2007). Countries would then lose control of their interest rates, or control of the currencies minting process (Molano, 2000). This would also mean countries lose control of their monetary policy to the control of another country. Losing monetary control would mean limited control in response to their own issues, even during crises (Galindo and Leiderman, 2005).

The differences can be marginal between dollar bloc and dollarization. A dollar bloc is when a group of countries peg their currencies to the US dollar without adopting the dollar fully (Erceg et al, 2009). Dollar blocs have great benefits in domestic transactions (Tchatchouang, 2015). Dollar blocs generally gain increased foreign direct investment from the U.S. and trade partners (Wei and Choi, 2004). This presents a stable investment opportunity to foreign investment, creating a greater sense of trust in the zone. More investment creates more money in the country and greater domestic transactions (Jameson, 2001). Countries that join a dollar bloc that are developing economies also can gain economic size with lower transaction costs among counties that do not have a dollar bloc (Cameron, 2004). This creates more capital with foreign investment, with the security of the treasury of the other nation (Tchatchouang, 2015). In this it would be the policy behind the America currency it is pegged to. Countries can maintain national monetary policy control also because their separate currency can only remain pegged to the U.S dollar (Jameson, 2001). Countries may also create a free-trade policy by removing tariffs with each other (Jameson, 2001). This is beneficial to every country involved by creating increased access to less expensive goods (Chahrour and Valchev, 2023). Labor between countries is another reason why dollar blocs are beneficial. Labor trade risk can be mitigated by having a stable exchange rate between countries participating in trade, and creates less risk for the employer instead of having volatile currencies that constantly fluctuate (Erceg et al, 2009).

Dollar blocs are considered safe for investors largely due to the strength in the currency (Wei and Choi, 2004). This would create stability in the country, and region. The stability is due to the strength of the currency being closely related to the U.S dollar, but also having a shared macroeconomic policy (Rose and Engel, 2002). Countries in a dollar bloc have a similar economic policy to that of the U.S, or have one that is exactly the same (Rose and Engel, 2002). That is trust in the macroeconomic policy, which would be shared by the many countries in a dollar bloc. Countries with the dollar typically have high inflation in their countries, so the dollar provides a relatively safe and low inflation alternative (Click, 2007).

Dollar blocs lead to increased foreign investment (Wei and Choi, 2004). Pegging to the dollar makes economic conditions more predictable (Cameron, 2004). Policy credibility sends a message to foreign governments that there is a stable economic policy (Jameson, 2001). Greater credibility leads to lower borrowing costs from these countries (Jameson, 2001). Lower interest rates makes investment more feasible for foreign investors (Jameson, 2001). To investors, safe capital returns and safety.

However many advantages there are, there are disadvantages to a dollar bloc. In a dollar bloc, countries lose their monetary independence by ceding it to the U.S treasury (Jameson, 2001). In a dollar bloc, a country can not independently adjust their own interest rates or implement monetary policies specifically for their own economic details (Erceg et al, 2009).

Whether a country wants or needs to follow their own economic needs, they would have to follow the U.S's economic policy. If the U.S were to raise interest rates to combat their own inflation, a country in a dollar bloc would have to follow in the procedure, regardless of their own economy perhaps being in its own recession, or benefit from lower interest rates. The country in a dollar bloc must maintain a lot of foreign exchange reserves to defend the peg to the dollar, which is financially straining (Wei and Choi, 2004). In an economic crisis, financial instability and limited ability of the government to respond properly to shocks is due to a lack of monetary policy flexibility (Erceg et al, 2009).

The absence of interest rate behavior in dollar blocs could increase unemployment and hinder economic performance (Jameson, 2001). With countries pegging the dollar, the inflexibility of interest rates can have negative effects on economic performance, and even employment (Jameson, 2001). Interest rates are important for managing economic policy (Belongia and Ireland, 2014). Interest rates could be lowered to help growth during recessions, or could be increased to help over-performing economies (Belongia and Ireland, 2014). In a country that does not manage their own interest rate, the country may struggle with all of the economic conditions that are a result of that (Erceg et al, 2009). A country that is not able to manage their own interest rates can have the wrong interest rate and contribute to unemployment (Jameson, 2001). Businesses would face less demand, and higher interest rates from other lenders (Erceg et al, 2009).

There is another viable option in arranging a currency union in Latin America. The other option in creating a currency union to benefit all of Latin America would be a limited currency union. A limited currency union would be made up of countries in Latin America that are the best economically performing, and capable countries. Countries that may be used as examples for the economic system may be Argentina, Brazil, Chile, Colombia, Peru, and Mexico (Diaz–Hermolo and Vassolo, 2012). This economic system would be seen as advantageous to the economic policies of many of these countries, creating a greater willingness for them to join a currency union (Jameson, 2001). This would create economic benefits for these countries that are already the top performers in Latin America, leading to greater trade and more economic benefit (Wei and Choi, 2004). This cooperation would lead to economic cooperation between these countries, and help counter regional destabilization (Hafner and Kampe, 2018).

A currency Union between only the highest performing countries in Latin America would create a tremendous increase in growth in GDP and trade for these countries (Hafner and Kampe, 2018). A limited currency union would eliminate the issue of exchanging currency, currency devaluation, and fluctuation (Miles, 2006). A common currency would make trade much easier, and create a stronger region with more advantages for trade with other nations (Hafner and Kampe, 2018). A union with no borders and free–trade with each other can create many new opportunities for business, cooperation, and innovation (Hafner and Kampe, 2018). Strong currencies invite investment to the region encouraging economic activity (Miles, 2006). This would also help business growth in the countries (Miles, 2006). Economic activity in this union would have more coordinated GDP growth, and have positive effects on even nearby regions. (Hafner and Kampe, 2018).

Sovereignty against stronger currencies would also be another benefit (Berg, Borensztein, and Mauro, 2002). A strong currency would create an economic boundary against being forced to deal with dominant currencies like the Euro and the Dollar (Hafner and Kampe, 2018). Countries in the limited currency union would be able to rely less on foreign countries and international lenders for their own financial stability (Hafner and Kampe, 2018). There would no longer be a need for economic assistance packages to be able to operate as countries, and not need frequent loans as-well with economic independence. The union would not be dependent on foreign countries and be subject to their, at times, harsh policies (Hafner and Kampe, 2018). As an independent region, the countries would have better bargaining and negotiation powers with these dominant currencies as-well (Hafner and Kampe, 2018). When the countries would have great performance and enough to create a strong currency, they would be able to become lenders as a dominant currency in the region, and world. The governments and banks would have greater freedom in making their own policy decisions, instead of being at the mercy of international lenders or nations with less-favorable terms.

There are many strong and well reasoned advantages to a limited currency union. However, the same can be said for their disadvantages. One reason would be that in the past there have been many agreements between countries for similar systems (Hafner and Kampe, 2018). However, one way or another, these agreements all ended creating no effect (Hafner and Kampe, 2018). The main reasons for these failures have been that the countries involved were not able to be committed and coordinated enough to form a currency union (Paiva and Gazel, 2004). A limited currency union faces the same risk and problems by many of these countries. These countries may also have different political viewing governments that can end up affecting their economic partnerships. What could be worse is if these countries can not work together, and create conflict over trade and resources. This troubled past creates an uncertain future for such a plan.

Border barriers are one effect of the idea of a limited currency union that is seen as a great advantage. However, it can also be a great disadvantage. Free–trade between these countries can be seen as beneficial in the movement of goods and services (Hafner and Kampe, 2018). Although this could also possibly lead to an economic imbalance between states (Rose and Engel, 2002). Countries would no longer be able to tax trade, and lose another source of revenue (Jameson, 2001). In a limited currency union, there is the possibility of creating an economic divide between the nations (Berg et al, 2002). For example, if one country is facing a natural disaster and much of its economic activity leaves to another country, then it could lose local businesses. As well as another source of revenue in times of need for such a country facing a natural disaster, due to free–trade. The transportation and smuggling of illicit goods may also have the opportunity to increase and abuse this benefit (Melvin and Ladman, 1991). What would follow is an increase in illegal funds and crime in countries that already face an existing issue with security (Melvin and Ladman, 1991).

This concept would also have the capability of creating an economic divide in much of the region. This could have an adverse effect of creating a greater inequality in a region that is already facing troubles. Countries in the currency union would also have the possibility of seeing a greater increase in security issues with each other and organized crime.

Towards a Latin American Currency Union

Partnerships between countries, especially economic ones, create a stronger sense of community in the region (Hafner and Kampe, 2018). Currency Unions create benefits for the countries in which they are in, not only economically, but also socially. Countries in a currency union have common interest with each other, leading to increased political unity (Miles, 2006). This is especially beneficial in regions that are politically volatile (Miles, 2006). Having common cause with other countries creates a new era of communication, and partnership. This would not only create peace between countries that could have had past grievances, but also mend relationships with rifts that go back centuries. Countries that have had differences in the past could now move forward working with each other in the interest of doing better economically. Political differences could have less consequences than they would without a currency union (Rose and Engel, 2000). Political disagreements would have less power in decisions such as boycotts and even war (Schmidt, 2019). When the citizens of the country start to earn more from a stable and reputable currency, politicians would have less power to initiate or continue dangerous situations such as a conflict for resources, when all the citizens would want is peace for economical gain (Feng et al, 2023). Cooperation among countries in the currency union leads to greater communication and coordination with all of the financial implementation of strategies (Feng et al, 2023).

In a currency union, stability is in the numbers. If there are enough countries with similar status and operating economies, it would be more difficult for there to be a massive economical shock that leads to a recession (Hafner and Kampe, 2018). The philosophy "stronger together" takes economic form in a currency union. When countries partaking in the currency union create a strong enough partnership, government economies would agree to share fiscal policy (Hafner and Kampe, 2018). This would not only be to trade from a beneficial standpoint, but also be able to react with a proper and unified response to any economic shocks from within, and externally (Hafner and Kampe, 2018). A response would most importantly come from a unified and unanimously elected central bank. The central bank would have the responsibility of enforcing unified responses using the inputs from all of the different union countries (Hafner and Kampe, 2018). This would be especially effective in combating economic shocks, creating a uniform response that can help deal with such shocks with beneficial responses. Countries can leave behind the worry of having central bank strategies that are not only poorly efficient, but also can make a region suffer more economic consequences (Berg et al, 2002).

Currency Unions are proven to be effective for all of the countries involved, no matter the size of population, or GDP for starters (Wei and Choi, 2004). While there is a narrative that currency unions are only suitable by the contributions of larger countries, most currency unions have countries of all economic positions (Rupnik, 2011). A currency union helps already larger economies increase in size, and also smaller economies (Rose and Engel, 2002). Free trade between countries, especially larger to smaller countries, are very beneficial for the smaller economies (Cheong and Cho, 2009). Countries attempting to create a larger economy have to no longer face high or even transaction costs in general anymore between countries in the currency union (Lacina et al, 2011). Business transactions would be more affordable in the smaller countries, leading to a prospering business sector, and economy in general (Miles, 2006). Inflation would have less of a toll on society leading to more calm and trust in the government response by the business and civilian community (Braž and Kočenda, 2018). There would also be a more manageable by a unified response by the governments to fight inflation, and stamp out any issues also in the foreseeable future (Hafner and Kampe, 2018). Another sector that would flourish with a low inflation rate is tourism, that is a source of revenue upon which many world economies rely on, and inflation may hinder in many cases (Pektas and Unluonen, 2020).

However well a currency union can work tougher for their policy, there can always be disadvantages with such a large union. Underdeveloped economies could create problems for the currency union in general, and in the case of a recession, require a bailout (Ozturk and Sozdemir, 2015). One example of this was in the European Union, when Greece had serious economic problems. This required a bailout by the EU to implement a recovery strategy. The Greek economy had fought to recover its economy for years, and finally as of 2024, is showing signs of a recovery (Ozturk and Sozdemir, 2015).

Currency Unions are built on the strength of the shared policy of its members. All member countries agree to tackle economic, and sometimes even political, challenges on a united front. While this seems beneficial for all the countries involved, there is a detail that would create a potential problem in the relationship between countries. In a currency union, ideally there is cooperation that benefits everyone in a harmonious relationship. However, this creates a dependency on the promise of cooperation between each other (Kenen, 2002). Disagreements happen, and assuming countries in a currency union will have harmonious relationships can be wrong. This could also then lead to favoritism between countries, for example, higher performing economic countries favoring other higher performing economic countries in strategic partnerships. This would also create a strong dependency on a foreign country for a balanced fiscal policy, possibly leading to lower regulatory standards (Kenen, 2002). Countries with lower regulation can be affected by corruption, inflation, and poorly performing commerce sectors (Hafner and Kampe, 2018). This also leads to a difficult problem with a currency union, a uniform and united response.

United responses to face fiscal policy is what makes currency unions so attractive. The fact that countries could agree on a collaborative response for many economical issues together. However, that is a big assumption that countries would agree to a united response in the first palace. While cooperation between the member countries is a highlight for currency unions, countries may have trouble working together due to many reasons. Some reasons may range from historical conflicts, differing politics, and how to respond to fiscal policy (Schmidt, 2019) The extreme of this may be that some member states leave the currency union, or cause hard to the union due to its disagreeing viewpoint. Member states could cause issues in the united responses for the union, and cause problems such as delay in economic policy. Member states will not always agree with each other on certain technicalities in their responses, but not accepting other member state responses is a big issue in the unity brought by a currency union.

One large question currency unions have to answer is can there be countries that use their system without being directly in it? Take for example the country of Montenegro in Europe. Montenegro is not a member of the European Union, however, they use the Euro currency (Nones, 2024). This can be possible due to Montenegro not agreeing formally with the EU for its use, however, they have simply just adopted it (Nones, 2024). Countries can benefit from using a currency union's currency without directly joining, due to its strength and protection by several of the world's largest economies (Hall, 2019). However, Montenegro does not have the option of voicing its opinion on economic and also political matters in the EU parliament (Nones, 2024). This is important because since it is not a member state, there can be many actions, for example the use of tariffs, done to non-member state countries in the region that may also affect it.

Sweden has famously joined the EU, but not adopted the currency (Hall, 2019). Sweden is a member of the EU, however it does not use the Euro, using instead its local currency, the Krona (Hall, 2019). The Swedish people rejected adopting the Euro nationally in favor of its own currency. This is because countries may want the economic benefits that a currency union in their region may offer, without having to compromise its own sovereignty. Sweden has done this trying to protect its economic independence, since sometimes policy can benefit but also disadvantage different countries (Hall, 2019).

One potential issue that faces countries joining the EU is whether their country meets the standards for entry. Sweden meets these requirements, and so does Denmark (Hall, 2019). Denmark is also a member of the EU but does not use the Euro, largely for the same reasons as Sweden. However, Denmark has a more unique status in the EU. While Denmark does not use the Euro, and is in the EU, it does have an Opt-out status (Hall, 2019). This essentially means that Denmark has the benefits of being in the EU, but can choose which policies to adopt or which ones to avoid (Hall, 2019). Denmark states it follows these policies to protect its sovereignty, and values its independent decisions highly, contrasting the unilateral decisions by the European Union (Hall, 2019).

We have covered every benefit and types of currency unions. We now have shown what happens when there are some countries that do not want to participate in every economic policy of the currency union, but only want to partake in some policy, or even just use the currency. This information is helpful to the Latin American idea of a currency union. There will be some problems that countries face when joining. This is because there are many countries in the area, and not all of them are at the capability level of contributing enough economically. Sweden and Denmark represent a perfect example of what might happen in a currency union in Latin America.

While currency unions might not particularly like the fact that some countries do not follow all of their policy, but adopt some or the currency alone, it is useful. The countries contribute to the power of the currency, and increase the strength of the currency union. One great solution to all of the countries involved, is if a smaller country adopts this policy at first. Adopting only certain policies could help protect the countries themselves, and create a perfect situation for those countries to begin changing their economies for the better.

Latin America would be a great candidate for a currency union between the countries.This is because of how there is a different currency for every country in Latin America, and many of them are destabilized by politics. This could change however, when there is a feasible Latin American currency union model that can help every country. The main reasons this would help would be to create a competitive advantage for the Latin American countries over other trading partners, negotiating as a whole and receiving fairer terms. For a currency union to successfully start in a region as volatile as Latin America, many countries are needed to join. Countries willing to join this union might be Argentina, Brazil, Chile, Colombia, Costa Rica, Ecuador, Uruguay, Peru, Paraguay, Venezuela, Guyana, Panama, Honduras, and Mexico. Some countries that might not want to join are Belize, Nicaragua, Guatemala, and El Salvador. It may take some time for smaller economies to be able to join the currency union, which leads to them not being able to join the union. Another reason could be the politics within the country.

Conclusion

To conclude, there are four possible models which we have explored for a currency union. These are dollarization, pegging to the dollar bloc, a currency union consisting of only the economically well-off states, and a full currency union. Which makes one stand out the most. Not all of them are feasible in today's economy and political atmosphere. That is why I believe that a full-fledged currency union is the best option for Latin America to become a stronger economy that is not overlooked in the world. The benefits are much more than any alternative, and has more reasons to make the countries want to make a union.

Finally, to end the paper, we need to recognize a few limitations. These limitations do not make this paper not work, but this paper covers what it might work without certain limitations in the future, and what that might look like. We recognize the political difficulty this project faces were it to be implemented today, including how difficult it would be to get governments to join. This is a problem that changes often with the political situation in countries, however the economic needs of countries in Latin America currently demonstrate how a currency union might be useful. Using other currency unions and past examples as a comparative for our model are risky but these currency unions we used are strong performers of what a Latin American model may look like with similar economic indicators and regional performance. One limitation may be that some countries are performing better than others, and this could be an issue if all the currency union countries were trying to form a currency union. However, our model is based on a Latin America that will continue performing the way it is right now. If there are any massive changes in the economic state of these countries, our model might not work. This seems unlikely since there has not been a recession in this region in quite some time, with no current worry of one forming. Another limitation a Latin American currency union may face is opposition from Latin American countries opposed to a currency union. These countries may wish to go against currency union to keep their own political narrative in their country, but there can be an opposition formed that can harm its creation. Organizations trying this could easily be countered simply by the fact their economy might not be performing as strong as other countries in Latin America, and these countries can use that to their advantage by not being affected by measures of any kind, such as a tariff. These potential limitations, though in no way disabling factors for my research, perhaps signal that the issues of monetary policy and currency cooperation spanning across the entire Latin American region are not settled matters. This paper merely attempts to adumbrate what a possible union could look like and what the benefits, which far outweigh the dangers, of such a cooperative monetary model might be. Accordingly, the future may necessitate deeper research on a range of related questions. For instance, currency unions should consider which countries in Latin America might pose a risk to the other member states if they were to join with an unstable economy. Another question Currency Unions should ask is how can a currency union effectively support citizens in dictatorial governments unofficially.

Acknowledgments

I would like to thank my advisor for the valuable insight provided to me on this topic.

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