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MR. DERVIŞ: So good morning, ladies and gentlemen. Sorry to be just a tiny bit late, but our guests came from far away, and this is a wonderful day, wonderful event. President Bachelet will join us in about an hour.

And in the meantime, we will launch with Minister Andrés Velasco, one of the most well-known Latin American economists. He got his Ph.D. in economics from Columbia University. He taught at Harvard. He also was a post-doctoral fellow at the Massachusetts Institute of Technology. He was the President of the Latin American and Caribbean Association, 2006-2007. He was the NAFTA negotiator in 1995. That I didn't know, and (inaudible) is not today's topic, but that's quite an interesting thing also.

I will not take more time because Andrés is very well-known, but one thing I'm very, very jealous of, I must say, is that he has also published two works of fiction. I wanted to try it, but couldn't finish it. But I still have ambitions on that domain. So, if I get a chance, I will ask him for some advice also on that.

And, of course, we have our own Mauricio Cárdenas, who directs our Latin American and Caribbean Program as a Senior Fellow and Director of the Latin America Initiative.

He was the head of the largest, very well-known Colombian think tank, the Desarrollo. He was Colombia's Minister of Transport and of Economic Development.

He also was active in the private sector on financial products, in fact, on securitization a very interesting and certainly timely

topic, but he did not get anybody into trouble, so congratulations. And he was selected by CNN/Time Magazine as one of the leaders of the new millennium at the turn-of-the-century.

So without further taking more time, let me ask Minister Velasco to start the discussion. We are in an incredibly an interesting moment. I think until about a week ago, everybody -- not everybody -- but lots of people convinced themselves that we were in a V-recovery after all. That is wasn't going to be L.

Markets were buoyant all over the world. Emerging market spreads were getting lower and lower, and there was much good news -- I mean not good news in the real sector, but in the financial sector. Of course, unemployment was still rising everywhere.

And then the last two days -- I don't know what's happening today, but all of a sudden things look much worse. And yesterday, people were talking about a W-shaped development.

So I think all we can say really is that there's lots of uncertainty in the world economy, and we don't really know how things are going to evolve.

But it is interesting that Chile stands out as a very, very successful case, not only over last almost two decades now but also in terms of managing this practice. If I'm correct, Chile was one of few countries that got upgraded in terms of the ratings. Chile managed its fiscal policy in a countercyclical way for quite a while. It utilized the copper revenues, which are very significant, of course, in Chile, very wisely by accumulating reserves when times were good.

And I think this is an example for so many other countries.

I think Chile also ever since the present coalition won election has been engaged only in trying to create a more equitable society. That has been somewhat more difficult, I think, than just the macro economic management. So I think this is another topic Mr. Velasco will address.

Please tell us a little bit about all this and also your perspective on the whole world, not just Latin America and Chile.

MR. VELASCO: Thank you, Kemal. And let me start out by saying that I am delighted to be here. I am especially happy to be sharing this podium with these two very eminent economists and friends. Mauricio and I have known each other for a very long time. We have coincided at many a meeting on Latin America, on the world economy, and I am happy to be here at Brookings being hosted by him. And I'm delighted that he's invited very graciously not only the Chilean delegation, but the president of Chile to come here to Brookings today.

And, of course, Kemal Derviş is a leading figure on world economics, both in his work as a leader of Turkey in the financial area, and then at the UNDP.

And, of course, having been the next-door neighbor to one of Turkey's arguably leading economists, Dani Rodrik, I have tried over the years to learn a little bit about Turkey and Turkey's economy, but, of course, that is a big task, and Dani got me some way along the way, but not as far as I would have liked to have been.

The world economy, of course, is not an easy subject about which to make projections today. And, as you pointed out very well, it's really alphabet soup today.

Some people talk about Vs. Others talk about Ws. Others talk about Ls and Us and all kinds of things.

I will leave the short-term projections to those who earn a living, some more successfully than others, I should say, making such projections.

Let me just point out that from the point of view of a small, open economy like Chile, what really drives us is not so much the day-to-day fluctuations in the stock market -- it was up last week; it has been down at least in the last 24 hours yesterday -- not even so much the prices of commodities, which, of course, matter a lot, but they don't have an immediate impact -- among other reasons, because we tend to stabilize the effects of the price of copper.

What really matters for us is world growth and the world demand for our products.

And from that point of view, 2008 has not been a good year. And if one is to believe the projections by the World Bank, by the OECD, by the IMF, 2009, as a whole, will not be an easy year.

The IMF is telling the world if you use market rates that the world economy will contract at 2.5 percent per year. The World Bank yesterday, just yesterday, had a higher figure, that is to say a more negative growth. And Chile's trading partners will shrink at about 1.5 percent.

And this has a big impact on the price of our exports, and, to a lesser extent, it also has had an effect. We've managed to counteract a good deal of it, but to a lesser extent also on the volume of our exports and on national income.

And this is a big shock indeed which requires offsetting with a variety of tools, including fiscal policy, including monetary policy, financial policy, et cetera.

That is why I very much like the title of this meeting, "Designing and Applying Stimulus Policy," because it takes to a Latin American context a discussion that so far has taken place mostly in developed economies, and for a very good reason: Because economies in North America or Europe or occasionally Japan could, in fact, engage -- had engaged historically and are engaging today -- in countercyclical policy.

The budget deficit of the U.S. this year is expected to be 13.8 percent of GDP. Britain's is about to reach 10 percent of GDP; Spain's, 7.5 percent of GDP. Those are big countercyclical policies.

And, of course, interest rates by the ECB, by the Bank of England, by the Riksbanken in Sweden, Bank of Canada, and the Fed have all been brought down to the one percent range or below.

So the fact that we're seeing countercyclical policies in the rich world is an important sight, a dramatic sight, but not a novel sight.

What is novel, in my view, and which I think is something that we ought to be looking at carefully, but also celebrating, is the fact that for the first time in a very long time, perhaps for the first time in

modern financial history, emerging nations are being able to carry out countercyclical fiscal and monetary policy.

It is happening certainly in Chile, and I will tell you more about that. It is happening in Peru, and we have here in the front row the former Finance Minister of Peru.

It is happening in other countries in Latin America, Brazil among them. It is happening in Asia. It is happening, to a lesser extent, in a couple in Eastern Europe, so on and so forth.

And why is this news? It is news because historically we couldn't do this, because countercyclical policies are not something you invent overnight. You have to build for them. You have to prepare the foundations. You have to prepare the institutions. You have to gain the credibility.

And basically you have to build two kinds of foundations, and Chile has built in both, I am happy to report.

First, you need institutions that guide the conduct of fiscal policy so fiscal policy is not decided upon every day. You don't spend whatever you happen to earn that month. You have procedures. You have rules. You have credibility. And most important of all, you have savings.

And in Chile, between 2004 and the closing of last year, we managed to save \$42 billion, and \$42 billion is a good share of a GDP that is about \$140 billion, \$150 billion at current exchange rates -- \$42 billion out of \$150 billion.

That had never happened before in our history, and that is allowing us today to carry out very countercyclical fiscal policies. This year the budget deficit in Chile will be around \$6 billion, or slightly over four percent of GDP, which is much less than the U.S. or Britain or Spain, but we are, in fact, doing it deliberately because it is a good way to cushion the impact of this very large external shock.

And how are we financing this? We are financing this partially by issuing debt domestically and partially by drawing on our resources abroad. And this financing has to be balanced, because we have to look at the effects on different financial prices when we design financing policies.

We look at the effect of competitiveness, which matters a great deal, and there are some leading representatives from the export sector here in the room with whom we have worked, because we understand that competitiveness is an issue. But we also have to look at the effects on interest rates, and we have tried to balance the two.

Now it is also important to realize that even this very expansionary countercyclical policy is spending a small share of the amount that we saved. We saved \$42 billion. That is the sum of the fiscal surpluses from 2004 to this day. And our deficit this year is \$6 billion, that is to say this year we will spend one-seventh, or approximately 14 percent, 1-4 percent, of the total amount accumulated in surpluses over the last five years.

That is to say we can do a strongly countercyclical fiscal policy and still leave Chile at the end of the year as a net creditor nation.

We have never been a net creditor nation before. We have more assets than liabilities. We will have more assets than liabilities at the end of this year, too; and, therefore, after carrying out the strongly countercyclical policy, we will still leave behind by far the most solid fiscal situation that the Republic has ever had at any time when one government handed over power to another government.

So you can do fiscal policy that is countercyclical, but you have to build the foundations for it. And the same, of course, is true for monetary policy. You can cut interest rates vary sharply in a downturn, but in order to do it, you need credibility.

And you happen to have sitting on this podium somebody from Turkey, somebody from Colombia, and somebody from Chile. These are precisely the three emerging nations that have cut interest rates the most in the course of this year.

Turkey and Chile have cut interest rates by 750 basis points, and Colombia by somewhat less, but, still, it has cut interest rates very, very sharply. Why?

Because Turkey and Colombia and Chile built institutions -- credible central banks, inflation targets, inflation that has oscillated, but on the whole has been low. And we draw upon that credibility. We use that credibility today in order to stimulate the economy.

How different is this -- let us not lose sight of this -- how different it is from what we did in crises in the '90s or in the '80s, when the big concern was the currency is collapsing. And, as a result of a collapse

in the currency, interest rates were 14 percent, 15 percent, 20 percent, 30 percent. And that added to the shock.

Today, we have low interest rates, and that subtracts from the shocks, and that is a very, very big difference indeed for Turkey, for Colombia, for Chile.

Now that is a macroeconomic countercyclical policy. Those are policies that when the demand curve goes down because people are buying less from you, well, you try to bring demand back-up. You try to substitute external demand and put in its place domestic demand so that the economy does not suffer such a large demand contraction.

And in Chile, this has not been an easy task because of the size of the shock, but to a very large extent, we are managing. The World Bank yesterday came out with an estimate that says that Chile will contract 0.6 percent this year.

That is compatible with the range that both the central bank and the Ministry of Finance have set, and that is, of course, very, very different from the contraction -- it is not too different from Colombia's performance. We're very much in the same boat.

I'm not quite sure about Turkey's this year, but it is very different from the kind of performance you're seeing in Asian countries, where a nation like Singapore, one of the stars of economic growth, is expected to contract I've heard six percent, seven percent, eight percent or the Baltic countries where once upon a time growth was very high, and this year we're looking at contractions of GDP of 12 percent, 15 percent, and in the case of Latvia as high as 20 percent.

Now that's on the macro side. I also want to argue that there's scope for doing countercyclical policies at the micro level, and I want to mention two things that are important. They're not easy to do, but they're important. And in Chile, we endeavored to do them.

One has to do with financial markets, because being prudent is a great thing. And the fact that Chilean financial markets and Chilean banks were prudent over the last six or seven years is, in fact, a big asset of Chile today.

But like most good things, prudence can be overdone, or to put it in technical economic jargon, too little appetite for risk at a time of crisis can magnify the effects of a crisis. So it is very important to get banks to lend again, especially if the banks, like Chile's banks, are well-capitalized.

If they have capital, if they have no toxic assets, which in Chile they don't, if they have no funny things off balance sheet, which in Chile they don't, then there ought to be room to resume lending.

And there's room for public policy to help this happen, and in Chile we've been doing this, and I will not go through the long list, but we've changed some aspects of bank regulation, and we have brought other actors onto the picture -- insurance companies, credit unions, and the bond market -- so that banks will feel that there's competition, that there are other people there trying to lend.

And, in fact, if you look at Chile's bond market, it is quite remarkable how over the last six months or so there's been a nascent

boom in bond issues, which is something that is quite extraordinary when you think that we're in the midst of a world financial crisis.

Chile's bond market is doing very well, which again attests to the mixture of regulation that is countercyclical and underlines solidity.

And in fact, Peruvian companies and Mexican companies and companies from elsewhere in the emerging world are coming to Chile to issue because Chile is a well-functioning capital market. Other big, rich country markets are not.

And finally, and I will stop here, there's also some room for taking this countercyclical logic to the labor market.

This is never an easy issue, of course, and it is politically a more sensitive issue but in the labor market and working with the leading business associations in Chile, and Rafael Guilisasti, the President of CPC is here on the second row, and with the leading unions in Chile, we found ways to discourage -- using incentives not coercion -- layoffs and to encourage training.

From an economics point of view, a time of low demand is a good time to train your workers, because if you're facing low demand today but you may face high demand tomorrow, the return on using the worker today may be low, but the return training a worker, employing him tomorrow or employing her tomorrow is high.

So this is a good time to do training. And we have endeavored to develop new contractual arrangements and to facilitate financing both from private sources and from public sources to do more training so that we reduce the effect on employment today, and just as

important Chile is well-prepared not just for the crisis, but for the post-crisis world.

Let me stop there, because I've probably gone on too long, and I think the idea is to have a dialogue. So thanks very much, Kemal.

MR. DERVIŞ: Thank you very much. That was a wonderful overview of a very successful country, and I wish we had more like that. But really, Chile has performed extremely well. Mauricio?

MR. CÁRDENAS: Okay. Well, this has been spared of a conversation, and I'm very grateful that Minister Velasco has gone into the details of what's going on in Chile. I think Chile has been for most of us and to a lot of countries in the world an example, and certainly there are many things to follow from Chile.

I want to take this conversation a little bit outside Chile more in the regional context, and let me, before I make a few points just to engage Andrés in a conversation, also thank the ambassadors that are joining us here today; Kemal for having moderated and provided input to this conversation, and, of course, Andrés for joining us.

As Andrés said, we're long-time friends, coinciding on many, many, many things, and it's really good to have you here.

But you are now the Minister of Finance, and Ministers tend to be shaping the conventional wisdom or at least following the conventional wisdom.

And the conventional wisdom today in the region is more or less what Andrés said, with some adjustments, but that more or less applies to other countries.

Countries in the region are very proud that they're able to deal with this crisis in very different ways than what happened a decade ago, mostly because countries are being able to implement counter cyclical policies, not to the extent that Chile has been able to, especially in the fiscal accounts, but certainly in the monetary front as well. The reduction in interest rates speaks for itself.

So the conventional wisdom is that this is a crisis that we did not generate. It had nothing to do with us, but because of our sound policies of the past we're better able to cope with it.

And we're dealing with the crisis very effectively, and we will be out of it very soon. That's the last sentence. And we will be out very soon means that next year we will be growing again and that the rebound is going to be significant. If you basically compare next year's growth to this year's projections, it's a rebound of at least four percentage points, and in some countries it could be as large as six, which is the case for Mexico. That's the conventional wisdom.

There are people who are a bit more pessimistic, so they say the contraction this year is not going to be minus two. It's going to be minus two and a half. I think the range is larger for Mexico. The conventional wisdom, or the average consensus, now it's about nine or six minus five and half is yesterday's World Bank report.

The people who are more pessimistic about Mexico talk about a minus eight. But for the rest of the countries, it's in a smaller range, say, between minus point five and minus one and a half. That's the result. That's Columbia. That's Chile. And then next year is not back to

normal, but certainly much better, plus two, plus two and half, even plus three percent.

So that's the conventional wisdom, and I wonder if that's a realistic view of things. And I wonder if it's a realistic view of things for three reasons.

The first reason is the numbers we're getting for the first months of '09 are looking really bad in terms of output contraction, in terms of unemployment rates, and I guess they're worse than what we expected. That's the basis for these revisions in the outlook for '09.

But somehow these revisions have not really taken effect on the forecasts for 2010 and following.

So the numbers are not good, perhaps with the notable exception of Brazil, which is showing positive industrial growth, mostly coming from the automobile sector, and a lot of it related to these fiscal or more precisely tax incentives that the government gave to the purchase of automobiles.

But for the other countries, we're still seeing double-digit contractions in industrial production. And for the countries for which we have quarterly GDP data already available, it's a significant contraction. I think Chile's contraction in the first quarter was about 2.4, if I don't remember wrong.

Mexico already has its figure. It's also a contraction. Brazil also has a contraction also in GDP first quarter.

MR. VELASCO: Brazil and Mexico are larger; right? Mexico was --

MR. CÁRDENAS: Yeah.

MR. VELASCO: Four something.

MR. CÁRDENAS: Right. So that means if we're going to, say, have -0.5 during the year, we'd better, you know, hope for a very good second half of the year. That's the only way in which you can square these facts.

And that, of course, is an assumption. What are my concerns and why do I think this conventional wisdom has to be at least challenged? I don't want to be the Latin version of Dr. Doom. I want to basically frame this in the context of what I think is realistic.

I think there are three factors here that we have to consider very seriously.

One is the U.S. recovery. Of course, there's little to add to the debate here in Washington about the U.S. recovery. You see data coming every day.

The only thing I can say kind of like looking at it from some distance in from the outside is that for every indicator that you could potentially consider as a green shoot, there is another one saying just the opposite.

So you can always make the case that things are improving, but then this measure showing just that we are still in a recession.

My take on the U.S. data is that we will see a positive figure only by the end of the year, by the fourth quarter of the year, and that we're still talking about the second derivative. Things are falling but are not falling as much as they used to.

So that's basically one concern. A lot of what we're forecasting about Latin America is based on the assumption of the V-shaped recovery of the U.S.

That's not my main and most important point about challenging the conventional wisdom. I think the other two are definitely more important.

One is China's growth. You know China's growth is very important for the region, as it is a key driver of commodity prices. And Latin America, to a large extent, remains a commodity exporter. More than 50 percent of our exports are commodities. That's certainly the case in Chile, in Colombia, in Brazil, not so much in Central America and Mexico, but certainly in the other parts of the region.

We've seen an increase in commodity prices, and it's been kind of surprising to most analysts, especially starting with the oil prices. But how sustainable is this, which has been a good source of optimism for Latin America.

Well, if you look at China, China is growing at about 6.2 percent. That was the data for the first quarter. But exports from China are contracting. The last data we have is May, and it shows a contraction of minus 26 percent. That's exports from China.

So what's happening in China is that China is growing based on the increasing investment, essentially public investment in infrastructure -- that's stimulus package. Luckily the Chinese have also very sound fiscal policies and sound fiscal institutions. The deficit is very

low. They almost don't have any debt, and that's why they were able to put together these huge expansionist programs.

So growth is based on domestic sources, not so much on external demand, not so much on exports.

How sustainable is that? The Chinese are saying that they are not going to change the model, that their model is export-led growth, and this is just temporary; also because extending domestic demand in China has implications from the point of view of competitiveness in terms of, say, the salaries of the Chinese workforce.

So I don't think China is going to be able to continue doing domestic demand for a long time, and exports are, again, contracting at 26 percent.

And the other thing is that one type of commodity basket is the one that is required to basically supply this increase in domestic demand in China, and a different one -- and this I think is related to copper in Chile -- is the one is needed for producing manufactured exports.

So, in the case of China, I would say we have to be at least somewhat worried about the capacity to continue serving as the engine of growth, and that will reflect and Latin America.

But the final and most important point, I think, has to be made on capital flows to Latin America, and particularly private capital flows.

Andrés was mentioning the report that was released yesterday that had a devastating effect on the markets. I'm sure you saw what happened in most of the capital markets throughout the world. It's

called the Global Development Finance Report of the World Bank. By the way, I thought it was a fantastic report. I thought it was a really good report.

The World Bank took more time than the other multilateral banks to put together a report. But this one I think is right on target, and it's saying essentially the following with regard to private capital flows: There is a gap of \$350 billion this year in terms of financing needs of the developing world. There is a gap between what the countries need in terms of the short-term debt, the amortizations on the medium- to long-term debt and the capital that is available, both through foreign direct investment and what has been also offered by the official lenders -- \$350 billion is a lot of money.

I'm sure countries like Chile, Colombia, Peru, Brazil, Mexico, will be able to tap the markets, will be able to access the market if it's necessary. Chile hasn't done it. It doesn't need it. It has a lot of savings.

But countries like Peru and Colombia have been able to issue bonds in the market. But many other countries in Latin America are not able to do that, and they depend heavily on official flows.

My view is that these countries, especially the ones that have current account deficits, especially the ones that depend on remittances and tourism, the ones that do not have access to private capital markets are going to face a major adjustment -- and this is Central America; this is the Caribbean -- a major adjustment which basically would challenge this view that things will be back to normal by the end of this year or next year.

And even for the countries that are able to access the markets, then there is the question of the private corporations. The private corporations need a lot of funds to really roll over their debts.

More than 3,000 corporations in the emerging countries were able to get syndicated loans; 700 corporations in the emerging world issued bonds in the international markets. And they have to pay back those bonds. And they have to pay back those loans as well. And they don't have access to the capital market.

So we depend a lot on the ability of banks in the developed world to really lend again to the emerging countries, and that's easier said than done, because the capital requirements are increasing. Or there is discussion about increasing capital requirements. Now the credit standards of these banks that have to originate loans are getting stricter, and also there are liquidity issues. It's difficult in the intra-bank markets for these banks to get liquidity.

So I think we should be concerned about that, and given that, I think we should also moderate a little bit about our optimism about what's going to happen in the next year or year and half in terms of growth in our region. Thank you.

MR. DERVIŞ: Thank you, Mauricio. Let me ask two questions to the panelists first before we open for some discussion.

Following on what Mauricio said and very much interested in what Mr. Velasco has to say as a governor of the IMF, this picture which you just painted was exactly the picture we had at the G-20 in London. And, you know, I was there with the Secretary General at the time.

That was the whole reason to increase the size of the IMF, to bring the IMF to a point where it would be able to lend an additional \$200 billion, \$300 billion, \$400 billion. Now things have moved somewhat.

The U.S. Congress has actually finally passed the U.S. contribution to the new agreement to borrow, arrangements to borrow. So there is a chance, I think, that the IMF can kick in and compensate for this massive failure of the private capital flows to sustain themselves. And to some degree, I think that could then alleviate the crisis for the emerging markets in general.

Again, Chile doesn't need it as a country, because it has all these reserves. But many, many emerging markets need that finance.

So it would be interesting to hear both from Andrés and from Mauricio how they see the role of the IMF in all of this, not necessarily with respect to Chile, but with respect to Latin America and more generally the emerging markets.

Second, the issue of size. I think something quite interesting has happened. I haven't done a quantitative analysis, but it seems that definitely the large countries have fared much better, because the trade channel has been so important in this recession.

One and talk of the financial assets channel come and that has not been important for most emerging markets because the toxic assets were not there in the banking system. There is a financial credit channel, which you just mentioned, which is important, particularly for the countries with large current account deficits and financing needs.

And then there's the trade channel. And clearly, the trade channel has hit the open economies much, much more than the less open economies, and usually an economy is more open when it's small.

We see China and India growth. The latest projection -- I haven't seen the World Bank India -- I don't remember. It's above six percent. China is above seven percent. And Brazil is doing better than most in Latin America.

So is there a comment on size and maybe on regional cooperation and merging, you know, having bigger regional trade blocks? Andrés, could I ask you maybe to just address these two things?

MR. VELASCO: Great questions both of them, and very much related to Mauricio's point, which I would summarize with the following sentence, which is not my own coinage but is Larry Summers' favorite policy approach. We're seeing Larry later on in the White House. Larry likes to say, hope for the best, but prepare for the worst.

And what Mauricio is saying is be careful because as far as the world economy is concerned, it is not altogether clear we're out of the woods yet. And I would tend to have some sympathy with that proposition, especially in the following sense: We tend to miss that, because not only do we have a large chunk of GDP in cash, we also have access to the capital markets, as Colombia has, as Peru has, but few other countries do.

Can the IMF do the job? Yes and no. Yes, the IMF ought to be taking a larger role and the decisions at the G-20 in London and the recent discussion in the U.S. Congress, et cetera, et cetera, are all

pointing us in the right direction. We need a liquidity provider maybe not as a last resort, maybe as a first resort.

However, the question remains is that enough? My initial conjecture would be "no," for the simple reason that you need the liquidity, which will be going to the countries that need balance of payments support, but you also need development finance for simply financing for investment, for infrastructure, et cetera, et cetera. And that certainly is not the role of the Fund.

It is the role of the private sector. It is also the role of the other development institutions. And that is why I think it is so important, and it is an issue that President Bachelet has brought up in the past, and that she will bring up again in this trip.

That is why it's so important that the IADB should have more capital and that the IADB should be lending not just for short-term balance of payments support, but also for infrastructure for investment for development purposes.

The same is true of the World Bank. The same is true with the Asian Development Bank in Asia, et cetera, et cetera.

Size. Yes, size does matter in economics. And the three countries you mentioned are the obvious example of that -- China, India, and Brazil. The other extreme of that continuum are the Baltics or Hong Kong or Singapore. Would anybody ever have guessed that Singapore would be contracting by six percent or Hong Kong, you know, thereabouts; that Estonia, the model reformer of Eastern Europe would be contracting at 12 percent per year or maybe more.

Some of it has to do with imperfect macro policies -- current account deficits that were way too large. When your current account deficit is 20 percent of GDP, you're probably exposing yourself too much.

But much of it, in fact, has to do with simply the size of the shock. And smaller, open economies have received bigger shocks. Countries like Peru, countries like Colombia, countries like Chile, which are quite open, have received shocks that as a share of GDP are tremendous.

When your exports fall in value 35 percent over 12 months, 40 percent over 12 months, and your exports as a share of GDP are 40 percent, 50 percent, 60 percent, 80 percent, that is simply a humongous macro shock. And offsetting that is a major task.

In the short run, the tasks have to be addressed with the tools we have, and the tools are mostly macro -- interest rates, fiscal expenditure, financial regulation.

Over the longer haul, of course, integration would help indeed, and we have gone part of the way toward greater integration in our region, but certainly not far enough. And there is a danger today, which I hope will not materialize, that some countries, not Chile certainly, could react to this crisis by ramping up protection not only worldwide, not only vis-à-vis third partners, but also within the region, and that certainly would not be a good response for the crisis. It would only aggravate the demand problem we have today.

MR. DERVIŞ: Mauricio?

MR. CÁRDENAS: Just a couple of comments and points

here. The IMF can do a lot, and I think we should be very happy that the U.S. Congress finally approved the -- increasing the allocation of the ESDR (phonetic) for the U.S.

But we still have to see this happening and 75 percent of the voting shares of the IMF are in other countries, so we need to have the other countries, you know, playing their act as well, especially countries that have pledged to increase the funds to the IMF.

But we have to remember that this is an issue of the private sectors more than the governments, because, if anything, governments are in better shape in the emerging world and especially in Latin America.

So we need to make sure that there are mechanisms to basically channel these resources to the private sector.

And that's when we get into difficulties. If you look at the debates here in Washington about the IMF -- the recent decision to provide more funds from the U.S. to the IMF, what some of the U.S. Senators had to say is that this was going to end up in bail out money for the European banks that had made bad loans to the Central and Eastern European countries.

So this is the type of challenge we're going to see given today's world, which is the problem is in the private sector. It's in the corporate sector. It's not so much in the governments.

Let me also say that even if it takes more time for the U.S. economy to recover, the question we should be asking ourselves is what can Latin American countries do if things do not turn out as well as

expected? Is there additional firepower in terms of the monetary and fiscal stimulus?

If you read the minutes from the central banks, what they're saying is that the reduction in interest rates is coming to an end; that they don't have the capacity to cut rates any longer. That's what Mexico said, for instance, in the last communiqué.

And in the fiscal expansion, think about, for instance, the debate in Chile. I was reading during the weekend, given that you were coming, what people are saying in Chile. And people are saying in Chile, well, our fiscal deficit is too large. We have a deficit that is even larger than what the structural calculations would suggest.

So I'm saying, well, how's the political debate in Chile if you needed an extra source of fiscal stimulus? Is that going to fly easily? Is that going to be acceptable?

In this case, it's about using savings, but think about other countries that probably don't have the savings and need basically to access more funds from the international market.

So my concern here is that we've done a lot, but I don't think we can do a lot more in Latin America in terms of fiscal stimulus.

So we have to be prepared for a situation in which the recovery takes longer; the financial markets remain very closed to the emerging countries and that our ability to steer the situation is somewhat constrained and least compared to what happened in the first phase of the crisis.

MR. DERVIŞ: Thank you, Mauricio and Andrés, and now

let's open it to the floor for some questions, quick comments, not long comments. I think we will have maybe 10 minutes or so for that.

And I'd like to take a few before we go back to some final words, if we have time. Yes? The gentleman there.

MR. CHEN: I have a question for Minister Velasco. I'm Jian Chen from Johns Hopkins University. About two months ago, there was another forum talking about the financial crisis and the global impact, right across the street at Johns Hopkins. And the chief economist of the World Bank, Justin Lin, was there and Kemal was there as well, and Justin mentioned something about the successful experience of China is dependent, or at least partially attributed to the fact that they do not have very open capital markets.

And in China actually the capital markets only on liquidity. There is no fixed income. Capital markets are not open to the external world.

So actually he thinks that for development without crisis one of the key factors he thinks is you do not necessarily need to have very open and sophisticated capital markets.

And it seems that, you know, Minister Velasco is attributing the recovery of Chile partially to the capital markets Chile has. So do you have any critiques on what Justin said?

MR. DERVIŞ: Thank you very much. We'll take -- yes?

MS. BABBITT: My name's Hattie Babbitt with Jennings Strouss. I also had a question for Minister Velasco.

You indicated on the labor market that you began to speak

about, you indicated that Chile had found a way to discourage layoffs and to encourage training. Whatever green shoots we've seen in the United States have not included any improvement in our unemployment numbers, and I wondered if you could expand a little bit on what Chile has done and how that might be applicable to the economy here?

MR. DERVIŞ: All right. Yes, the gentleman here.

MR. ROLENSIA: Phillippe Rolensia (phonetic), World Bank. I was wondering how would the political landscape with the many upcoming elections in the Latin American region will compound or ease the economic panorama?

MR. DERVIŞ: I think they can take one more if there is or – okay. I think we'll turn to maybe in the opposite -- we'll go in the opposite.

MR. VELASCO: We may have time for one more.

MR. DERVIŞ: Okay. Yes. All the way in the back.

SPEAKER: Can you comment on the prospect for small economies of Latin America, such as Ecuador, Panama, and El Salvador that are (inaudible)?

MR. DERVIŞ: All right. Well, very good questions. We'll turn to the panel again. Andrés?

MR. VELASCO: Thanks very much. I will allow Mauricio to take the one about elections. Or I will talk about elections but at lunch. How's that?

These are good questions. Capital account liberalization. I think the question is not: Is a liberalized capital account a good idea? I would rephrase the question respectfully and say: When is it a good idea,

at which point in the development process, at which point in the macro stabilization process?

What we learned -- we've learned it in Asia, we learned it Latin America, and certainly we learned it in Chile in the '80s -- is that if you liberalize the capital account before you have liberalized trade, before you have put in very strong prudential supervision into the banking sector, before you have cleaned up bank balance sheets, before you have stabilized the fiscal situation, then bad macro plus capital account liberalization is a very toxic combination indeed.

And we have seen again and again cases of that being so.

A different question is whether toward the end of your opening up process, once you've got trade nice and open, once you've got your banks capitalized and well regulated and once you've got strong fiscal accounts, do you then want to move towards capital account liberalization?

I think the answer is yes. And that is more or less the path we have followed in Chile. Capital account liberalization was the last thing to come into place.

We don't have 100 percent yet, but we're getting there, and, in fact, we have seen that the capital account has worked, in fact, as you might have expected to. And, in this sense, adjustment in Chile and the capital account has worked almost like a textbook case. Why?

Because you would expect that as rates of return abroad go down, as interest rates in the U.S. fall, as U.S. banks get into trouble, money would flow back, and that's exactly what happened.

Chilean pension funds have brought money back into the country. Foreign direct investment has carried on and yesterday the Foreign Investment Committee in Chile disclosed figures for the first half of the year, and they are very good.

They're, in fact, much better than last year and much better than the year before. So real foreign direct investment is not only continuing, it's continuing at a very fast pace.

In short, yes, you want to do it. The question is when? And my answer is once everything else is in place, not before.

MR. CÁRDENAS: Can I just quickly --

MR. VELASCO: Yes.

MR. CÁRDENAS: Add one little point here,

MR. VELASCO: Of course.

MR. CÁRDENAS: Which I'm very interested in looking at Eastern Europe. How would you add to your comments, you know, in evaluation of the issue of bank ownership and also the balance between foreign financing in the sense of subsidiaries of foreign banks versus fully domestically incorporated banks?

MR. CÁRDENAS: That's a very good issue. I'll give you the recipe.

The background -- I think, Kemal, of course, his reveals he understands very well. I would suggest two conclusions.

First, we should not look to bank ownership per se as an issue. It doesn't really matter who owns the banks. What it does matter is for them to have local capital, and for them to be subject to local

supervision.

And, in fact, this is what I believe is Colombia does; this is what Chile does.

The big Spanish banks, the big American banks, the big Canadian banks, the big British banks are all in Chile, and we, in fact, welcome that.

But they operate as Chilean companies with Chilean capital and subject to Chilean supervision. That's conclusion number one.

Conclusion number two, and this is an issue for other countries of the region, you should not believe that because you have foreign banks, you have guaranteed access to foreign financing.

This was a big issue in Argentina in 2001. People said, "Look, a good chunk of our Argentine financial system is guaranteed -- is foreign owned. That means that any capital account constraint is a thing of the past."

That does not happen. The fact that Citibank is in your country and that, you know, Santander is in your country does not guarantee that all American lenders, or all Spanish lenders will lend to you in a crunch.

The story of Argentina back then showed that that is far from being true.

Labor markets. I certainly do not want to make the claim that in Chile we have found any kind of panacea. Labor markets are a delicate subject.

And, in fact, it is a subject about which clichés are very

quickly overturned. It is quite striking, for instance, that the biggest increases in unemployment have taken place in countries where conventional wisdom would not have suggested it.

The biggest increases in unemployment have happened in the U.K. and the U.S.

And lesser increases of unemployment have happened in continental Europe. It may be a matter of time. I don't know. But the adjustment has been quite striking to the eye.

In Chile we have worked hard with economists, with business, with labor to come up with arrangements. There are four or five alternatives, but they all have the following flavor.

You have a worker. The company might consider given current demand conditions firing that worker. Develop a program so that you can keep the contractual relationship so that the worker still has severance payments, rights, seniority, pensions, medical care, but, during that period lighten the burden on the firm and make it more likely that the firm will, in fact, train that worker.

And for that, the worker and with the case of the instrument we designed gets half a wage, not a full wage, for up to five months, and during that period -- using unemployment benefits money, using private money, and using a bit of government money -- we guarantee training, and we have universities, and professional institutes and technical institutes to make sure that the training is not a waste of time, that the training is of good quality.

And we estimate that by using different variations on this

theme, we will be able to save about 100,000 jobs in Chile during this season.

Does that mean that we will do away with impact on unemployment? No, Chile has seen an increase in unemployment already and we know that in winter months typically, unemployment goes up, and it will be strange if it did not happen this year.

But combining macro issues with creative micro changes, we can at least hope to make a dent on that trend, to contain it. Certainly we would not expect to do away with it altogether.

Elections is a subject for Mauricio. Central America, you, Mauricio, know a great deal more than I. Let me point out that the combination of dollarization and very limited access to financing abroad is a particularly lethal one.

And, when I was saying earlier that there are a number of countries in Latin America which will need greater access to financing and that institutions like the IADB and the IMF have to play a role, I was thinking precisely of such countries and those countries will need a very present set of multilateral institutions in what is for them not an easy time.

MR. DERVIŞ: Mauricio, all about elections or --

MR. CÁRDENAS: Well, just a quick comment.

MR. VELASCO: We welcome the Chilean delegation that is joining us.

MR. CÁRDENAS: But we are saying that there is movement in the back of the room. Elections. Well, let me just say this, this crisis has turned out to be quite favorable to the governments that are beginning

to do something about it.

If you look, for instance, at the approval ratings of President Calderón in Mexico, President Lula, President Uribe, President Balchelet they have increased during the crisis.

So the idea is that there is this thing happened that we didn't create, but we're responding to it, and we're responding to it in a very decisive way.

And that the electorate likes. The risk of that is that the response may be too large, if you are facing elections in the short run, too large compared to what is sustainable, to what is adequate from the point of view of the long term level of debt.

So that's the risk that the fiscal expansions are going beyond what is reasonable.

In terms, of the electoral outcomes, it's difficult to know. It is difficult to know because all I've said is true but, it's also true that probably countries like Venezuela are not going to suffer as much in terms of a contraction. So they're going to be able to show well, we kept this economy growing plus one, plus two percent when the rest of the region was contracting.

Why is Venezuela going to be able to grow, contrary to what all these projections are guessing? Because of the coverage of oil prices and the fact that consumption is still growing in Venezuela.

So electoral outcomes, that's not my field. I wouldn't do on that, but at least I could say that the current governments and the governments that are responding in an effective way are getting a lot of

approval in terms of the population.

MR. DERVIŞ: Thank you very much, Mauricio. I think President Bachelet is about to enter the room, so I thank the two panelists very, very much, Andrés and Mauricio.

(Applause)

MR. DERVIŞ: And I must say it's hard to listen to Andrés and not be a little bit envious of Chile's performance, but it is due to the really wonderful leadership of the team he's part of and generally of the political coalition that has been guiding Chile for quite some time.

Let me just until President Bachelet arrives, maybe make two points again. What is we should probably remember is that the crisis in terms of the real sector, in terms of employment and GDP, is still very young. It's less than a year that we really faced the real sector crisis.

And in that sense, people are still coping with it. Even if you're unemployed, you have some reserves. You have a little bit of savings. Your family held to a little bit. I'm talking worldwide.

So the political reaction, whether it's in Turkey or in other parts -- in Mexico where the growth contraction is, of course, much worse than in Chile, or in Eastern Europe where it's the worst -- I think people are waiting. They're unhappy, many of them are unemployed, but it's recent.

If things turn in a good direction, I think this will be overcome and people will say well, we had a bad year, but we're back to normal.

If however, if this lasts, I can say for my own country and countries like it, minus four, five percent growth, high unemployment, if

this lasts beyond a year, if it goes into a second year, I could see political reactions which would be very, very different and much longer than what we've seen right now.

And the second point I'd like to make, and I fully agree with Andrés, of course, that the IMF alone is not the answer, the combination of the IMF and the multilateral development banks, you know, of the strongly proactive, countercyclical role, helping the countries that are being hurt, and this time being hurt largely not because they did anything wrong, but because of the crisis that happened in the center of the world economy, I think having these institutions be extremely proactive, including, as Andrés said, the multilateral development banks providing development finance, long-term finance, is critical, and I hope this will happen. I think it is happening, and I think, for all the critics, we're happy to have these institutions. If we didn't have them now, who would be able to channel these things? Who would be able to mobilize these resources?

And in that sense, I do believe these efforts are extremely important. And now we're waiting for President Bachelet, who should arrive any minute I think.

President Bachelet, thank you so much for honoring us with your presence, for joining us at Brookings. And I'm so happy personally to be able to welcome you with my colleague, Mauricio Cárdenas, who is directing the Latin American program, and, of course, I'm so happy to be able to share the podium with your Minister, Andrés Velasco.

I don't think you need much introduction at all. Everybody knows you, certainly everybody in this room, but also everybody around the world. But still, let me say a few words, reminding people of your extraordinary life and career -- somebody who studied medicine and pediatrics but also military science, somebody whose family suffered terribly from the dictatorship.

And I do personally remember those days, I just want you to know, President Bachelet. I was in Turkey, far away from Chile. But, for us, the Allende days were days of hope for all of those who hoped for more equality and democracy in the world, and many, many countries followed these events from very far away.

Chile, of course, has overcome that history, has become an example of democratic governance, of tremendous economic progress, of combining markets, which sometimes the Left in the '70s didn't fully realize, combining markets and private initiative with equity and a strong role for the government.

And you played a key role in all of this as Health Minister but also as Defense Minister, the first woman Defense Minister on the continent, certainly an example for all over the world.

And then becoming President, President of Chile as a woman, again setting an example and following a time where the coalition you represented really had put Chile on the course of a very sustainable, very

solid growth path -- still, of course with challenges. The challenges never end, but having a solid record which you continued.

And now, of course, in this moment of crisis for the world economy, we are a little bit -- all of us -- jealous of Chile, I must say, because the fact that you're upgrading your creditworthiness; the fact that you're a net creditor nation, as Andrés told us again; the fact that, yes, there will be a little bit of negative growth perhaps this year, but almost insignificant compared to countries that are suffering much more, suffering contractions at times of 5, sometimes 10, percent of GDP. Chile is again, I think, setting an example.

So we have a tremendous amount to learn from Chile and from you personally, from your wisdom and from your courage, and that's what we are looking forward to hearing now.

Thank you very much, President Bachelet.

(Applause.)

PRES. BACHELET: Thank you.

Well, good morning. Still, it's good morning.

Mr. Kemal Derviş, Vice President of the Brookings Institution, thank you for your kind words. Mr. Mauricio Cárdenas, Senior Fellow and Director of Latin America Initiative, Brookings Institution and still Andrés Velasco, Minister of Finance, dear friends, well, first of all, I would like to tell you that I am very happy to be here, and thank you for inviting me to

participate in this seminar, and for giving me the opportunity to share my thoughts with such eminent panelists and such a distinguished audience.

This afternoon, I will be meeting President Obama at the White House. We'll be discussing our responses to the international economic crisis that has just had such major impact on our nations and all over the world. For the last nine months, the government has made the response to the crisis our main priority. We have deployed technical know-how, financial resources and political will to find ways to cushion the impact of the global financial meltdown, so has the U.S. government and much of the world.

But this crisis not only has influenced in the way in which governments conduct their affairs, it has also put an end to a way of thinking, if I might say, and this is why the title of this seminar is so appropriate: designing and applying stimulus policies. Not only because of that, because we do believe it is important stimulus policy, but also because I think that we should look at the crisis, or -- should I better describe -- we should think at the end of crisis, when better times come, not that we're going to go back to the same situation we were in before because that would mean we haven't learned the lessons of the crisis. So we need to think and reflect and see what are we going to do? What are the kinds of institutions we have to change? What else are we going to have to do to avoid, if possible, a new crisis in the future?

That's why I'm sure not only that everybody says that from every crisis comes an opportunity. I think it's our duty to try to, after the crisis or within the crisis, to build a better world, better institutions on the basis that we have learned what happened, why the crisis came and what we have to do better.

One of the issues when responding to the crisis is the idea of designing and applying stimulus policies, and this is very important, because by definition, a stimulus policy reflects the political decision to act decisively, to use the levers of the state and of public policy to stabilize the economy, a political decision to deploy our best public efforts to reverse a major failure on the private side.

The time has passed for a paradigm that prevailed for too many years, which maintains that the best regulation of the economy is no regulation at all, and this was an almost blind belief that markets, no matter how complex, can solve in a magical way the countless market failures, informational asymmetries and conflicts of interest that arise -- a belief vigorously advocated in this very city not too long ago that the state is part of the problem, not the resolution.

Well, we believe that the state is part of the solution. This approach of no regulation and defining the state is part of the problem is an approach that in Chile we have come to call the Paradigm of Passivity. The crisis has taught us what we should have known all along, that the

state is not and cannot be passive when it comes to economic activity or to financial regulation.

But do not take me wrong. I do not want to be misinterpreted in what I am saying. When I talk about not being passive, I'm not necessarily talking about an interventionist state. I'm not calling for a government involved in all sectors of the economy or prone to over-regulate markets.

When I talk about not being passive, I'm referring basically to three things:

First of all, public policy must pay great attention to potential and actual market failure and must use pro-market rather than pro-business tools in an effort to strengthen markets and make them more competitive.

Second, just as the micro economy does not self-regulate, neither does the macro economy. John Maynard Keynes made this point six decades ago, and the crisis has brought it home unambiguously and with painful force: We need a state that uses fiscal, monetary and financial policies countercyclically.

Third, good economic policy and good social and environmental policy are one and the same. Social cohesion and green growth are goals that can and should go hand-in-hand. For this to happen, we must design such policies in a smart way, so that they can be financeable, sustained over time.

It is for these reasons that I favor an active state, rather than a passive one. But keep in mind that an active state is not the same as an interventionist state.

Bearing the three elements in mind, we can now talk about stimulus policies. Chile and Latin America have been affected by this crisis, and not only financially but especially in the real economy. The initial shock was financial. Starting in September of last year, appetite for risk went down, the spreads went sharply up, and access to financing became much more difficult for governments and companies in the region.

But this time in Latin America, fundamentals were better and the policy response was swift. The region's central banks moved quickly to offset the lack of liquidity in dollars, using either sovereign funds or international reserves accumulated during the commodity boom earlier this decade.

In addition, this time around, the region's banks were mostly well-regulated and healthy, I must say. This is one area where regulation helped, and hugely so. In the case of Chile, we had this crisis in the '80s. We learned lessons. We introduced regulations. So our financial system was really in very good condition.

Unlike the U.S. and much of Europe, in 2009, Latin American taxpayers have not had to bear the burden of bailing out their local banking system. Earlier lending and regulatory prudence has paid off.

But we should not overdo caution, however, when it comes to lending today. Healthy banks can and should lend and support the recovery plans of our region's firms. In Chile, we have adopted measures both to stimulate bank lending and to bring competition from other players: insurance companies, credit unions and bonds investors.

After the financial shock came the real shock. The collapse of global demand and a sharp slowdown in world trade have been particularly detrimental in Latin America. And I would say in Central America, it has been very important, too. Our open economies in the region have felt the impact both in the demand for their exports and the price of the goods they sell abroad. Dealing with this shock has been made easier by the adoption of flexible exchange rates and by the use, wherever possible, of countercyclical monetary and fiscal policies.

Please allow me now to tell you a bit about the way in which we have reacted to the crisis in Chile, although I know that probably Minister Velasco for sure must have also referred to some of those issues. It should not be a surprise that such a deep external crisis would affect an economy like Chile's, which depends to a large extent on foreign markets. In the past, it was a wonderful choice, but you cannot win every day. We had a wonderful choice and we'll continue going there, but of course, we have felt the impact.

Our terms of trade fell 25 percent during the last quarter of 2008 if

we compare to the last quarter of 2007. The values of exports dropped at a similar rate. In 2009, our partners will experience negative growth of nearly 1.5 percent. These are big shocks indeed, and that is the bad news.

The good news is that we spent the last decade preparing to face such shocks. In 2006, we passed a fiscal responsibility law that gives our fiscal policy a long-term approach. We spend only permanent revenues and save windfall income, for instance, from copper, in two rainy day funds.

Please allow me to give you just one piece of information: Our sovereign wealth funds hold today more than \$20 billion. Can you imagine what enormous political will it takes to accumulate such funds without succumbing to populist temptations? Or, how I said in the past, how much more popular I would be if I would be populist?

In the two years ending in December, 2008, we have earned more than \$2.3 billion, thanks to present and transferent administrations. Our funds hold no corporate bonds and no equities, and as a result, they may be the only sovereign funds on the planet that have not lost money during the crisis.

All of this has earned us recognition from abroad. Just to mention one example, the Swiss Institute for Management Development, IMD, ranked Chile as one of the countries that is best prepared to resist

external shocks. Chile was placed not only above the average of emerging countries and above Latin America, but also above China and the average of advanced countries of the OECD.

But what about stimulus policy? On January 5th, I announced with the Minister of Finance our fiscal stimulus package for 2009, equivalent to 2.8 percent of the GDP. According to IMF figures, it is the fifth-largest in the world as a share of national income.

This package was designed to inject resources directly into the pockets of the most deprived families, to promote employment by increasing public investment and granting subsidies to youth employment, and to encourage private investment with temporary tax rebates. Since January, we have added a number of complementary economic incentives. First of all, I will have to tell you that, as I said before, last year, we decided for this year our priority will be how we respond to the crisis and how we respond to the crisis so that the crisis won't hurt the more vulnerable families and how we work to respond to the usual unemployment that exists during and after the crisis.

So we have been doing all of this, and I'm telling you, but it is not just a big announcement. We are working every day in the field, in the region, following the money and the investments, I would say -- following employment and unemployment really into great details.

I am saying it really because I myself have been traveling to all the

regions, discussing with the regional governments, seeing if it works or doesn't work. And, if doesn't work, why? And we have added different initiatives that were necessary, because, for example, we were assured liquidity but banks were not lending the money to the people. So that's why we decided on the first stimulus plan. But then afterwards, if they have new things that we needed to improve and to change, we have been doing so.

So as I told you, after January, we launched a lot of other initiatives. In March, for example, because of the problem with access to credit for consumers, we launched the pro-credit initiatives in an attempt to increase access to credit for consumers and for smaller companies and to strengthen the capital market.

In April, in a historic agreement with labor and business leaders, we launched a number of novel labor market mechanisms to discourage layoffs and stimulate worker training, because at the first, we decided on a lot of money, \$700 million, for public investment in order to generate more employment. We know that in Chile, 8 of every 10 jobs is produced by the private sector. So we said, okay, let's try to generate employment, but let's protect the employment that is already there and let's protect the workers that sometimes will be unemployed.

And, in May, I announced an additional bonus payment for low income households and an insurance system to keep students from

having to quit college in case a parent should lose their job. This was made for us. We have said we are going to be a developed country in the future, and people and youth, our human capital, are so important. So it's not possible that because the parents lose their job that the students have to quit university. We developed a special system in order to assure that.

But fiscal stimulus is not the end of the story. I should also mention the consecutive cuts in interest rates applied by the Central Bank of Chile since the beginning of 2009. Only one other central bank in the world has cut the target rate as much since the beginning of the year. In short, we have acted decisively and committed resources.

Forgive me for saying that this manner of facing a crisis is unprecedented in Chile and, I don't know, maybe in Latin America. I don't mean to be arrogant, but I think it was a pretty new way of doing things.

Why are we able to act like this today? Because we have acted responsibly in the past. We have the resources for this plan. I am sure many countries know what they have to do, but they don't have the resources to do it.

And we don't have the resources by accident. It's not an accident. It was a decision, a political will to be able to have resources for the moment when the economy won't go very well.

But we did not only think that it was so unjust that the workers, the poor people, the more vulnerable ones should have the impact of the

crisis. So we not only maintain social expenditure, but we increase it.

We have shown that responsibility in politics pays and pays a great deal. At first, one witnesses pressure from all sides, I would say, not only from the opposition but also from the friends who thought we have a lot of money and let's use it now. Of course, there is a high cost to be paid if one resists those pressures. It is tough indeed. But after a while, responsible behavior starts to reap its rewards.

Chile could not be immune to such a deep crisis. We knew that full well. After having achieved an annual growth rate of 4.2 percent during the first three quarters of 2008, growth dropped to only 0.2 in the last quarter of the year. And during the first quarter of 2009, there was a contraction of the economy of 2.1, if you compared it with the same period of the previous year. But in spite of those figures, we are committed that we will overcome this crisis.

Several markets which have slowed down, among them real estate sales and construction, have begun to show signs of recovery, and I believe we will be seeing further signs of recovery in the second half of this year. We will keep our strategic bets to be well prepared for the post-crisis world. We have done this not only by increasing our budget for innovation and technology adoption. We are building clusters around key export sectors, striving to take advantage of our competitive edge in certain niches.

We will also continue investment in education, human capital accumulation and worker training. In the midst of this crisis, the Chilean Government is increasing four-fold each year the number of students who go abroad to pursue post-graduate study. As a matter of fact, in the United States, we have two kinds of programs: one called Equal Opportunities, that we designed with the government two years ago, and one with California, Chile-California plans, and we send abroad a lot of our students.

I don't know if Minister Velasco told you because when copper was very high, we developed a special fund called the Bicentennial Fund. This is not a sovereign fund. It's another. It's \$6 million whose interests are to send our students to study abroad.

Why I tell you this is because in the past, in the '60s, we signed the first Chile-California program. We went there to ask for scholarships, to ask for credits, to ask for a lot of things. Now we have a more partner-to-partner relationship because we were responsible. We decided to invest in our people. And now we can send abroad a very high number of students that will help us to improve the capacity of our human capital and the capacities of our universities, and then we really could meet the goal of being a developed country in the future.

We also developed innovative energy policies aimed at promoting less contaminating energy, and this is one of, I would say, not the more

relevant but a very relevant area of cooperation with the United States. Some hours ago, we just signed an agreement between the National Commission of Energy and our Minister of Energy, and this is one of the areas where we are going to work with Obama's Administration very strongly. And I always say that if we have trillions and trillions of dollars being used to respond to the crisis by identifying or developing new ways and new technologies in order to also tackle with climate change, we'll be doing things great.

As a result of the visit, as I told you, the United States and Chile will make progress together in solar energy, ProEx in the north of Chile. I don't know who -- I mean, not the Chilean ones but the rest of the people who have ever been to the Atacama Desert. Well, it's the driest and some people say the desert is where you can find more solar energy. So we're going to have great plans there.

Well, dear friends, let me end by asking: What is it that we have learned from this crisis? Very briefly, of course.

First of all, we would need to change our mindset to understand that the time has come for the state to act.

Second, even in the midst of the crisis, we must keep our eyes trained on the future. Growth will resume when trust has recovered, when people start investing again and when families return to their normal consumption pattern. Of course, there are no magic formulas to this other

than trying to make markets function properly again.

And, third, when I said that we need the state to be active, I meant not only in the restrictive point of view. I was always thinking multilaterally because I think the response is global, and if we don't respond globally it's very difficult for any country at all to solve their problems completely. So I think we still need to go further.

And when I said the post-crisis world, I meant also the post-crisis institutions, because Bretton Woods institutions were wonderful for after the Second World War, but now it's time to introduce all the changes of a new world, where you have a lot of emerging powers who were not as strong in the past, and now you need to incorporate it more vigorously in the institutions. And we need to find ways of how institutions can, I would say, have early warning systems, prevent this sort of thing, and also have quicker response.

Also, I would say have more transfer and more democratic ways of organizing. I think we need really a reform of the institutions, even though I have to say I understand there are times for things and times for other things.

I always say, because we are an earthquake country, that if you have an earthquake right now -- don't get scared. It's just symbolic. And the building comes upon our heads. Probably, the first thing everybody, the police and firefighters will do, is rescue us. But then you will have to

build the building again. Of course, so there is a time for rescue plans, but there is a moment also for building a new infrastructure, a new institutionality that will mean that in the future an earthquake won't bring the building down.

I think it's the same thing with the crisis. We need to do both things because sometimes you feel people are thinking "No, we have to do A" and the others say, "We have to do B." We have to do both. We have to rescue, to help the economy recover, but also we need to make the changes in institutions that will assure us, assure our peoples, that things like this won't happen again or, if they will, they will be made better prepared for it.

I would say, third, we need strong political will to make hard decisions when we have to, to avoid getting carried away by pressure of all sorts, and to convince the population that the chosen road is the best for everybody. And I say that because, as I mentioned before, when we developed this policy of fiscal responsibility it was neither populist nor popular, it wasn't very popular at all. But now people understand that was the best choice because now we have what we need to do what we have to do.

As I said, being popular is not the same as being populist. But I think it's more serious, responsible and, in the case of Chile, it works. So thank you very much.

(Applause.)

MR. DERVIŞ: President Bachelet graciously agreed to take one or two, at maximum, two questions, but the first will be from Mauricio.

MR. CÁRDENAS: Thank you very much, President Bachelet. It's an honor to have you here, and it was a great speech.

You talked a lot about Chile, and Chile is certainly the best house in the neighborhood. It's in very good shape. I wonder if you want to talk a little bit about the neighborhood, about your views on Latin America, especially the issues that you're probably going to touch upon in your meeting with President Obama, the agenda that you see for the region, where Chile can play a role in terms of bringing the U.S. closer.

And I'm thinking of issues like free trade agreements with countries like Panama and Colombia. I'm talking about or thinking about the energy initiative and how the U.S. can do more on that. Cuba is another front, although I don't think the U.S. is going to do much more about it in the short run. Anyway, your thoughts about the region and things that you can mention outside the Chilean issues.

PRES. BACHELET: That was a very long question, Mauricio, I must say. Well, I'll try to do my best.

Well, first of all, maybe one or two words about Latin America's general situation, not only about the crisis. First of all, Latin America has been a region where we have developed, I would say, democratic

development. Also, for the last half decade, all the countries have been growing a lot, have a very important economic performance, but not only economic performance, but we have been also asking did we get good results, did we think about the millennium development goals? We have been able to tackle poverty, I would say, as fast as in many, many years. So I would say this Latin America before crisis was a Latin America that was growing, that was consolidating democracy. Even when there had been political crisis, democracy didn't go down. So, I would say this is another Latin America, and I think this is very important, because it means that this Latin America is much better prepared for the crisis, too, even though having said that, I have to recognize that of course, nobody is immune to the crisis, and there are many countries where economic problems are there, and one of the concerns that I have is all these efforts made in order to improve the quality of, the dignity of life in a region could, how could I say, have a relapse because of the economical crisis.

So, I think -- I say this, because one of the things that we have been pushing a lot is not because my friend here has come; it's that we -- in every international forum we were pushing that -- when the G-20 decided to capitalize some regional banks at the beginning, they said only Asian development bank and we said no, we need the inter-American development bank to be capitalized, because we really need to help those

countries who, because of the lack of resources, are not in a situation to develop countercyclical policies or develop a stimulus plan.

So, this is something very important, and we believe it has to be done with more strength, because there are a lot of countries in Latin America that have had a lot of problems. And unfortunately, this is a sum of problems. For example, when we were in Trinidad, Tobago, one of the problems for the Caribbean countries is climate change. Some of them have had three or four hurricanes in a month, tourism was going down, and tourism is one of the main areas, initiatives of the economy.

Or talking with Felipe Calderon, president of Mexico, he already had the impact, because of proximity with this country and the strong bonds in the economy gives an important impact.

But then comes the flu, and the tourism has dropped a lot. So, there have been problems, but of course, we're all dealing with that.

But what I mean to say that this Latin America is a much more mature Latin America, and I think it's good to say, because sometimes you feel that in United States, they have a little bit of a prejudice about Latin America, and I think this is a region that can be partners. Of course we have diversity, and different opinions on how we deal with which is the role of market, which is the role of the private sector?

As you know, Chile has made a choice, and we believe in PPP -- Public Private Partnership. We believe that we both have possibilities and we have to work together. But the other countries will have some differences. It's okay, because we understand that unity has to be done within the difference, within the diversity. We have to integrate to solve our problems that are common, that we have our own ways of doing it because our countries have different political traditions, legislation, some cultural differences and so on, so it's natural that we have differences. But we can work all together, and that's what we have been doing in UNASUR -- 12 countries working together to find out special challenges to put together all of our capacities or synergies and see how together we can have a more coordinated and better response than from the isolated efforts of one country.

I think that, looking at the United States on Latin America, I have to tell you that one big step is already done, because the presence of President Obama in Trinidad, Tobago was -- and not only his presence, his message to the region -- was a very well welcome one, because he was very clear to say we want to be partners; we want a constructive relationship with Latin America and the Caribbean countries, and we don't want to impose anything; we want to have a strong political dialogue; sometimes we will agree; sometimes we won't agree, but we want to have this more partner-to-partner relation. I think that was so well received by

everyone. Everyone was saying this is the kind of relationship we want to be involved in.

And that doesn't mean that there will be always honeymoons. I mean, honeymoons -- unfortunately, they last not very long, no? Well, some people live in a permanent honeymoon. That's a miracle. But what I mean is that I think right now, there are the best conditions to have a close relationship between United States and Latin America. But, as I said, honeymoons don't last too long. So, we are near to developing a program, a cooperation program -- I've read what Hillary Clinton and President Obama have defined as some areas of cooperation, and I'm sure this will be part of our conversations a little bit later.

I know that for President Obama, energy is one important area where he sees that we can create a lot of important cooperation. But I also believe because of the challenges of Latin America, because we were tackling poverty but now with the crisis, we might not only not be able to advance but also to relapse, I think that the social programs fighting against poverty and bringing more opportunities to everybody are also a very important area of development between the relationship of the U.S. and Latin America.

The third area that I think is important is related to the challenges that we have in the region. I mean, every country has challenges of improving their economies, of developing employment, and

many of these, to be more competitive, more productive. And in order to do that, you need also to have more cooperation in areas related to human capital, education, innovation, and technology, and so on.

So, I think if we find a very important agenda in the framework of American states organization, in the frame of the U.S. -- the region -- or in different areas, I think that we will find a much closer relationship. But one of the things that Latin Americans have always felt about U.S. -- they feel that when Latin America was a field where you had a lot of revolutionary process, Latin America was in the scope of the United States. But when democracy is everywhere, it looks like we're not threat anymore, we are not important anymore, And I believe in the words of President Obama that Latin America and the Caribbean are looking to be some interesting partners that we can build things with and not relate to only because you have problem.

It's like we're always fighting with the people in Chile that speak of youth programs as "the problem of the youth." Now it's not the "problem" of the youth. It's not the "problem" of Latin America. There are a lot of capacities, challenges, possibilities, opportunities there. Let's work together in that -- I mean, it's a different scope, a different perspective, that when we said change mindset, it also means you could look at Latin America in a different way, because otherwise you will be losing a lot of opportunities.

We, as a country, you know, have developed a lot of FTAs with more than 66 countries. Four billion people market there, and we believe that FTAs are a great opportunity for countries. And I'm not going to say they're anything that is a secret, because I personally have been involved in calling and talking to members of Parliament to say that I think that the FTA for Colombia and Panama should be a possibility. A priority that should be considered. Of course when you negotiate FTAs, you can put a lot of considerations there, goals and so on, but it is important, because it's in the favor of the people of Colombia or of Panama.

What else. There's something else?

Just a general thing. UNASUR has been very successful not only because we have been able to develop specific counsel to deal with specific issues -- infrastructure, social cohesion, health, defense areas, financial issues -- but also because we have been able to be very active with other organizations -- inter-American states organization, for example, to deal with political problems. And when Bolivia was in these political difficulties, we met all the presidents in Santiago, we made a statement [Spanish], and we offer our best efforts to be able to go with the process of helping government and opposition to sit together and to find positive, democratic, specific ways of dealing with their differences. And every time it has been needed, we have been doing it.

So, even though we do not stand against other institutions, we believe that we can make something important, too. We can help our own subcontinent, subregion, to have good response for that. So, I will tell you, Latin America's a very -- and South America in particular -- but Latin America -- Chile's going to be in the head --I'm the pro tempore president of UNASUR. I will be leaving this position in August, and President Correa of Ecuador will be the next president pro tempore, but we're going to lead the group in Rio at the beginning of the next year. What I'm trying to say with that is that Latin America is very active, organized in themselves, trying to be part of the process internationally and regionally.

So I think we have the best conditions for a major step in the relationship between Chile and the U.S. to develop important I would say corporation plan in all areas -- political, economical or social, and so on.

MR. DERVIS: Thank you so much, President Bachelet, this was a wonderful speech, and then followed by almost another speech in response to Mauricio's complaints and question. So, I thank you all, the audience, but particularly of course President Bachelet; Andrés Velasco, who gave us a very focused view on his own country and on the crisis; and my dear colleague, Mauricio, for organizing this, and all of you for being here.

Let me just say that I think maybe the worst is over, but we don't know yet, and as we all said, if the suffering cannot be countered,

the political problems may become much more serious. So, we need the kind of leadership that President Bachelet gives. We need the leadership also of the United States, of course, and of that partnership.

Many, many thanks.

Please be seated. President Bachelet will leave first, and then we will all leave afterwards.

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CERTIFICATE OF NOTARY PUBLIC

I, Carleton J. Anderson, III do hereby certify that the forgoing electronic file when originally transmitted was reduced to text at my direction; that said transcript is a true record of the proceedings therein referenced; that I am neither counsel for, related to, nor employed by any of the parties to the action in which these proceedings were taken; and, furthermore, that I am neither a relative or employee of any attorney or counsel employed by the parties hereto, nor financially or otherwise interested in the outcome of this action.

/s/Carleton J. Anderson, III

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