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The monetary system of Uruguay at the crossroad. Which is the best route forward? - Lars Jonung (1)

Isidoro Hodara

Lars Jonung is an emeritus professor of the University of Lund. He is an economist who has centered most of his work on monetary and fiscal policies. In particular, he has experience in monetary unions and has accumulated experience on the matters of doing away with the national currency, or joining a monetary union, or keeping your currency in several countries in Europe. This sounds very important, very relevant, in particular to Argentina. But since Argentina is a case in itself, he has simply, at my suggestion, maybe decided to look at the monetary system of Uruguay. He has already been in Uruguay twice, and once he delivered a lecture at ORT University in which he precisely expressed each of the robust reasons Sweden had at that time not to join the Euro. Lars, I think this is as much of an introduction as you will get. We are very happy to have you here, and from now on, it's your turn to make it.

Lars Jonung

Thank you very much. I hope you can hear me and see me, and I wish I was in Uruguay now. I wish I could speak Spanish, but unfortunately, I cannot. My background is the following one: I have worked on the monetary systems of Estonia in 1992 when Estonia became a new country, and the choice was what kind of monetary system should Estonia adopt. I also took part in a study commissioned by the government of Iceland concerning the Icelandic currency system, and in both cases, we recommended currency boards.
I've also worked as research advisor at the European Commission in Brussels for 10 years, and my focus was on the Euro. So, my specialty is the Euro and currency boards, but I also took part in the debate in Sweden about inflation targeting and how to develop a system based on inflation targeting. And my background is also that I have been interested in the history of monetary unions, and history, I would claim, is an excellent guide for the choice of the proper monetary system for any country.

Basically, you have a smorgasbord, a menu of three monetary options for Uruguay. First of all, a truly fixed exchange rate arrangement. Under this heading, you could have a monetary union with a common currency like the US dollar and the Euro. You can have dollarization or euroization, and you have the case of Ecuador, Panama, Montenegro, Monaco, and Andorra, and perhaps your neighbour Argentina will have the dollar as well.

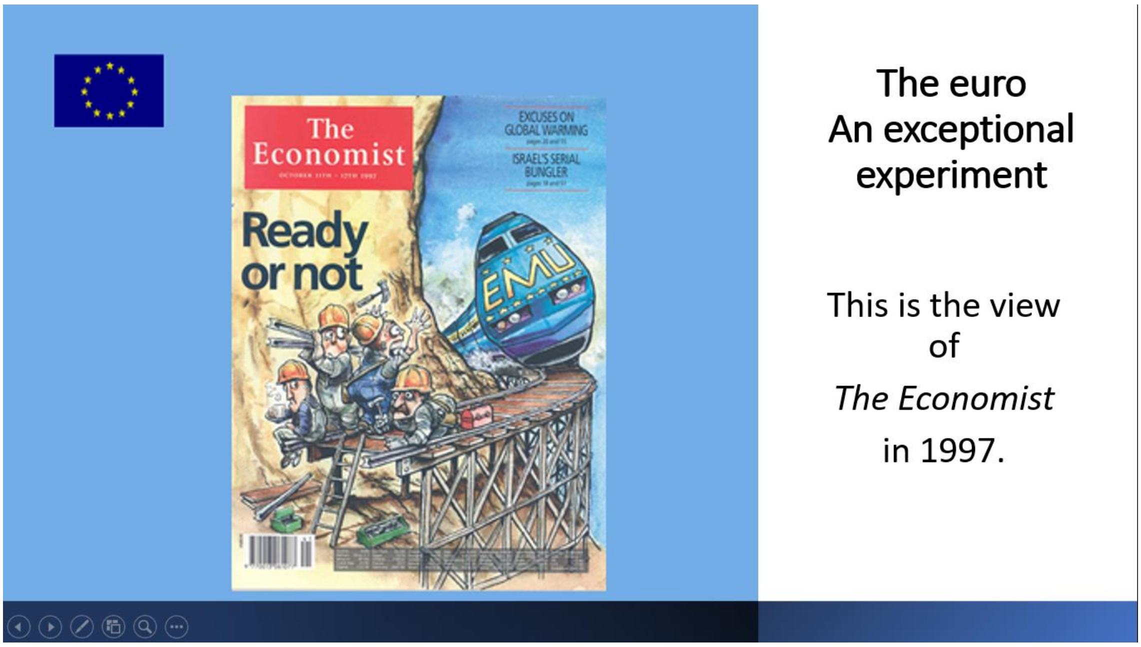
Then you have the case of species standards, the gold standards, the silver standard, and you have currency boards like Hong Kong, Estonia, and Bulgaria. The second option is a fixed but adjustable exchange rate, a pegged rate. We know this from the Bretton Woods system, various currency baskets, the ERM system. And the third choice is a free national currency, the floating exchange rate. And here you have two cases: the rules-based systems, and there are two rules-based systems that have been very much in fashion. First of all, Knut Wicksell's rule of price stability, that is, inflation is zero, or inflation targeting where inflation generally is set at 2% a year. And then we have also the case of discretion-based monetary systems, that is, systems have no rules at all. That's like Zimbabwe or Venezuela, hyperinflation, that we don't have any anchor for the monetary system.
So, the monetary options for Uruguay basically boil down to two: a truly fixed exchange rate arrangement, including no national currency or a currency board, or a floating exchange rate with rule-based frameworks because the political system has developed so we will not accept the gold standard, and financial integration has made it very difficult to have pegged exchange rates.
So, when you now move to Uruguay, let me start by asking the question: Does the size of the economy matter? And it's actually very important for the choice of monetary standards. Small countries, particularly micro-states like Andorra and Monaco, they tend to adopt the currency of another country. They basically import the credibility of another currency, reducing transaction costs in this way. And big countries, they are so big, so they are monetarily independent. They want to have their currency of their own, like the United States, China, India, and, I would say, Europe now.
How big is Uruguay? Well, Uruguay is in between, in the middle, like Sweden. You have a small open economy with an export-to-GDP ratio around 30%, a population a bit more than 3 million. You have a strong democratic tradition compared to the rest of Latin America. You're financially very open. Sweden is like Uruguay of Europe. We have a high export ratio, we have a population around 10 million, high GDP per capita, and a strong democratic tradition. And we are, since the early 1990s, financially very open. So, this suggests that a national currency is a viable option for Uruguay.
Now, which are the lessons from Europe?

I would like to discuss Uruguay from the Swedish European perspective because I'm not an expert on Uruguay. Well, basically, you can have a monetary union like the Euro area, you can have a currency board solution, or you can dollarize. Or if you do not accept a fixed exchange rate arrangement, you could have a floating exchange rate. And then under a floating exchange rate, inflation targeting is the main alternative today.

So, I'm going to talk about the advantages and the disadvantages of these monetary systems. And let me start with the Euro. The Euro is unique; it's a gigantic experiment with no precedence in monetary history. We have had monetary unions in the past, but nothing like the Euro in the sense that a group of wealthy independent nation-states have handed over their monetary sovereignty, their monetary policy to an independent Central Monetary Authority. In this case, the ECB, the European Central Bank. Still, they maintain control on a national basis of fiscal policy, and this is a very interesting case.

The Euro is an experiment.

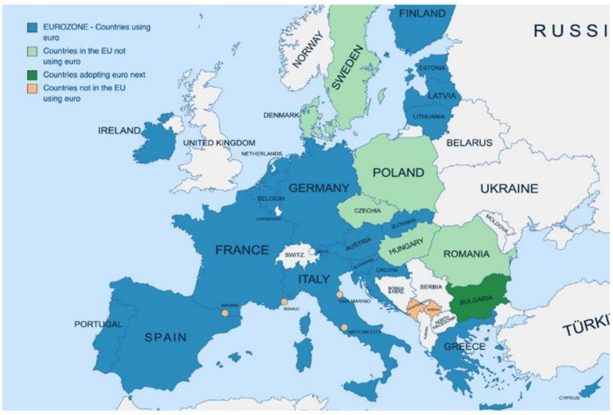
Let me show you the front cover of The Economist from 1997 here.



The architects of the Euro area are working while EMU, the “train grande Vitesse” (it stands for European Monetary Union), is approaching. So, this front cover shows the difference, or the tension between those who are designing the system and the political pressure to bring about a common currency. And among the architects, among the people standing out, we have R. Mundell. His theory about the Optimum Currency Area (OCA) theory has been very influential in the design of the Euro. Basically, he says an optimal currency area is an area where the benefits of monetary integration, monetary unification, are higher than the costs. And the benefits, we all know: lower transaction costs, more trade, more efficiency, dynamic effects. The costs are a loss of monetary independence, the loss of the ability to counter asymmetric shocks by a country of a currency of your own.

And I had the pleasure to invite Robert Mundell for an interview I made in 2009. And he was at that time called Mr. Europe because of his intellectual influence on the Europeans. And he said the Euro has been an unqualified success. Well, if you are the architect, you must be proud of your building, but he was too optimistic, I would say. Well, it's right that the Euro has been successful. There are now 20 members of the Euro area; you have them here on this map. And there are a few countries still standing, queuing to enter, and there are some countries that are not that interested in joining, like my own country, Sweden.

Today 20 of the 27 EU member countries are part of the Eurosystem



So, how has the Euro evolved?

For the first 20 years, it has a positive result. It managed to achieve price stability in countries like Greece, Italy, or Spain, which have had very high and volatile inflation.

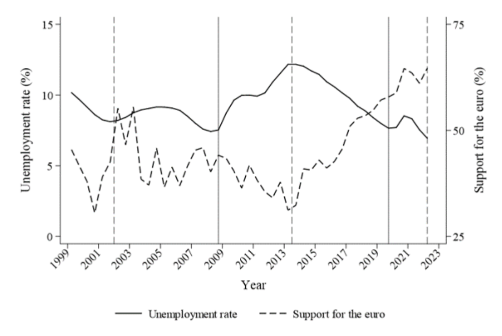
But there are also problems facing the Euro. I would like to point out, in particular, two problems: lack of fiscal discipline. We have a pact called the Stability and Growth Pact that was designed by the Germans, in particular, to keep government debt at a level below 60% of GDP and the budget deficit around less than 3% a year. That system has failed; the Europeans are now struggling how to cope with high volumes of government debt.

And the other problem is a lack of supply-side reforms. Many countries carry out a number of reforms to improve economic growth, but once into the Euro, the interest of making reforms disappeared; they were hit by Maastricht fatigue, tired of making reforms.

So, that's the scorecard.

The euro – a unique currency

- We have biannual data on the popular support behind the euro.
- The data show that inflation and unemployment drive the popularity of the euro.
- The importance of successful economic policies.



I also like to stress another aspect that's unique with the Euro: we have data on the popular support for the currency. I know of no other country in the world where you ask the public, 'What do you think about your currency?' And the data shows -it's fascinating- that unemployment and inflation are driving the popularity of the Euro. And this just shows the importance of carrying out successful economic policy in order to make a currency viable and sustainable.

And here is a picture of Mario Draghi, as the head of the ECB during the Euro crisis in the early 2010s. He showed the political will to hold together the monetary union. And I would like to stress this as an important aspect; you have to have political will in the public to make a monetary union stable.

So now, this is the European background. If we move to Uruguay, is a monetary union an option for Uruguay? Well, first of all, is there political will in Uruguay and its neighbours, Argentina, Paraguay, Brazil, Chile, to have a common currency? I doubt it; I would say no.

The second question I ask is, Is there an Optimal Currency Area around Uruguay? Does Brazil, Paraguay, and Brazil form an Optimal Currency Area? My guess is no.
I think the economic systems, the industries, the economies are not that equal to make an OCA.

And then my final question is, can fiscal policy among the members of a monetary union in South America be disciplined by any pact or agreement? Can you make it credible that if you join a monetary union with a common currency, that fiscal policy in Argentina will be the same as in Uruguay and Brazil? I said no; I doubt that, given your history. So, history is a guide.

So, then let's move to the option of dollarization. Is this an option for Uruguay? Well, I would say that dollarization is an attractive option when the public has lost complete confidence in the National currency. If Uruguay is a case of severe monetary mismanagement, then credibility for your currency can only be accomplished by, say, introducing the Euro. The question is Has Uruguay reached this point?

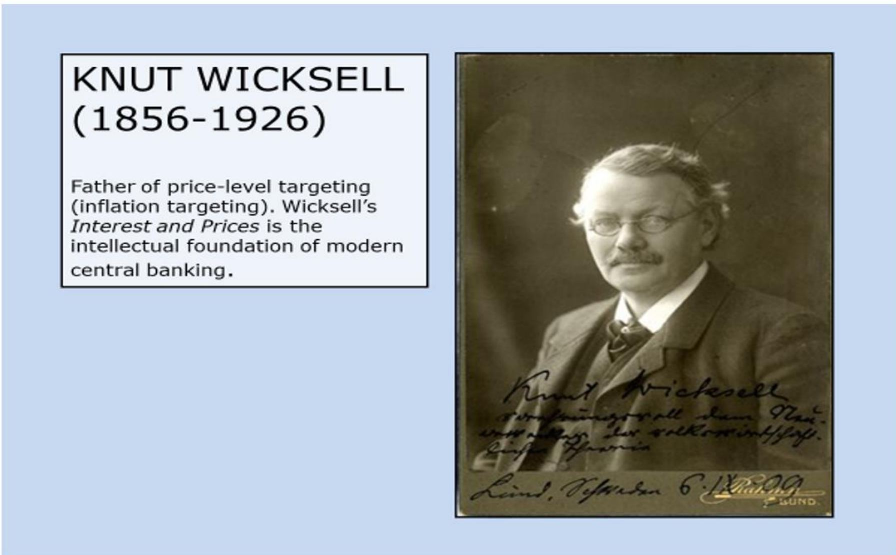
Well, I doubt that you have not had hyperinflation; you have a fairly stable rate of inflation, I would say. And dollarization is not an attractive option in my view. Viewing Uruguay from Sweden, and besides looking upon the fiscal policy of the United States, I'm afraid that the United States and the dollar, are up for some problems in the near future.

Still, the US dollar is used as a unit account and as a store of value in Uruguay. So, you have already, to some extent, dollarized but you have done it from a market view.

So, is a currency board an option? Well, a currency board is a form of monitor; it's an institution that issues notes and coins convertible into a foreign Reserve currency at a fixed exchange rate, and as reserves, a currency board holds high-quality interest-bearing assets in the reserve currency, and it has to have 100% reserve backing. The currency board has no discretion in monetary policy; market forces to determine the money supply. Currency boards have been tried many times in economic history. As a rule, small countries have adopted currency boards; in Europe, Estonia and Lithuania had currency boards before they moved into the Euro area, and Denmark has a very rigid exchange rate; they are like 50%, like a currency board.

A currency board for Uruguay would give some advantages; you would immediately have the rate of inflation in the United States, and you would have the interest rates of the United States. There's one major drawback of a currency board; you give up all monetary independence. You cannot meet a sudden shock, domestic or foreign, by having a moving or floating exchange rate as an absorber. Still, you can absorb by using fiscal measures.

So, the currency board is an interesting option, but perhaps the most interesting one is inflation targeting. Inflation targeting is now the dominant monetary system across the world. The big central banks - ECB, the Fed, Bank of England - they target their inflation rates. And central banks in small open economies like Sweden, Norway, Canada, New Zealand, are inflation targeters, and I would also like to include Uruguay there.



Now, I'm talking to you from Lund, a small University town in Sweden, and Knut Wicksell is the father of inflation target. He wrote and published a book called 'Interest and Prices' in 1898 in German, and he presented the idea underlying inflation targeting - that is, the central bank should have a target in terms of the development of prices, and the discount rate or the short-term policy rate should be the main instrument.

And this is exactly what's going on today. The goal of inflation targeting is price stability, commonly defined as a 2% rate of inflation, and the instrument is central bank policy. And the monetary framework or the monetary order is based on paper, an independent central bank, and free exchange rates and unfettered free financial markets.

So, this is Wicksell's world, 100 years after his book; he has actually a bigger influence on the design of monetary policy than John Maynard Keynes or Milton Friedman or Woodford or anyone else. So, this gives hope to professors working at small universities across the world - perhaps they would manage to make an impact.

So, if you move to the next question: How is a scorecard of inflation targeting? Well, first of all, it has been successful; it has reduced consumer price inflation across the world. However, asset price inflation has been a problem ignored by many central banks. In particular, in Sweden, we have 2% of inflation measured by consumer prices but 6-8% yearly asset price inflation. And this builds up financial imbalances that threaten financial stability. And the pandemic contributed to high inflation and probably an overreaction by central banks across the world, by huge increases in the money supply. But still, inflation targeting is an interesting option for Uruguay. You should back it up with a strong institutional framework, an independent central bank, a proper fiscal framework.

Sweden has a framework aiming government debt to GDP ratio around 35%; we are there. And we have a proper financial stability framework.

Then, Does Uruguay have the necessary institutional framework for a successful monetary policy based on inflation targeting (IT)? My guess is yes; you have the size, you have the institutions, you have the tradition, you have your history.

So, I think the IT regime should be fostered or strengthened in Uruguay. You should have a constant debate in order to improve its working, and you should have currency competition. And currency competition, I'll come back to that on the next slide. It's very important.

I’ve got this information from Isidoro recently: you have basically two currencies, two government-issued monies - the domestic Uruguayan peso and the foreign currency, that is the US dollar. And there's a market for both of these monies; they compete, and the public decides the optimal, or the efficient, or the proper mix of the domestic and the foreign money. And more than 70% of Bank deposits in Uruguay are dollar-denominated. When I saw that number, I said, 'Well, Uruguay is already dollarized,' but you still have your own currency. I think this puts pressure on the Central Bank of Uruguay to improve its performance and it makes a conversion to a currency board more attractive in case the Uruguayan peso underperforms.

So, I would like to end by saying, let the best money win. I think this is a perfect situation. Usually, if you look upon currency competition, you get into the huge literature of free banking and so on. Forget about that. Instead, this is not the question of competition between private monies; it's a competition between government monies, and that's an important point.

So, my conclusion is an independent central bank based on inflation targeting or a currency board are the best options, and as long as the present inflation targeting remains successful, it should be maintained. The floating exchange rate of the peso can still isolate Uruguay from shocks while the US dollar serves as the store of value. So let currency competition prevail; it allows the public in Uruguay to choose the money they prefer, and they don't need to listen to the advice of professors in economics in Uruguay or outside Uruguay; they make the choice. And my final conclusion is: What does Uruguay need?

Well, it needs growth. Every country in Latin America as well as in Europe, needs growth. The standard of living in Uruguay depends on high and sustainable economic growth. The choice of monetary system is important in the growth process by serving as a stable framework for the actions of the private sector. However, growth is ultimately based on efficient use of resources, that is, on supply-side reforms. And to carry out successful supply-side reforms, bringing out more competition, more openness, more trade, more of new firms, that is the key for the future. And such reforms should be given the highest priority to ensure a successful future for Uruguay, regardless of the choice of the monetary system.

So that's my presentation. I hope you have been able to follow it. And in case you're more interested, has my resource portal at Lund University with all my work on monetary systems and monetary reform.

I'm ready for any questions.

Isidoro Hodara

Thank you very much. Lars, you have been very clear and very coherent in your presentation. Just let me underline that there was a link between Robert Mundell and Uruguay. In the 80s, he directed a program in the Central Bank, trying to form economists at a high degree. And in the 2000s, he was received by the President of Uruguay at that time. So, it's like you; he has at least twice visited Uruguay.

I think we could ask all the audience to express their questions. But can I, as long as I have the floor, ask for one? Would the advice you gave at the beginning of the process of becoming a euro country or not for Sweden, would those reasons be valid today?

Lars Jonung

Yes and no. When I discussed these issues in 1998, we didn't know how the Euro was going to perform, and the first 10 years of the Euro, they were very successful. After the crisis, the great financial crisis in 2008, 2009, suddenly the Euro is running into problems, and in particular with Greece. The government of Greece had covered up the financial situation of Greece, and then we had an enormous problem of keeping the growth of government debt at bay. And ECB ended up buying a large amount of fiscal debt, which also goes against the idea of an independent Central Bank. So today, it's a mixed picture. The Euro area has developed in some bad ways and some good ways. Sweden has also developed in some bad ways, because we have actually followed ECB's interest rate policy. So, ECB and the Euro are the elephant in the room in Sweden. So, it doesn't matter very much if you live very close to the giant, you have to follow the giant. So, in a way, it doesn't matter very much if we are a member or not of the Euro area; we follow the Euro area. So, we are in a way not dollarized but euroized. So, there is a debate in Sweden - should we join or not? And I think we will have a number of government committees looking into it. We may join in the future, but it depends on the performance of the Euro. And just now, the Euro is not performing very convincingly.

Isidoro Hodara
Thank you.

Ignacio de Posadas

Thank you very much, Professor, for the conference.
More than a question, it's kind of a quandary because this country, which has had a dual currency or freedom of currencies, whatever you want to call it, has had a problem with that. It's the overpricing of the peso, which is something very constant; the central bank has been unable to influence it, at least decisively. And there are a number of explanations for it, none of which, at least to me, and I'm a bit of a layman in these matters, is convincing. Why, if there's a free supply and demand, is the stronger of the two currencies cheaper than the weaker, with all the impact that has on our economy? That's a bit the question or the quandary that we're in.

Isidoro Hodara

Before you answer, Ignacio was the Minister of Economics and Finance of Uruguay in the first half of the '90s.

Ignacio de Posadas

Nobody's perfect.

Lars Jonung

Well, that's a standard answer to this question, which I'm just debating in Sweden: why is the Swedish currency so weak to the Euro? How do you explain it? And the only explanation you can say is that expectations matter, the expectations of the market participants. And the expectations are based on history. I do not know exactly the history that behind these developments, but that's my standard answer, that you have to go into the history. And in case the history of the Uruguayan peso is a history of very large fluctuations, then, of course, you try to stay away from it. It's the price you pay for the sins of the past, and you do that for a very, very long time. So, I would say it's probably the case of original sin, but I must confess this is not a satisfactory answer. I'm not happy with it.

Ignacio de Posadas

Thank you.

Isidoro Hodara

We have a question from the audience. Let me fetch it here. The question is as follows: 'We do not have a fully independent Central Bank. In this case, can an inflation targeting regime have success?

Lars Jonung

It can make sense even if you don't have a fully independent Central Bank, and it's very difficult to create a fully independent Central Bank. It takes time. You have to have a history like Switzerland or Sweden where you make the selection of the members of the Central Bank such that it is accepted by all the political parties and that you get the right people there.
Still, you can have problems. We have had problems in Sweden. We had a central bank head for 17 years, and that was bad. You should have much shorter periods, and you should have also a set of qualifications, merits, for those who are on the Central Bank.
In the case, for example, of Iceland, when we discussed setting up a currency board independent of the Icelandic political community, we suggested putting foreign economists, people outside Iceland, on the board of the council.
You can do the same and put someone from, say, England or Germany or Switzerland on the board of the Central Bank of Uruguay, in order to create independence and credibility. You import it that way; that could be one solution. Ireland has done that; they put a Swede on the Central Bank Board of Ireland.

Isidoro Hodara

Thank you. The audience keeps asking for more questions. One reads like this: 'How does a country like Uruguay deal with large fluctuations in real exchange rates?

Lars Jonung

You cannot deal. The central bank can only control nominal variables. It cannot control real variables, and these shocks are something you should allow the markets to handle. The best way for a central bank to deal with them is to create a stable and low rate of growth in the money supply, in the volume of credit, so monetary policy is not a source of disturbances. But the real, you have to face it. You are a small open economy, like Sweden. Suddenly, the oil price changes, or the meat price changes, or the price of soybeans changes. You cannot avoid that kind of disturbances; you basically have to have an economic system as flexible as possible, to handle the shocks you're subject to all the time. We have huge shocks in Sweden or in Europe with the war in Ukraine, with the energy prices doubling four or five times, four or five times higher in a very short period. How do you deal with them? You cannot deal with them, but just adjust to them in the short run.

Isidoro Hodara

Thank you.

There's another question from the audience; let's see. It's a little longer. In fact, it's two questions by the same participant. The first is: given the irresponsible fiscal and monetary policies in the US, what about cryptocurrencies? like Bitcoin. I will read the second question afterwards; please address this one first.

Lars Jonung

First of all, I'm extremely critical of Bitcoins. It's just like a pyramid scheme. It's very dangerous. It is backed by nothing, and I wish that Sweden could be the first country simply prohibiting it. You can't prohibit it, but you have to inform the public about the dangers of Bitcoin. It's an enormous fraud. First, we had gold. To dig up gold, it takes a lot of resources. To create Bitcoins takes a lot of resources. It's so much better that the national governments are the producers of legal tender. Bitcoin will never be legal tender, and it's a money supplied by the grey or the black sector. Those who are acting there are not the kind of people you should try to interact with. So, I'm extremely critical of Bitcoin. I think it's something that is a dead end, even worse than that; it's destructive. So, I wish Uruguay could be the first country to prohibit it.

Isidoro Hodara

Thank you.
Personally, I prefer information to prohibition, but that's for whatever it's worth; it's my own opinion.
I have to read the second question from the same participant, and he says: about bank reserve rates, Uruguay has a similar reserve rate for the dollar and the peso. Should it be biased in favour of pesos, given high-dollar savings denomination

Lars Jonung

That was an interesting question. I don't have the answer. I would leave that to the market. It's a choice that the commercial Bank should make. However, from a financial stability perspective, much suggests that commercial banks are undercapitalized across the whole Western World. There are studies from the United States suggesting that you should have at least 20 to 25% reserve ratios. That's a high ratio compared to what you probably have today in Uruguay, and I'm inclined to have high ratios in order to maintain a financially stable banking system. That's my answer, but it's not very instructive, I'm afraid.

Isidoro Hodara

Coming from you, it is instructive. We still have another question from the audience, and then, of course, the floor is open for everybody who would like to have comments, questions, suggestions. Let me read this one.
There are two ways to carry out monetary policy: fix the instant interest rate or fix the amount of money. Uruguay does not have a capital market; the banking market is highly concentrated, and Uruguay is not characterized by having an accompanying fiscal policy.

For you, with a market of these characteristics, you said in some way that growth is the answer. With a fiscal policy like Uruguay has in such a relatively small country, what would its monetary recipe be?

Lars Jonung

Well, I'm very much in favour of a national debt-to-GDP ratio of around 30%. In Sweden, we have been suffering with the belief that fiscal policy could stabilize the economy, and we have learned through our history, that fiscal policy generally destabilizes the economy. We should be extremely careful about using fiscal policy to stabilize the business cycle. We have automatic stabilizers working, but discretionary fiscal policy is not something I would recommend. In case you have problems with maintaining stability in your country, a country like Uruguay, you should not give the policymakers or the politicians too much power in their hands. They would just hurt yourself, hurt themselves, and hurt your country.
So instead, if you want to copy a European country, copy Switzerland. The richest country in the world with a very strong currency. You could be the Switzerland of Latin America. It just depends on the institutions you establish and maintain. It's easy to say, but it takes generations.

Isidoro Hodara

Thank you. It would be going back to our past when, at sometimes, and not for these reasons necessarily, we were the Switzerland of Latin America. It was never true, but it was. May I inject a question of my own because I don't have any other questions from the audience so far.
The overvaluation of the Uruguayan currency, mentioned first by Minister Ignacio, is, in my view, also an issue of Uruguay exporting confidence, given, of course, the immediate neighbourhood. I'm not talking about exporting confidence to Sweden, but in the context of, say, Argentina, Brazil, Paraguay, Bolivia, Uruguay, sounds or is, more stable. Therefore, that moves a little bit of the portfolio of people from Argentina, Brazil to Uruguayan shores and, in some cases, to Uruguay and pesos. It's mostly when they come to Uruguay I would say, in real estate, in public debt. But it is also, in part, buying pesos and deposits. This is what, for lack of another way of describing it, I say Uruguay exports confidence and that over-values its currency. Does it make any sense?

Lars Jonung

Yes, I recognize the story. This is your comparative advantage: stability. It's just like Switzerland or Denmark. You have a pressure on your currency, because you're surrounded by neighbours who are more unstable than you. And you should accept this and profit from it. You should just sell yourself as the Switzerland of South America or the Florida of South America, without DeSantis. You should look upon this as an advantage that you could create. I would say a positive cumulative circuit process. Use it, and just don't try to stop it.
First of all, don't try to tell your central bank to control the exchange rate. Let the exchange rate be a free price, because that's a very important price signal, you need

that into your economy. So, I'm happy to have that your currency is overvalued. It promises a better future for Uruguay than for your neighbours. Then you can also discuss, like in Switzerland, who could buy property in Uruguay. My daughter bought an apartment in Switzerland, there are all kinds of rules that try to at least keep some parts of Switzerland for the Swiss. And you can adjust your overvalued exchange rate by that kind of measures, outside the standard measures of economic policy.

Isidoro Hodara

Okay, I am a bit sad that I had the insight in the right direction, and the problem is we have those who are producing exportable goods and those who are producing import-substituting goods. They are suffering because of the overvaluing of our currency. It is not all negative. Thanks to this export of confidence, when things got very bad in Argentina, we received an influx of capital, yes, but also of productive technology that transformed Uruguayan agriculture, let's say, around 2010. There was, if you want, part of this overvaluation was compensated by the fact that we, from then onwards, had a more productive agricultural system. They thought us those systems by voting with their feet. They were agriculture, the farmers, say in Argentina that moved to Uruguay, and brought a different way of production in agriculture. So, I'm sad, but I know it had advantages.

Lars Jonung

This is the same case as Switzerland because Switzerland, due to an appreciating currency, has all the time improved the productivity and the performance of its export industry. Watches, Airbnb, Nestle, and so on, they are getting better and better as a result of the exchange rate policy. And this is a problem for the Swedish industry because our currency has been undervalued, in the sense that we have had a rising euro, say, falling krona value. And this has implied that a number of ghost firms and companies have been able to survive in Sweden. We don't have the pressure through the exchange rate to improve our productivity. So, there's an interesting case here about how to adjust the domestic economy, so you can benefit from an overvaluation of your currency. And if you do that successfully, it will promise to give Uruguay a high GDP per capita, a high standard of living.

Isidoro Hodara

Well, has this exchange of views made you reflect on other new comments or suggestions or questions to Lars?

Juan Manuel Patiño

Yes, I have a question related to this. We have a difference with Switzerland in the sense that Switzerland is a highly industrialized economy, and we are a commodity country that produces commodities, which are so volatile and usually generate imbalances in our current account and the financial account. How does this affect the choices in terms of how monetary regime we can choose?

Lars Jonung

Well, your question reminds me of Iceland. Iceland was once the cod economy. That is, the volume of codfish harvested decided the exchange rate. And now, Iceland has moved more and more away from the cod period, having a more diversified system. In the short run, I see there are problems because some sectors will be hurt by a strong currency policy. I agree with you. But on the other hand, if you have a flexible economy, this should be a challenge that the economy can take care of, improving and diversifying in various ways. You may have to have some temporary support for farmers being hurt or hit by what's happening with the exchange rate. But still, you should keep on allowing for adjustment in the economy to the exchange rate. That is, in the long run, the most promising way. It's so easy to fall back to say more populist measures like tariffs, temporary restrictions on trade, and so on. But they are not, in the long run, worth the price.

Isidoro Hodara

Can I abuse my role and pose at least a comment to what Juan Manuel has just said? When we say we are commodity exporters, we are somehow limited in our appreciation, because a ton of Uruguayan meat today has exactly the same customs number than it had 20 years ago. But the production function of meat today is different from Uruguayan meat say 20 years ago. It embeds in beef Uruguayan exports sanitary, genetic, and even information technology services that are included in the package. You do not see them, but that makes it different from the composition of a ton of beef 20 or 40 or 60 years ago. So we are, in a way, while exporting commodities, exporting also part of Uruguayan talent. And second, there is another universe, smaller but not negligible, of exports that are services. Global services, all kinds of services, including logistical services, which are linked to the history and the geography of Uruguay. We were a country of transit trade for 500 years ago. So, we are a commodity-exporting country with commodities that are embedded with other elements, and we are also a services-exporting country. I think that the exports of services at this time are a little under half of the exports of goods. But somebody may have the right ratio. And these are two small qualifications to what Juan Manuel just said.

Lars Jonung

Concerning the export or import of services, why don't Uruguay open up for Europeans to move to Uruguay in the winter time and have connections with IT. Madeira and Bilbao in Spain, offer technology basis of platforms that make it easier for North Europeans to come and work with the new technology, hooked up to the rest of the world. You probably have a comparative advantage, a stable country, no fighting in the streets, and good food. I would expect that could be quite something for both Americans and Europeans to look into.

Isidoro Hodara

Uruguay has moved in that direction, but I have the impression, I have no statistical figures. I have the impression our Europeans are, in fact, Argentinians that have moved. I think the CEOs and personnel of two of the largest unicorns in Argentina are based in Uruguay. Somebody might correct this appreciation, but I think it's a case for at least two of the Argentinian unicorns setting up in Uruguay. So, we have moved in that direction. Perhaps we should do it more and diversify it more.

Lars Jonung

Just allow the markets to work. I mean, that's the most important thing. Then you get the adjustments. You cannot plan it. You cannot figure it out in the Ministry of Finance, what to do. You should allow the experimental approach. That is the most promising. Sweden is doing it now and we're very successful in it.

Isidoro Hodara

Any more questions, please? If it's not the case, then I believe we should give Lars a clap, and tell him you're welcome as a Corresponding Member of the Uruguayan Academy of Economics. We shall be sending you the document shortly. This presentation you made will be on the web of the Academy. Thanks.
Thank you for listening to me. I hope I said something that's new for you, and I hope someday to come to Uruguay again.

Isidoro Hodara
Very good. You will always be welcome. Thank you, Lars. We keep waiting for you.

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(1) 5 de diciembre de 2023