

## Questions and Answers

Following the discussion, the panel took questions from the audience.

*QUESTIONER: I have a question with regards to Mexico. My question is with regards to the attitude of the normal citizen with regards to the political parties. If we take the case of Mexico just several months ago, for the first time in the history of Mexico, an independent candidate won as governor. And in general, my question is, Are the Latin Americans now getting fed up with their parties, or is there going to be a move in this direction?*

GUILLERMO ORTIZ: Well, I'm not a participant. I'm the moderator, but I will answer your question. I think that the fact that an independent candidate won the election for governor of one of the largest states and the most industrial states in Mexico, in Nuevo León, is a sign of the dissatisfaction with political parties.

And not only did this happen in Nuevo León, but also the mayor of Guadalajara ran as an independent and won. And this has positive and not-so-positive aspects. It has positive aspects because it shows that you don't have to be an insider in the political system or belong to a party to be elected to office. That's good.

On the other hand, the bad part of it is fragmentation, and the political parties in Mexico are fragmenting. For example, the left, the Partido de la Revolución Democrática (PRD, Party of the Democratic Revolution), has been divided between [Andrés Manuel] López Obrador and MORENA [the Movimiento Regeneración Nacional, or National Regeneration Movement] and the rest of the PRD. So in the next presidential election it may very well happen that since we don't have a second round, and the second round has been taboo for the Partido Revolucionario Institucional (PRI, Institutional Revolutionary Party) because it's clearly not in the

interests of the PRI to have a second round. You have the case of a candidate being elected with 20 percent of the votes or 25 percent of the votes.

So that is the drawback on this issue of independent candidates, but it will be seen whether history validates that the positives outweigh the negatives.

*QUESTIONER: What is your opinion about the Peruvian economy? Is our economy solid, or are we still vulnerable? And what do we have to do?*

CARMEN REINHART: I think the vulnerability issues we've been discussing, the issue of commodity prices, the issue of uncertainty about global factors, very much affect Peru. So to your question of is Peru vulnerable? Yes it is. It is also, I think, vulnerable to other factors that occur in the region.

I had noted earlier the issue of contagion. I do think, however, that the management of the bonanza years in Peru has left it in very good standing in a very difficult environment. But the big open question, on which I very much agree with Mr. Valdés, is, How long will it last? How long will the downturn last? The longer it lasts, obviously, the more the resources are strained.

GUILLERMO ORTIZ: Rodrigo?

RODRIGO VALDÉS: Let me add one wrinkle to this: that I think all countries have some level of vulnerability in the sense that external shocks affect them. And we cannot do much from South America to avoid what happens in China and shocks.

The key is whether you compound those shocks or you contain them or what is the reaction. And like a person with high blood pressure, with high cholesterol, you are taking more risks. What many countries in Latin America have learned to do is that you have to control your blood pressure, your cholesterol. You have to be in shape.

And therefore, it's not that you are not vulnerable, but you are much less vulnerable than in the case in which you don't treat yourself correctly. And we have learned a lot from bad past experience, and many countries have improved a lot.

*QUESTIONER: Do you agree that—I think, except for the Bolivarian countries in the region—do you think that the institutional framework is there for the countries to survive the problems that they are facing? For instance, in the case in Brazil, do you see the institutions working or not?*

*And with that framework, the institutional framework, working, do you believe that some credit should be given to the country or to the other countries in the region that are facing similar problems?*

GUILLERMO ORTIZ: Carmen?

CARMEN REINHART: I think in terms of credit, on the whole if you look at the long history, meaning the last 200 years of Latin American history, commodity bonanzas and capital flow bonanzas have been an invitation for disaster, importantly because they've been mismanaged. And I think this time around, with all the problems notwithstanding, management of the boom has been much better, and that includes in Brazil when you compare it to previous experience.

Challenges for institutions—let me just address one. And I think one of the big success stories for Brazil has been in taming inflation, establishing credibility in the central bank in the framework of an inflation-targeting monetary framework. I think that is being strained now because we've seen a very large depreciation of the currency.

We don't know at this juncture whether the pass-through from exchange rates to inflation, whether that which has been subdued could resurface. So are there strains now on some of the institutional strengths that were built in the last couple of decades? I would say absolutely yes.

There are strains that were not there all that long ago. And I hope it works out for the best, but it is a challenging period.

GUILLERMO ORTIZ: Would you like to add anything?

JULIO VELARDE: I believe that there have been institutions in the recent past that you can see, even in democracy, even with the strain, that are supporting it. Before we had the case of maybe three or four elected governments and then a military

government. In almost no country do I see any possibility of a sort of coup d'état or military government now.

So it's slow, but institutions are getting built up and probably they are stronger.

*QUESTIONER: We were making a bit of a comparison with the Asian market and the Latin American market, and there is one thing on which I would like to have the view of the panel. The Asian markets are extremely well connected to the international financial marketplace. Certainly, you know, 10 of them have been there for quite some time, Hong Kong, Singapore, and all the other ones.*

*And they grow much faster. They want to try to connect to this international marketplace very quickly, and we see that in Latin America it's progressing, but it's progressing at a much slower pace. And of course, there was the commodity upside before, which was great, but now that there's a downturn, how do those Latin markets see the benefit or not of connecting with the international marketplace?*

GUILLERMO ORTIZ: Rodrigo, you want to answer?

RODRIGO VALDÉS: The evidence here is relatively clear that financial integration is good at the right time. You need some level of institutions to be in place for you to be able to manage the risks, the volatilities that come along with financial integration.

If you look at the growth literature, having good macro is clearly good for growth. Having open trade is very important for growth, not to mention human capital, which, by the way, I think is the true big, big challenge for the region for the next couple of decades. But financial integration is less obvious as a clear-cut case for growth for everybody.

Once you get to some level of development in terms of having proper regulations, proper infrastructure, you can integrate. And I think that many countries in the region are there and are integrated already. Many of our countries—in fact, the IMF separates the countries in South America into those that are financially integrated and those that are not.

Precisely reflecting this, but this has to be done carefully. The experience in the past was not great. The Asian crisis showed that very clearly, and many other crises in the region.

GUILLERMO ORTIZ: Well, this reminds me of Carlos Diaz-Alejandro's famous paper written about 30 years ago, 25 years ago, "Good-Bye Financial Repression—

CARMEN REINHART: "—Hello Financial Crash."

GUILLERMO ORTIZ: "—Hello Financial Crash." So this has to be taken with a grain of salt. Part of the Mexican crisis was explained by the very quick degree of liberalization of financial markets that happened in the early 1990s. But Carmen?

CARMEN REINHART: I'd like to just echo and briefly expand on what both Rodrigo and Guillermo have said. I think Asia's growth predates actually their financial liberalization and importantly is rooted in big shifts in human capital, the favorable buildup in demographics also and sustaining high saving rates, which Latin America lacks—also more equitable income distribution in Asia vis-à-vis Latin America, where Latin America has been making headway but is still behind in that.

Financial integration actually was a precursor of the Asian crises, and in effect, one could argue that it was intimately connected to liberalization efforts. So I would say that Mexico's experience of financial integration and then crisis, which was also Chile's experience in the early 1980s, was alive and well in Asia.

*QUESTIONER: (Speaking in Spanish)*

GUILLERMO ORTIZ: Why don't you translate the question first and—

JULIO VELARDE: There is a slowdown in Latin American economies; what policies might we adopt? In the case of fiscal policies, I believe there are countries like Chile, Peru that have some space, where public debt is 20 percent of GDP. In the case of Chile, it's less than that even.

We have had fiscal surpluses during the boom years, so we have some fiscal space. Even in monetary policy, although we have recently increased the interest rate, monetary policy is still in the expansionary phase, and unless we see a pickup of inflation or expectations for the future become unanchored, probably we'll

keep this policy that is moderately expansive. And Chile is also doing more of the same.

And some countries continue—Mexico is having low inflation, is having very expansionary monetary policies—so the countries are responding using countercyclical policies for the short run. The long run implies structural policies. Rodrigo mentioned some of them: work in human capital, in better civil service, institutions that were mentioned before, et cetera.

But it is a process. You have to accept for a time that maybe growth might be lower.

GUILLERMO ORTIZ: Rodrigo?

RODRIGO VALDÉS: Let me go back to something Carmen mentioned at the beginning, which is how temporary or how persistent or even forever, permanent, is the shock. And we really don't know.

What we are more or less sure of, though, is that this is not a V-shaped shock, that in two or three quarters we will go back to where we were six months ago or a year ago. So the notion that you can undo the shock and wait for things to calm down and to become again as they were, I think, is a very bad recipe.

We need to adjust gradually to a new normal that is there that the world is finding. We don't know where it will be—where it is—but we have to be nimble enough to accept that this has a large permanent component and therefore, you cannot do countercyclical things for permanent shocks. You have to adapt to those, and adaptation means you have to reallocate resources to different sectors—again, relative price changes, depreciation, which adjustment to this new reality is needed—and countries have to work through that.

And for the long run, as Julio mentioned, there is no way out from structural reforms that help at the end the supply side of the economy. And again, as I mentioned before, my sense is that human capital is still the basic bottleneck in the region.

GUILLERMO ORTIZ: You have the last word, Carmen.

CARMEN REINHART: Very quickly, to add to what was said in the context of fiscal policy and the persistence of shocks and so

on, let me add an issue on transparency. Transparency of balance sheets, everyone's balance sheets—the public sector, the central bank, the private sector—because it is in bad times that debts that were hidden, off-balance-sheet items, banks that were borrowing, or a central bank having positions in derivatives or these kinds of adverse surprises—an adverse shock or an adverse surprise of that nature—can really trigger a financial crisis.

And my last word will be, I think for Latin America just avoiding financial crises will be a big step in having higher sustained growth rates.

GUILLERMO ORTIZ: Well, with this I first of all want to thank again Julio, for all you have done to make this a memorable meeting, and thank the panelists for these very insightful observations. A big round of applause, please.