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LATIN AMERICA ECONOMIC PERSPECTIVES:
IS THERE A FUTURE FOR FINANCIAL AND COMMERCIAL INTEGRATION IN LATIN AMERICA?

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P R O C E E D I N G S

MR. KAUFMANN: Buenos días, good morning to you all. It is really my pleasure and an honor to kick-start this exciting session with such an eminent panel of both experts and presenters.

The presentation and discussion will focus on the 2012 edition of the BLEP series which is being released right now. And, by the way, I should introduce myself, just to day that I'm Daniel Kaufmann, from Brookings, the Global Economy Group.

And you, hopefully, all received this impressive document. It's just out now. The BLEP, which actually stands for "Brookings Latin American Economic Perspectives," it's the fourth edition, and it analysis economic and financial trends in the region. That's the general approach from every series. But this new edition focuses in particular on the prospects for stronger financial and commercial integration ties among Latin American countries -- which, the report argues, it would shield the countries in the region from a volatile world growing slowly nowadays, and also have some other advantages, which Eduardo will present much better than I would do.

We have in front of us five "eminencias" here. And I say it in Spanish, because the word "eminencia," I think is so much more telling and powerful than saying "eminence" or just "expert," in English.

It is my duty that I've been given and asked for to introduce the main presenter, Eduardo Levy-Yeyati, and the moderator and panelist, Alejandro Werner -- who, Alejandro, after I step out, will moderate and provide comments, as well. And then that will be followed by the other eminencias. They have all promised, as far as I understand, that we will have a very interactive session, with real debate, which is what we usually do at Brookings, and it's very important. Actually, it's what we usually do throughout the Massachusetts Avenue corridor think tanks.

Let me say a few words about Eduardo Levy-Yeyati first. There are many details in the handout for everybody, so to save time -- because when we have eminencias, the bios can be very, very long and very impressive -- I will just say a few things, that Eduardo is a non-resident senior fellow with the Latin American Initiative here at Brookings, a professor at the Universidad Torcuato di Tella in Argentina, and Buenos Aires, where he also directed its Center for Financial Research. He was also a director of economics at CIPPEC, which is Argentina's top think tank, was the head of Emerging Markets and Latin American Research at Barclay's Capital, and chief economist of the Argentinean central bank.

Eduardo, can you raise your hand? Eduardo is seated in the middle there, and you will see his presentation very soon.

In the far left from the audience side is Alejandro Werner, who is a top executive at BBVA Bancomer, where he oversees investment banking. And before that, he was professor at the Instituto de Empresa in Madrid, Spain, also served as deputy minister in the Mexican Ministry of Finance, and headed the research department at the Mexican central bank, and at the Ministry of Finance, where he also had many other senior positions. He was also recognized a number of years ago by the World Economic Forum as a Young Global Leader.

After Eduardo's presentation, which I know is very interesting and substantive, Alejandro will formally present the three other panelists, José de Gregorio, Santiago Levy, and Moisés Naim. Even if none of them need a lot of introduction, frankly, but since they are eminencias, and happen to be my friends, as well, let me take this opportunity, without formally introducing them, to challenge them up front on a couple of dimensions, before I step out and let Eduardo take over.

And the challenge, I guess, is for the whole panel, including also Alejandro and Eduardo. And since this excellent report, the focus is on regional integration, then an obvious first question is going to be whether the potential gains from integration are likely to be as vast as some analysts and experts may think?

Let's keep in mind that we think -- and being a Latin American myself -- we think very highly of our region. It's extremely important. But we are, at the end of the day, in the single digits on almost every dimension, in terms of share of the world economy -- also in terms of population, in terms of, exports, in terms of FDI, in terms of GDP. So in an increasingly globalized world, what is the extent of potential global gain of internal integration among the countries within the region, versus the rest?

Then, I'm sure, there are going to be also the questions of correlation versus causality. We all know -- and it is part of a literature, it's also in this good report -- that associated with increasing integration, regional integration, for any region in the world, one finds a correlation with lots of good things in terms of economics, including growth and so on. But, as economists, we always say that causality is science, correlation is superstition. So the bottom-line question is, is there strong evidence of a causality, a direction?

And then, since it's one of my pet issues, I will end with one other question, it's about how realistic is significant additional regional integration in our region, given the political economy and the politics nowadays? Isn't it the case that one of the many impediments so far for additional integration may be the troubling governance and institutional picture in some, particularly in some prominent Latin American nowadays? If it is the case that the large share of the regional, the countries in the regions have a governance deficit that may impede integration and longer-term sustained growth even at the country level?

I will not go into details. People like Moisés may have comments about the blatant case of Venezuela, which is well known. And he will probably mince no words about other countries -- I hope. And even José de Gregorio, because you're not anymore the head of the central bank of Chile, but you're more in a private capacity -- may even comment, will be interesting to comment about Chile, which is also my country. I don't know whether we may share the sense that, relatively speaking, it's a case study in relatively good governance. But even there, there are clouds on the horizon, and some political economy challenges and governance challenges nowadays that may become serious impediments to the required reforms to lift its growth rate.

What about Mexico -- which Alejandro knows so well, and which Santiago knows so well? The report is to be commended, in fact, for including in this BLEP an interesting table and graph on the economic cost of violence in Mexico, the 1 percent a year in terms of GDP growth that is lost. But at the same time, it will be very important to hear whether that continued challenge in the corruption/narco-violence nexus may not become a major obstacle for country economic progress, or FDI progress, and for additional integration.

And, finally, to Eduardo, a question -- who is about to present. Let me state the obvious regarding the governance elephant in the room today, since many people are attuned to the news of the week, of the day, namely the Argentinian expropriations of Spain's Repsol stake in YPF. The President of Mexico, Calderón, has already sharply condemned it.

So Alejandro may also have comments, and Santiago may have comments. Is this just a blip that ought not be taken out of proportion, ought not be exaggerated? Maybe something that it made sense? Or is it a rude reminder that governance does matter, and does differ very vastly across countries? And in that case, wouldn't that affect also the prospects for continuing integration, if those aspects of governance differ so vastly across countries?

Let me stop there, because we have such an exciting panel of eminencias. And I will give them now the floor for their presentation, which will last about 15, 20 minutes, with a PowerPoint, and a lot of data that Eduardo has in stock for us. And then the panelists are going to have their remarks, their comments, and then the floor will be open for everybody to discuss in an interactive fashion.

Thank you very much.

MR. LEVY-YEYATI: Thank you for coming. Since I have 20 minutes to present 80 pages, I need to be selective.

But before starting, I want to give you sort of a perspective of the whole BLEP, which is, as you see, quite comprehensive.

This is the fourth BLEP, and typically, our structure is similar to this scheme we have in the first slide. We have the first pages, in which we look back on what happened in the last six months -- essentially windows in which we show the data, and try to single out particular trends.

Then we have a new section that updates what we call the "Global Wind Index," which is a way of measuring how the three main global drivers -- risk appetite, global growth, and commodities -- affect a big chunk of Latin America. Because we're referring to, essentially, the commodity exporters, the big countries in Latin America, LAC-7. And this (inaudible 00:12:19) to introduce my main presentation. But, you know, this is the second section in the BLEP.

Then, typically, we have a centerpiece that tries to tackle one or two topical subjects from a forward-looking perspective. And this time around -- I mean, there we have already talked in the past issues on macroprudential policies, exchange rate policies, Dutch disease, these types of things.

And in this issue, we picked a subject that I think is long overdue, something that I would say a fad, or quite popular in the '90s and, as you will see, not only the subject, but the whole process of regional integration remained stagnant during the 2000s. So we thought that, in the current context, it was worth having a second look.

And to finalize the BLEP report, typically, presents an in-depth analysis of the key countries in Latin America, prepared by real experts, really, local experts. And we are always honored to have some of the key, some of the top-notch economists doing our work. And some of them are here. Alejandro Grisanti just arrived. He covered Venezuela. Alex Werner covered Mexico -- and so forth. There is Rafael Romeu -- now we are introducing, also, a coverage of Cuba, which is particularly topical in these months. And Rafael was the one that actually helped us with that.

So this is the complete structure of the report. And, as I mentioned, I had to be selective. I will focus essentially on the core section which, this time, speaks about, discusses the scope for further regional integration, and tries to make the case that there are at least two dimensions in which further integrations may be helpful for these countries in the current context.

Let me go through the main arguments first, and then I'll show you some charts. And I'll try to make the point using data, the points that are made more specifically, more thoroughly in the report.

The line of this story is essentially this one: If you look at the world right now, and compare it with the past decade, it looks like the global backdrop is not going to be as supportive as in the 2000s. That's not new. But even for the forward-looking perspective, it doesn't look like it's going to improve significantly, looking forward. What I'm trying to say is that even though nobody expects a collapse on a Lehman, the fact is that the commodity boom, the increasing commodity prices, the level of global growth generally will be below the ones that we saw in the past decade.

And to that we have to add that growth in Latin America has created some demands. So even if we were having this support from the global context, we still need to change our approach to growth, simply because the low-hanging fruits of recovery have been already reaped, and we now have, you know, a growing middle class, we now have more sophisticated demands that -- the standard pattern of, at least commodity-exporting countries, will not be able to meet in the next years.

So, against that backdrop, I think regional trade, regional integration, is one factor that can help remodel or reshape the pattern, the growth pattern, in Latin America. And we have a few arguments that I want to illustrate for everyone.

The first one is that, of course, regional integration has been stagnating in the past decade. I will show you that it didn't go anywhere. But, more importantly, it's starting from a very low level, comparatively speaking. You know if you compare Latin America, either the regional trade agreements, or South America and Central America's regions, geographical regions, with Asia or Europe or even NAFTA -- North America -- then we see that the region has been lagging behind, very clearly. And there are a number of reasons, as we explore in the report.

Another key argument, another argument to advocate for the regional integration, is the fact that trade integration, in principle, at least by increasing hypothetical relation with the region, can link individual countries in the region to a region, Latin America, that is, at least in expectations, is likely to outperform the world. And simply saying that you want to link with the regions in the world that will grow faster.

And, of course, Asia is one of them, at least at the current context. But if Europe and the U.S. are growing less than before, and, you know, are growing at the volatile rates, then having closer ties with Latin America looks more solid, can help mitigate the effect of a volatile global context.

A third argument in favor of further integration is the fact -- and I'll how this, it's very interesting -- the fact that, typically, regional trading is more resilient to global collapses. And we will look at how is this true for Latin America, and for Asia -- particularly looking at what happened in the recent crisis, but also have evidence in the report looking at past crises, past trade collapses, global trade collapses.

And finally, we believe -- and that's maybe provocative, because it's something that has to be studied further -- but we believe that regional trade, through both an effect on the composition of trade, and on the economies of scale, regional trade integration can foster a specialization away from a model that looks increasingly, I would say, "China-dependent," but that's sort of a simplification -- a model that essentially consists of exporting natural-resource intensive products, and importing pretty much everything else. If we look at the composition of regional trade, you will see that regional trade, in principle, has a higher degree of sophistication.

And one could speculate that, through regional trade, these countries can start building a more sophisticated basket of exports, prior to going to the world. That's, in a sense, trying to answer one of Danny's concerns -- you know, how to reconcile globalization with the fact that regional integration is, in a sense, limiting globalization by focusing on the region. This integration may be thought as a first step towards, you know, going out in the world -- something that is not new, actually. I think this is one of the arguments for regional integration, a long-dated argument, actually pushed integration in the '90s and '80s, and particularly in the '90s.

So these are the arguments. And this is the data.

First thing, as an introduction, I mentioned that things in the global context don't look that well. We have many ways to show this, and have many charts associated with this one, but this is sort of a summary statistic. We constructed what we call a "Global Wind Index" to measure whether we have tail-winds or head-winds coming from what we call "global drivers" -- essentially risk appetite, as measured by, say, spreads or volatility. You know, the BEx is one of the typical risk measures, global risk appetite measures.

We have a global growth index that is essentially conflating G-7, growth in G-7 countries and in China -- separately, because they don't tend to correlate so much.

And the third factor is commodities. And you have like a commodity index.

And we but everything together, calibrate to the six largest countries. We exclude Venezuela, because Venezuela is typically characterized by idiosyncratic factors. But the six largest countries, plus Uruguay, we calibrate the index to approximate their growth patterns. And that's what we get, essentially. You know, there are two lines there: One, the smoother one, is the index. The more volatile one is the growth of these countries, essentially -- growth of the region. And it correlates relatively well.

And that tells us, by looking at expectations about these three factors -- you know, risk, commodities, and growth in the rest of the world -- it allows us to sort of depict what we think is going to be the case with the global context in the near term. And the picture is a little bit like that.

And if you look at the period -- there's a problem here, because we don't have the years, but I can tell you which one it is. You can tell it from the big decline, it's essentially associated with the end of 2008, and the year 2009, which is associated with the crisis. Then you have the recovery. You see the pre-crisis level was relatively high, and the recovery period was also high because we were essentially catching up, recovering from the crisis.

If you look forward, the level of the index is still positive, but it's not as high as before. That implies that, as a support, it will be a weaker support than it was prior to the crisis. That means not that this is going to drag down growth in Latin America, it means that it will push much less than before. So, instead of corresponding to a growth rate of 4.5, now we're talking about a growth rate in Latin America associated with this index of 2.5, 3 percent. So we have less of a tail-wind, that's what I'm trying to say.

So, in that context, the question is whether the region can make up for what I call the "global debt calm" -- you know, the fact that you don't have a tail-wind or a head-wind but, you know, just you are coasting by yourself, and the focus turns to local policies and local factors -- or regional factors.

Now, I mentioned that regional trade integration was lagging behind other regions, areas. And here we are comparing exports and imports within either regional trade agreements or areas in 2003 and 2010, just to compare how this evolved over the years. And we are comparing different regions to see, cross country, how that looks.

And the trade agreements are Mercosur, NAFTA. "SA" means "South America," geographical region, just to see whether Mercosur improves upon South American. It's interesting that you see there is no particular, no difference between the two. So the fact that you have a regional trade agreement there didn't imply that we are more integrated in practice.

Then CAN is the Andean Community, the Andean Pact. The MCCA is Central America; it's a trade agreement, trade area in Central America. ASEAN is the Asian countries, small Asian countries. ASEAN+3 is the small Asian countries plus Japan, China, and Korea. And then we have the European Union.

And if you compare, for instance, Mercosur and South America, or the

Andean Community, or the Central America, with Asia and Europe, you see the difference. You see that they are trade integration is essentially less than half of what you find in Europe or Asia.

Interestingly, NAFTA -- and we discuss that in the paper, in the report -- NAFTA actually looks more integrated, but essentially because of the particular trade links between Mexico and the U.S., which we'll talk about this in a minute. But it's an outsider in any respect, because, you know, it's essentially the reflection of a complementarity between the U.S. and Mexico based, among other things, in the very wide dispersion in a variety of factor endowments, essentially -- you know, skilled labor, you know, wages. There is a big complementarity, and it is a particularly strong trade relationship that, interestingly and importantly for our analysis, brings Mexico closer to the U.S. and farther away from what we call the Latin American region.

And one implicit question in our analysis was whether Latin America, in fact, can be thought of as a region, or do we have to concentrate on, say, South America when we're talking about trade integration?

But, anyway, so you see trade is actually, trade links are actually lagging behind Europe and Asia, and have been stagnating, in the sense that they haven't been converging to those levels.

So the natural question is why? And we have a few hypotheses there.

One of them is that our trade links, our trade flows, are essentially final goods, but we don't have -- as is the case, clearly, in Europe and in Asia, particularly in ASEAN plus the three big countries -- we don't have a lot of intra-industry trade, meaning essentially the reflection of industries that are disseminated within the region, and explode the economics of scope, and explode the differentials in factor endowment to trade between each other -- to distribute the production process in different countries of the region.

We don't have that. And we tried to illustrate this fact by, for instance, constructing this standard -- although not particularly intuitive -- Grubel-Lloyd Index, which essentially measures -- you know, the index is essentially high whenever the net exports for a particular good, a particular sector, are relatively low relative to the gross exports. So, in that sense, what it's trying to measure is whether -- if I'm trading, I'm selling to you things from the same sector you're selling to me, which is the case you have that intra-industry trade. You know, the same industry exports and imports from the countries in the area.

So a large, a high number would mean more intense intra-industry flows. And a low number means the opposite.

And if you look at either individual Latin American countries, or a comparison between, say, Latin America, LAC-7, with Europe and, particularly, Asian, ASEAN+3, which is, you know, the big Asian area, we are lagging behind. You know, if you think of Europe, trade in Europe and trade in Asia, it's essentially, for the most part, intra-industry trade. In Latin America, we have the opposite. You know, we sell something to another country, and the other country sells something completely different to us. But it's not the same -- there is no multi-Latinas that trade with each other across the whole area. That's the whole point -- right?

Why? One of the answers that we suggest in the report is that, as I mentioned before, our countries may be not only too small, but also too similar. I mean, why don't we have these corporations, regional corporations, the multi-Latinas? Why are they so few?

Of course, scale is an issue. But also, if you look at the dispersion in terms of income per capita, skilled labor, and wages within each of these regions, you will see that, for instance, the LAC-7 are much more similar than, say, NAFTA or the European Union, or Asia. A larger number means -- a larger standard deviation means that wages or incomes are more dispersed, more diverse. And that means that these complementarities, as I speaking before, that for instance, I conduct, do my labor intensive part of the production in a country that has lower wages, and I do my more sophisticated and skilled-labor intensive section, or capital-intensive section in another country that has skilled labor or higher income and higher access to capital, then in Latin America this scope for diversification, geographical diversification, is much more limited.

So that's one possible reason why we don't have this intra-industry trade that is so typical in Europe and Asia.

Now, there is another hypothesis we proposed in the paper I think is important, it has to do with the whole motivation of the study, and it is essentially pointing at the effect of emerging nations, particularly China. We call it the "China effect," although this is a simplification, because the pattern is also present in the region's trade with the rest of the world. And these charts are trying to illustrate that -- the fact that the region essentially exports natural-resource intensive products, and imports manufactured, essentially imports pretty much everything else.

That's, again, it's a simplification, but if you look at, for instance, the share of manufactures in extra-regional export, for the region is the red line, and you compare this with, say Mexico, which is NAFTA in this case, Europe, or Asia, you see that the share of manufactures that we are exporting to the rest of the world is relatively lower, much lower. And we are importing a lot of manufactures here. These are the imports from the rest of the world to the region.

If you look at the same thing within the region, the trade is much more balanced. So here we have exactly the same charts, but this corresponds to the intra-regional trade. So if you look at what we export, say, for instance, Brazil to the rest of South America, or imports from South America to Brazil, the share of manufactures is relatively equal, although still much lower than before because, again, we are exporting, particularly Latin America is exporting to themselves and to the rest of the world, particularly natural-resource intensive products.

So, composition is an issue here. And the story behind this is that you may think of emerging nations, the demand from China, say, is a centrifugal force against the buildup of this multi-Latina, simply because it's much simpler, or more profitable in the short run, to concentrate on the production of natural-resource intensive products that don't require this degree if regional diversification, or the buildup of big multi-Latinas, big firms that distribute their product within the region according to differential factor endowments. In fact, it's much easier to export -- if you export soy, essentially Brazil, Argentina, will export soybeans to China, and there is no need to trade anything in between. It's just a direct export to an emerging nation. And that me be discouraging the buildup of these big conglomerates that are the basis of intra-regional trade.

I mentioned that one of the arguments for further integration was the fact that you want to have correlation with regions that are actually likely to grow. This is not new. There are a bunch of papers written on this. It's just an updating of an old saying that says that your relation with the countries to which you trade are typically higher than the relation with the countries that you don't trade with.

And here what I'm showing, essentially, is for each of these Latin American countries, each point is a country, I'm showing on the x-axis trade integration, essentially a share of the exports that go to Asia in the first chart, Latin America in the second, and the United States in the third one, and how the share that goes to the region correlates with the cyclical correlation -- correlation of cyclical output with the cyclical output of the region. In other words, an upward-sloping line implies that the more integrated I am, the more correlated I am with that particular region.

And you see it works for the three areas. And, in particular, it is telling me that if I trade more with Latin America, for good or bad, I will be more correlated with Latin America. And if I believe that Latin America is a better trade partner, better looking, has a higher, brighter growth prospects, probably I would like to trade more with Latin America or with Asia, and less with the United States or with the European Union. And to do that, regional integration helps.

I mentioned also an additional reason why we would like to have further integration with the region in the event of a very volatile context, is that regional trade. For many reasons -- some of them are essentially mentioned in the report -- regional trade tends to be more resilient to global trade collapses. What I mean by this is, for instance, if you take the evolution of regional trade -- I'm sorry, regional trade and regional trade flows during, starting from the trade collapse at the beginning of 2009, and move forward, we see that the recovery was much faster for regional trade than for extra-regional trade flows. And the same happened with imports. And the same happened for Asia -- even more clearly.

If you see, the upper line is essentially trades to the region, exports to the region, and the lower line is -- the downward-sloping line is trade to the rest of the world. The trade to the rest of the world didn't recover after the fall. This is starting right at the bottom of the collapse. Whereas the trade flows to the region recovered rather rapidly.

So, in a sense, if we are in the middle of, if we are in a world in which another trade collapse, or trade flows in general are subject to this external volatility, for some reason our regional trade is a little bit more immunized against these shocks. We can count on our neighbors for a number of reasons, including, probably, the fact that, you know, trade credit and trade finance is easier within the region than internationally. There are a bunch of potential hypotheses that explains this.

But the fact is that, you know, regional trade tends to be more resilient, more robust in the case of global, big global shocks.

Why don't we have more trade integration in the region? That's something that we tried to answer at the end of this first part of this section.

There are number of hypotheses. Institutions are one of them. We don't touch on that so much, but I know that José de Gregorio has worked on this and, in fact, has a paper that has some similar (inaudible 00:34:58) compatible to ours. And I think he focused on institutions and governance as part of the reason why we are lagging behind in integration relative to the rest of the world.

We proposed a few other potential candidates to explain this. We need to understand the reasons if we want to actually further integrations.

And one of the reasons I mentioned before -- you know, the attraction of emerging nations, or China, if you look at how the composition of exports, this geographical composition has changed over the decade, you see that the only one that's actually growing very rapidly is the one, is the share that goes to Asia. And that chart, I have to add, includes Mexico. If you take out Mexico, this is even clearer, because Mexico actually has a very strong share, a very high share goes to the U.S., and it's been growing.

So, one question would be, one topic to debate, at least, would be whether the short-run appeal of selling to China is working against our long-run benefits, in terms of further trade integration? And if some policy action is needed to correct this possible distortion, in the sense of creating incentives -- these centrifugal incentives -- to produce natural-resource intensive products, and concentrate increasingly on a particular region?

There is another aspect that we emphasize in the discussion; it has to be with leadership. And there is a long discussion, and to make this discussion shorter, I wanted to show you this chart, essentially comparing what is called the "trade interdependence" of, in this case, the largest economy within the region. Particularly, the question here is why isn't Brazil more interested in furthering, in strengthening trade links within the region, being Brazil is the largest economy -- within South America, at least?

And we compare the trade interdependence of Brazil, in this case, which is the bolder line, the blue line, with the same measure for each of the other areas. And particularly important, look at the light blue line, and this one here --I don't know, it's also blue -- that corresponds to Germany.

What is trade interdependence? It's a complicated formula that essentially measures the ratio between what I export to the rest of the region, over what the rest of the region exports to me. And if I am exporting a lot to the region, like in the case of Germany, for instance, I would be more interested -- or that's what the hegemonic theory of trade integration postulates -- I would be more interested in ensuring that it has institutions and the arrangements to facilitate integration. Whereas if I don't export a lot, or if, essentially, I receive exports but I am exporting somewhere else, like Brazil for instance, probably due to the increasing importance of China in its trade flows, then I simply don't care.

And one question is whether, you know, this actually is working against further integration, or whether, again, some policy debate should be done to make the leader care (inaudible 00:38:20). And this, in fact, in the report we show another chart in which the second largest economy in the area also presents the same pattern. Argentina also doesn't care. So it's essentially the same thing, you know. Argentina is exporting a lot to the rest of the world, particularly emerging nations. So they don't care so much about furthering and enlarging the market -- the Mercosur, in particular, and South America, in general.

So there might be some political underpinnings to these underwhelming results in sort of regional trade integration.

So the arguments, again -- just to conclude this part of the section, of representation -- regional trade integration has been stagnant, and it's been lagging behind other areas, particularly Europe and Asia, but also North America. I mean, there is an obvious question whether North America has to be considered an area, whether Mexico belongs to Latin America or North America -- something that I probably would like to leave for Alex to discuss.

But, you know, if you look at trade flows, clearly Mexico and North America -- sorry, Mexico and the U.S. constitute an area that's comparable with Asia, and it's far and away much intense than the rest of Latin America.

The second argument -- trade integration can link output to the winners, assuming that Latin America will be among the winners, which is conventional wisdom right now, but, you know, you never know. But, in principle, you should -- we would say that Latin America looks stronger, looking forward, that Europe or the U.S.

The third argument -- regional trade is more resilient to global volatility in trade flows.

And, finally, regional trade, through composition and economies of scale, can foster specialization away from this China-dependent model that has characterized the past decade.

Those are our arguments for further integration. Our conclusion, at least, is that we should, I mean we should have policies that specifically try to strengthen regional trade.

The second part of the core section, which I will go over very quickly, tackles another dimension, very specific dimension, of regional integration, which is integration of reserves, very simply, or integration of global safety nets -- I'm sorry, the integration of safety nets. You know, the buildup of a regional safety net.

The global safety net, the financial safety net, essentially refers to the presence of an international lender of last resort that can provide liquidity in the event of a global financial collapse -- something that the IMF has been trying to do for the past 10 years, and more recently has been trying to improve on facilities that provide this liquidity, this emergency liquidity, for countries that suffer the contagion from financial crises elsewhere. All right? All these flexible credit lines and global stabilization mechanisms that have been proposed by the IMF are trying to fill that gap, presumably to deter the very rapid accumulation of precautionary reserves in emerging economies.

Now, the question with IMF, something that has been discussed even in our BLEPs before, is that because of moral hazard considerations, those facilities are not strictly automatic, so you have to request that. And requesting something from the IMF has a strong political stigma so, ultimately, these facilities, although they have been improved over time, they haven't been used, or have been used very scarcely. So if something is not attractive from a political perspective, it's not going to be used during a crisis, then it's almost as if it were not there.

Now, where is this discussion right now? Well, even in some of the most recent proposals by the IMF, the institution recognizes that the next step is -- that this is as much, as far as they can go, and the next step has to be the articulation of these, whatever safety net the IMF can propose, with the regional arrangement that's up and already in place in Asia, in Latin America, and probably, due to the recent crisis, in

Europe.

And this regional integration requires to have, you know, a regional agreement which, you know, countries within a region pool reserves, and possibly go to the IMF, or some of the international financial community, to get emergency assistance if those reserves that are pooled are not enough during the crisis.

So, the question is whether there is scope for further integration, for deepening of these regional pools within the region. There is one there, and the whole section, this whole (inaudible 00:43:14) actually refers to that one, which is the Latin American Reserve Fund, the FLAR, which is already working. It's very small. It comprises a few Andean countries. But that, in essence, is a symmetrical reserve pool. Countries commit a given amount of reserves, are allowed to withdraw, to borrow for up to 2.5 the amount of reserves that are committed -- right?

Now, I believe that this can be deepened, this FLAR, the Latin American Reserve Fund, can be extended to include all Latin American, or at least South American countries, and can be made more reliable by having some big countries as lenders within the fund. If you compare the Latin American Reserve Fund with the Asian peer, the Chiang Mai Initiative, which is, again, is a network of central bank currency swaps, in which, clearly, there are two or three countries that are lenders within this scheme -- you know, China, Japan, particularly.

Then one thing is very obvious, if you look at FLAR and compare it with the Chiang Mai Initiative, is that if there is a crisis, all countries within FLAR will need the reserves at the same time, and if everybody is allowed to borrow 2.5 of whatever they committed, simply there are not enough reserves for everybody. So that's one of the key flaws of the FLAR, something that actually the people at the IMF have been pointing out when Latin Americans try to make the case for a better FLAR.

Now, we acknowledge that problem, which we call the "correlation risk" effect, that reserve declines are correlated in case of a global crisis. But we tried to make the point, also, that there are advantages within these pools that can be exploited, even though there is this limitation of the absence of a lender of last resort -- in fact, an issuer of last resort, like Japan in Asia, somebody that can issue, in the middle of a crisis, because it's benefitted by the flight to quality typical of a global financial crisis.

So, I don't have time to show all of this. I mean, the correlation between reserve movements increases during a crisis. It's pretty obvious. You know, if you look at Latin America, everybody was having exchange rate pressures in 2009 simultaneously. So it makes sense to see how the correlation between the reserve changes, increases during the crisis.

The difference between the FLAR and the CMI is that if you put all reserves together, FLAR was losing reserve all over the -- all countries within the FLAR were losing reserves in 2009. Even if we include Brazil and Mexico and Chile, you would have these countries suffering exchange rate pressures, whereas if you look at the CMI, the total reserves were relatively flat during the crisis because Japan was gaining reserves. Because, you know, the yen is one of these safe-haven currencies, and capital outflows from the rest of the regions were, in fact -- part of it, a big chunk of it, was feeding into capital inflows in Japan. So if you pool everything together, the fact is that you have the reserve to lend back. You know, these inflows to Japan can be lent, un-lent to the countries within the Asian fund, whereas in Latin America, we have this problem that nobody is actually, you know, able or willing in that context to lend part of their reserves.

Now, what's a good part of this? A good part of that, it's something that I think needs to be studied much more, the fact that if you look at the financial institutions -- both the Latin American Reserve Fund, and another regional multilateral organization, the

CAF, which is an Andean development bank, and you compare the ratings, the credit ratings, or the borrowing costs of FLAR and CAF with those of each of their members, it's remarkable that the credit rating and the borrowing costs -- the credit rating is typically higher than the best of the members, and the borrowing cost is typically lower than the member with the best access to capital markets.

So, in a sense, multilateralization tends to reduce the -- enhance access to markets and reduce the borrowing costs and, particularly, reduce what's called the "carrying cost" of reserves. If I need to borrow reserves, borrow money to hold reserves, it will be cheaper to do it through a reserve pool than doing it individually.

Based on this tradeoff between the absence of an issuer of last resort, and the fact that you can actually access markets in a better position by multilateralizing these reserve holdings, we made a few recommendations, particularly we proposed that the FLAR should be recapitalized, and it can be, it should be made truly Latin American, or at South American -- I don't know whether Mexico would be interested in joining the FLAR because it has a special relationship with the U.S. But the rest of Latin America, I think, may improve by joining the FLAR, in a way that is closer to the Chiang Mai Initiative, in the way in which some large countries can borrow less than the countries that are more needy, in the case of a global turmoil.

And, of course, one thing that needs to be done is to formalize the rules of engagement, or everybody can -- today, everybody can borrow almost automatically, and that, of course, if you extend this to a large amount of borrowing, can increase credit risk for the whole institution. So you need to have eligibility rules -- something that the Asians are working on right now. The Chiang Mai Initiative typically was accessed through an IMF program, and that actually killed the initiative, since nobody wanted to go through the IMF to request assistance from Chian Mai. Now they realized that, and they're trying to move towards something that's close to an Asian IMF, an Asian monetary fund which is called the Asian Monetary Research Authority, or something like that -- AMRO -- that's essentially the seed for having an institution, local institution to do the eligibility process and the surveillance, and replace the IMF.

But, again, something like that should be done, otherwise, you know, automatic access for everybody can increase, create risks at the point at which the lender can't risk, and will no longer participate.

And, finally, one important thing, I think, going back to the recommendations by the IMF itself, FLAR, or regional agreements like that, can be probably the best and the only vehicle to articulate the international financial community, the liquidity of these global lenders with the countries in regions like Latin America that don't count with an issuer in a moment of a crisis, and issuer within the region. So it would be probably easier to borrow through FLAR in the case -- from the IMF, through FLAR, in the case of a crisis, than asking the countries to go and request, individually, a program, access to the facilities of the IMF.

So -- four recommendations, and finally I close with these two questions that I think are behind, underlying the whole report, which is whether Latin America can, and is ready to work together after all? And whether Latin America is a region?

I think, I have strong doubts about the concept of Latin America, and it has to be revisited whether if you can still think of "Latin America," or we have to start thinking about South America, and Central America, and Mexico in specific ways.

But those are open questions, and we'll stop here. I think I spoke too much.

Thank you. (Applause.)

MR. WERNER: Thank you very much, Eduardo. I think we had a very thought-provoking presentation.

And, I mean, I want to introduce the panel. The panel was introduced as having three eminencias here. All of you know our panelists today. And I think they're pretty well suited to analyze these two issues of trade and financial integration. And I think, hopefully, we will have a discussion that focuses first on the technical aspects on whether -- first, I think we have a policy framework that is biased against integration. I think that might be an interesting thing to understand, if actually policy-makers in Latin America had created a policy framework that actually works against financial integration and trade integration, that I think it doesn't make any sense to bias your policy-setting away from intra-regional issues.

Secondly, I think it will be interesting to know whether it makes sense to bias the policy framework in the other direction. I mean, one of the conclusions that we might think the study brings is that maybe we should strive to sign free trade agreements to extend Mercosur to the whole region, et cetera, therefore creating a policy framework that is biased to generate a larger trade integration. And I don't know if this makes sense or not. So I think that would be another interesting area where the panel should focus.

And I think, also, it will be very relevant to think if we are at a point in time in which trade integration is every actually on the agenda of anyone in Latin America -- if financial integration through policy instruments such as the FLAR are being thought by anybody in the region. And, given what we are seeing in the region, does it make sense to push for something like this?

And I think at this point what we are seeing is that, first, economies in Latin America are being subject to a very different set of stimulus, depending if you are in Central America, South America, et cetera. I mean, part of Latin America is being driven more by the commodity cycle, and part of Latin America is really much more by developments in the U.S.

Secondly, I mean, we are seeing very divergent policy frameworks in Latin America. We are seeing a group of countries who have, I think, taken as a lesson from the crisis that obviously we should focus much more on financial regulation, et cetera -- the topics that were at the core of the international financial crisis -- however, that we should strive to strengthen the openings of some of these economies to provide, I think, an impulse for productivity and growth. And I think there are another set of countries that have taken as a lesson from the crisis that you should even move your policy framework to a more protective policy framework, to a more local base, in terms of capital provision, integration with the rest of the economy, basically to restrict the integration of your economy to the world economy.

So, I mean, inside this framework, I think it's hard to think that you can have the incentives in an important number of countries in Latin America to strive to push for a policy agenda that would look for trade and financial integration.

And then you have even, not only on the ideological front, but in terms of policy implementation, I think some countries in the region have been responding to the international currency wars with -- I would say with local, regional trade battles. So, I mean, in this environment, I think it's actually, I think that this report is very good just to focus the discussion on the other direction, signaling the benefits of integration, et cetera, when we are seeing a response to external shocks, basically on the financial front, with some of these Latin American countries responding with protectionist initiatives against countries in Latin America.

So I think, I mean, making an important argument on the other side, on the side of trade opening and integration, it's very good at this point in time. Because we are gradually moving on the opposite direction, and I think it's a very dangerous move that the region is taking.

I mean, on the financial front, I think, technically, it makes a lot of sense, the arguments we heard on the FLAR. And if we had Eduardo Levy sitting on the board of every central bank in Latin America, maybe we should be discussing that.

However, again, policy objectives of central banks in Latin America are so divergent that if we really want to strive for the objectives that were posed on the presentation, maybe we should be thinking of sitting down and talking with the IMF on a redesign of a flexible credit line, that it's targeted to the objectives that the region wants to achieve. I think we need to import an institutional setup for these types of frameworks that has already been designed by somebody else that has stronger institutional underpinnings than one that we have in the region that is very weak, where extremely divergent policy views are being implemented.

And, finally, I think in all these topis of regional integration, I mean, we have a very divergent set of policy frameworks in the region currently. Secondly, we don't have -- and I'm thinking Europe 20 or 25 years ago -- the pull of, a center of gravity such as Germany, where a lot of the countries, even though not fully accepting all the policy framework in Germany, wanted to gravitate towards interest rates in Germany. So there was a strong pull to accommodate the shape of policy-making in Europe to achieve financial integration with Germany that we don't see now in Latin America.

So, I mean, being, I guess, a little bit negative and skeptical on regional integration being driven by, let's say, a policy initiative now, I think what we're seeing is the private sector integrating much more in Latin America. I mean, we're seeing -- I mean, in Mexico -- we're seeing recently Colombian companies coming in and buying pension funds in all of Latin America, buying one of the largest pension funds in Mexico. We're seeing Brazilian banks looking over the Mexican financial system, in Mexican telecoms going all over the region. We're seeing firms on food and beverages going all over the region.

So I think, although maybe the policy framework will not be fully incentivizing this movement, I think the private sector has realized that for the next decade we will have a very invigorated region, a very strengthening of domestic demand on these countries. We have some common cultural elements. We have important historical relationships. And we have a lot of similarities that makes, I mean, a very logical region to expand your business. And we are seeing this move being driven, I think, much more by the private sector than by policy initiatives.

So I think, along these lines, and maybe the last topic is diplomacy and geopolitical issues in each of these countries. And I think, on that line also, we see key divergences. I mean, we see some countries in the region looking much more to Asia, to China, to the Greeks. Other countries, you know, in Central and North America, looking to the U.S.

And in that sense, also, I haven't seen regional integration, again, not even in the agenda of finance ministers and central bankers. And I think that it's not in the agenda of our foreign ministries, as well.

So, I think we have a lot to talk about on the merits of the policies, but also on the possibilities of pushing again an integration agenda in Latin America, given where Latin America policy-making is today.

Thank you.

So we might start in -- I don't know, let's say in alphabetical order -- with José first. Go ahead -- de Gregorio.

MR. DE GREGORIO: Thanks. It's a pleasure to be here.

It was great to read the BLEP -- what's the -- the BLEP. There are so many acronyms. And this reminds me, because in the mid-2000s I was doing a paper on Latin American growth and no-growth, and I started looking at these same numbers, the comparison of trade, intra-regional trade.

And I was extremely surprised that South America had currently about 20 percent of this trade is intra-regional. That was the standard for Asia in the '60s. And then look at data, Latin America was much more in the '60s, in terms of integration than most of the regions today. I found, for example, that North America, they trade among themselves for almost a third. East Asia, 50 percent, 60 percent, depending on how you measure. Europe, 70 percent -- but for them now, it's 70 percent. And advanced economies, 60 percent.

So I started thinking about this. And all my trade friends told me, well, but this is because of factor endowment, and (inaudible 01:02:25), and reminded me all of the things that we learned and we have forgotten a little bit on trade. And I think that Eduardo has made a very good job even providing some areas of factor endowments and differences across countries.

However, this was 2005, and I thought about two things. First, that poor Bolivar, that always tried to have one region, and integrate the region, and since Bolivar, we haven't succeeded. And I haven't done the research -- it's very difficult to do it, also, because they acronyms, not just the BLEP, there are so many acronyms for agreements that we have in Latin America -- Mercosur, ALALC, ALALI. And when you are public official, you have to go with the guy next to you that's telling you what means each acronym, because you have a meeting with who knows. So it's a, "Who is (inaudible 01:03:18)?" And so they tell you a story that in the '70-something they created this new agreement, and there are some diplomats there. And people say, well, "Bolivar." But we haven't succeeded. And it's a pretty tough question.

And there are things that have to do with -- and you would think -- we don't need too many regressions just to say, well, if countries can trade with their partners, it's kind of the first way to go. And then you start conquering the world.

But then they say, "Why?" So you join all the three complaints, they say because there is no -- I think that I like Mexicans. And Alejandro put it very well; there are "divergences." I think there is no trust in Latin America.

So, this was '05, when Chile had a spike in energy prices because we have some agreement, there is all this discussion, with Argentina gas. And so the price of energy went up in Chile, and there was a huge discussion because they didn't have no gas, or they need the gas for them, and all that. And at the same time, Bolivia said, well, and we will never sell gas to Chile. So -- hey, that's fine.

And then we come today. And today, it's not just Mexican (inaudible 01:04:33) cars we produce in Argentina and Brazil -- despite having a lot of free trade agreements. This is not just this way.

Uruguay signed a free trade agreement, Mercosur, is full member of Mercosur. They didn't go in a trade agreement with the U.S. to be Mercosur because "Bolivar." So at the end, to blame Bolivar, the problem was Bolivar. So they didn't go. And now they have a lot of trade restrictions from Argentina, the partner.

So this is -- it's unbelievable. So I have to say Argentina is maybe right. I don't know. But this, the fact is that it's very difficult to do business in the region.

So where you push it, how you do it -- and it's quite difficult. It's quite complicated, especially because -- the BLEP has a very good point. They say what you do is basically, you integrate manufacturing. So you produce parts in different regions, in different countries. So, but to get stuck with your parts, it's quite a problem, with the corks for the wine bottles of the other country, and to get a lot of corks is -- so, better you do the corks and the bottles and everything. (Laughter.)

So, I think that -- no, I'm very serious about it, because I think that we have -- I don't have -- and I think that Moisés, and people that know more about the politics in the world can help -- but I really think that we are quite special.

Then it happens, the following -- then we go to meetings, to international meetings, and we go to talk about trade integration. And appears a big country that says, no, but the policy that there is a currency war. And all the discussion during three days is whether, in the communique, there will be a mention or not to the kinds of work we were just to reach an agreement to trade among ourselves. So it's quite -- this is what Alejandro has called "divergence." So we have a lot of "divergence."

But I think that it's very difficult to trade when institutions are weak, where there is a lot of disparities, and when there is no -- we cannot build, really build trust. And I think that it is pretty bad. And I think that's pretty bad. I don't, I'm not making a big fuss about this. I think that it's very bad for the region, for the (inaudible 01:06:50).

I am extremely optimistic. And I have to be. Since I'm not a public official, I can say all these things. I'm extremely optimistic about the Chile, Peru, Colombia, Mexico possibilities, and Uruguay. But we have problems even with countries that are so successful, like even Brazil. But to reach agreements that really can have long duration and be very strong.

So I think that this is what disturbed me many years ago, and I still think that it has to be with institutions, with things that go much more beyond the issues about trade explanation.

There is one thing that is also interesting, and I was thinking when Eduardo was talking, it is bad to do commodities or standardized products? We tend to say, well, we specialize in commodities. They are lousy. They are bad. We should do --

like the old thing; we should do electronics -- eh? This was kind of the, so many years ago, very sophisticated electronics, because copper is lousy. But it's quite expensive.

But there is one thing in trade, which is the crisis has shown -- and you can show even, you can see even in the collapse of trade around the world -- the countries that were more hit were the countries more industrial, because they were part of the machine around the world that were producing parts for European, and from here, and Asia was collapsing, and many countries collapsing. But when you produce a bottle of wine, you just, instead of selling in Europe you put it somewhere else. It's kind of easy.

So, I'm a bit, sometimes, I have to say I'm a bit skeptical about -- I don't want to, I just want to provoke a discussion -- I'm a little skeptical about saying these things are kind of low sophistication, they're lousy. And sophistication, for example, in the wine industry, is not to have a -- all wines may be the same at the end, but the distribution, the marketing, it's an amazing thing that you have to do. It's not -- so, just, that way, which is doing pretty well.

And, finally, we get into FLAR. This is the other thing, the Bolivar. Bolivar was first trade, now it's finance. Let's do -- the FLAR story comes from the Chiang Mai initiative, that was -- Asia said, let's get rid of the IMF because they really did very bad with us in the '90s -- this is the standard view of my Asian friends. -- "Let's get rid of. So let's do our pooling of reserves, let's do an initiative, and we do our own IMF." We have never used it, but let's do out --

So they say well Latins; we say, well, hey, let's do the same. They are Asians, and they'll do fine. (Laughter.)

I have some concerns about this. First, do we want- -- and this has to do with -- which I am very critical about the contingent credit lines of the IMF -- do we want to get rid of the possibility of accumulating reserves? I would say no.

Why? Because if we contract a flexible credit line with the IMF, or we have a pool of reserves -- a small pool of reserves compared to our own reserves -- at the FLAR, we won't have the excuse to accumulate reserves and to defend our exchange rate. That's what we do, Latin America, all the countries, or countries that really reserve to prevent a sudden stop, and then we have, and run regressions.

But we want -- one reason -- there is a strong mercantilistic reason for accumulating reserves, which is avoiding an appreciation -- temporary, you will do it in a very rural base in Chile, because we are more orthodox. People do it. But that's (inaudible 01:10:52).

So, accumulating reserves has two purposes: self-insurance, and currency. If we separate these, and we say, well, we have a good insurance, we have great insurance, we lost the ability to say we will accumulate reserves now to defend the currency.

So, first thing, I think that I like to have reserves, I think that we should accumulate all the creations -- and they have fiscal impact, I fully agree, (inaudible 01:11:19). But all of the discussion about finding instruments to have less reserves, it's sort of self-defeating with the currency issue. So we spend, and we have tons of conferences on contingencies.

Second, I had this discussion -- this is an issue that I discussed with some Asian friends, with (inaudible 01:11:41), about pooling reserves. They were much in favor of that.

Then we were discussing governance. How we do with governance? How we do with governance? Let's say, Latin America, we have $2 trillion, $3 trillion we seed on all our reserves are together at the FLAR. And we seed. And then there is a country that says I need the reserves. And then we said we'll do conditionality. We'll put the guys with the black, you know, briefcase go into the country and say, "Well, you have to do this, this, this -- " -- or we'll do it the Latin way. (Laughter.)

So governance is a mess. Governance is a mess. Because then they say "divergence," that my Mexican friend said -- it's the divergence.

There is a country in Latin America that want reserves, not because of (inaudible 01:12:26) or current account, want reserves in order to do more spending. So can now a country come (inaudible 01:12:33), there will be 2 trillion now to the spending.

I had to -- I will recognize that, I don't say the country; there was a forum in Latin America. I receive lot of letters, (inaudible 01:12:45), but they want to pool reserves in order to finance infrastructure. So what are we talking about?

I love FLAR. I think that FLAR and CAF are one of the best institutions, well run, in the region. I think that FLAR is very good to manage reserves, to do technical advice. I didn't do it, but when I was a governor, I tried to get into FLAR because I think that they do a great contribution to the region. I think that technical assistance, we were trying to create a Latin American bond fund, and trying to do some form of integration that is very little scope, but that can help to do better integration than -- we have the Banco del Sur, we have so many things in the region that it really scares me to now say, well, now 2 trillion at the FLAR.

So I think that we can try, we can try hard. But I think that the practical, trying to replicate, we have to think if we really want to build trust in the region, what we have to do is small steps, very humble, but that really help us to think that, despite all the divergence, we can have some common goals.

And that, I think, that will be what will help us to build the trust in order to have a better region, more integrated.

Thank you.

MR. WERNER: Thank you, José.

And before going with Santiago, I think I need to say that it's good to have José de Gregorio back, after many years of being a central banker, without being able to talk -- (laughter) -- and now we have heard him in all his color.

And I think it's very good to have you back with a very clear opinion.

Santiago.

MR. LEVY: Thank you, Alejandro.

Well, good morning to everybody. And let me begin by thanking Eduardo Levy-Yeyati and Brookings for inviting me to the event -- and congratulate Eduardo and all the co-authors for the report.

My take on the report is it makes one big core point, with which I'm fully in agreement. And I think the core point is the next decade probably won't be as favorable to Latin America as the last decade. The tail-winds are going to slow down, and therefore we have to get our act together if we want to continue growing at the rates we were continually growing before. And that's what I think is the big point of the report. And that big point is a big point that I'm fully in agreement.

The report does mention that in previous years Brookings has also looked at other dimensions of this issue, and in this particular issue, they're looking at the integration dimension. But it's important to put the question in the broader context, which is this is a region, for the last 10 years, faced an extremely favorable set of circumstances. The index that Eduardo was showing, this kind of direction of the wind index, it was an extremely unusual set of circumstances, and, you never know, but it's unlikely to be repeated looking ahead.

Therefore, you know, we have to turn to the deeper structural agenda. And that, I think, is the big point.

Would I put integration at the top of the structural agenda for the region? So my take on this is as follows.

I would separate integration as an end in itself -- you know, Bolivar Dream and all that, which I take as really not relevant for the region -- versus a more technical approach, what I would say is what you want is a commercial policy that does not discriminate between countries. And if, at present, your trade agreements, and your tariffs, and your whole setup is such that you're biasing your trade pattern against intra-regional trade vis-a-vis the rest of world, then you should correct it.

When I look at indexes of intra-industry trade, and they say, well, in Latin America it's only 20 percent, but in Asia it's 40 percent, what does that tell me? The honest truth is I don't know. Because I don't know whether the right number for Latin America is 30 percent or 50 percent.

Theory would say, well, the number is whatever emerges from the region's comparative advantage in an unbiased trade setup. So, the positive direction that I would suggest is, do revise your arrangements -- your trade arrangements and, you know, your agreements, your FTAs, the whole bunch of FTAs that we signed over the last decade -- and ensure that you're not discriminating across countries, and you're not discriminating to the possibilities of trade within the region.

That said, there is a very important dimension of trade goes beyond that, which has to do with transport costs and logistics. A lot of what might not be reflected in the data is transport costs within the region are very high, and that has been because of insufficient investment in infrastructure. And then what Eduardo is probably telling us is the region should probably invest in a lot more infrastructure internally. It would lower transport costs internally, so that moving goods from Brazil to Peru -- you know, think of the distances, think of -- you know, "Peru" really means Lima, and Callao really means the coast, so you think you have to go over the Andes and come down the Andes, and you have to think of what does that imply in terms of transportation costs.

So, if you look at the geography of the region, you have to think there's a huge amount of investment in infrastructure there you would have to carry out to lower transport costs. And some work that we did at the IADB, we find that about 50 percent of the total barriers of trade within the region is regulations, tariffs, you know, all that stuff. And about another 50 percent is transport costs and logistics. So, a lot could be gained simply by removing discrimination on the infrastructure side, and sort of make the trade more.

Would that generate more intra-industry trade? Probably. Because you'll be lowering trade costs and you'll be lowering transportation costs, and it would probably do it.

But I don't like the angle of entering into it from the integration perspective. That -- what I said before, I like the angle more from: What is happening in the productive structure of these countries that generates this pattern of, you know, locating themselves in the world of comparative advantages?

And I think the core issue -- and this was last year's report -- is, in my view, productivity. At the end of the day, what really, really matters, if we're going to face winds in the world that are not going to be as favorable as they were in the past, is that the region does its homework to raise total factor productivity, and the deep factors that are behind very slow productivity growth. That would trigger a process of growth, and my byproduct of that process of growth would be more trade, naturally, because income per capita in the region would grow, firms would get larger, there would be more economies of scale.

Now, we could discuss a whole report on why is productivity growth in the region lagging. There are deep issues. It has to do with informality, it has to do with labor markets, it has to do with education. It has to do with sort of the really deep core issues that the region hasn't tackled -- that it didn't tackle in the last decade and, by some dimensions, worsened -- and that it should tackle in this decade because we're still growing. And, as Europe shows us, tackling those issues in the context of high indebtedness and slow growth is even more and more difficult.

So, I would say a productivity-driven agenda, accompanied by a trade agenda that removes biases within countries, that lowers transportation costs with a huge amount of infrastructure investment, and that goes at the deeper issues behind productivity would probably be the best defense that the region would have in what -- I agree with the report -- is a decade looking ahead that doesn't look as good as the decade looking back.

So that on sort of the real part of the report. Let me very, very briefly say a couple comments on the financial part.

One more observation on integration -- I agree with what José de Gregorio was saying -- the political will to do this is not there. And if you think long term, and you think historically, the Europeans developed the political will for their integration after they had two world wars. So they first went at each other twice. You know, they went to their necks. And then they realized, you know, we've had two world wars among ourselves, let's construct a different political construct, and let's try to put it.

Latin America has not had that experience. My experience with policy-makers, in general, is a huge amount of distrust. I agree with what José is saying. There's a lot of rhetoric about Bolivar, and integration, and all that stuff, but when you go to the Nicaraguans, and the Costa Ricans, and the Hondurans and say, look, it really makes sense to have an integrated electrical system of economies of scale, where generation is here, and the dispatch is here, no country is really willing to let go of the dispatch of the electricity to another country.

And if you say, look, if you hand off the Panama Canal, and the Panama Canal is going to have these huge ships, now that they're enlarging it, it doesn't really make sense to have a port in other parts of Central America. Just make a three-lane highway going up and down, and that will really lower transport costs.

And then you go to Nicaragua, or Honduras, or Guatemala, and you say, "Don't have a port." They don't trust, because of the institutional setup to be able to do that.

So there's a huge amount of political change that still has to do, for sort of the deeper integration stuff, and for a renewed concept of sovereignty, in which, at the end of the day, what we have to think is really, what are we going to mean by sovereignty in a much more integrated world?

Comment on the financial side. I agree a lot with José de Gregorio's remarks. My own view is that, because of the correlation issue that you bring up, the shocks, the financial shocks of the region are probably going to be correlated. So there's very little scope for risk-pooling in a context in which most of the shocks are going to come in from the outside world, into Latin America.

And therefore, I think the best bet for Latin America is to participate in a risk-pooling arrangement that diversified risk vis-a-vis the whole world as a whole. And I think that's called the IMF.

Now, it's a very imperfect, erratic, and with still insufficiently good governance arrangement, but I think the bet that we should do is to try to improve the arrangement in such that access to insurance, through an improved flexible credit line, and through improved mechanisms, is such that it enlarges to all countries -- and not, as it tacitly is today, only to systemically important countries. And that the kind of exchange agreements that are there could, in fact, be extended to many countries, it would provide much better insurance. A lot to be gained by improving the governance of the IMF. A lot to be gained by having more resources, and to truly transforming the IMF into an institution that can do this.

That still leaves room for some arrangements for reserves along the lines of what Gregorio was saying. People want them for exchange rate reasons, to defend them. There are some bits of self-insurance that countries want to do.

But the financial integration agenda would go, in my view, beyond these exchange rate arrangements. I think there's a lot of work that could be done by protecting agreements for investment across regions, for better regulation across the banking systems, for trying to homogenize some of those regulations. I lot of this would lower transactions costs, would lower uncertainty, and would make a little bit integration cheaper.

So let me in here. What Eduardo is saying is something we agree. In the region, the macro is much better than the micro. How long can the macro stay good, when the micro is not so good? The answer is -- well, now less, because the world is not so favorable as it is before. We really have to turn to the micro agenda. That, as a side resort, will produce more integration if we do the infrastructure and we do the trade agreements.

And I'll end here, instead of saying, "All together now?" would not be my question. My question would be, "Are we more productive now?"

Thank you.

MR. WERNER: Thank you, Santiago.

And now, our last speaker, Moisés.

MR. NAIM: So, I had many of the points that have been already made. So everybody made the points, but I didn't. So I'm going to make them again. (Laughter.) Because I prepared it.

I'll try to be -- the first point is that I also want to welcome José back. And it's so refreshing to see how much more interesting a central banker is after they are no longer, since they come back.

I, like others, I did enjoy the report. It did bring back things that have been long forgotten, and I congratulate you for picking the subject, and finding that specific niche, and bringing the conversation to something that is needed.

So I liked the report a lot. But I had a problem with the report, and that is when I was reading it, I was reading it on the plane as I was coming back from being part of, attending the Summit of the Americas -- which is the best antidote to integration that you can have. (Laughter.)

So, spending time with people that talk about integration, and then see that nothing happens, and then reading the report is all you need to see the gap that José and others have mentioned. So that is a very powerful message that then brings you a reality check to a lot of the proposals, and a lot of the possibilities and the constraints that we have.

The second point that I wanted to make is how much, despite the inability of these governments to get together and do things in favor of integration, how much has happened. There is a lot happening, regardless of the governments' not doing enough, regardless of the lack of infrastructure, regardless of everything that we -- there is, you know, it's surprising how much is happening, despite the lack of priority, attention, resources, and clarity.

But, having said that, of course, hard to disagree with the central message of the report that integration in the region is lagging, both to what it should be, and compared to what others are doing.

That lag is explained, in part, by what is happening globally. Let's just remind ourselves that this conversation about integration takes place in the context of a world in which Latin America is squeezed between quantitative easing, and yuan undervaluation, and massive overvaluations of the currencies. So you have a region in which everyone has currencies that are overvalued, competing with countries that have undervalued exchange rates, and with massive liquidity and quantitative easing, and all that. If you put all of that, it's no longer about trade, it's about something else that makes it very hard to compete, export, integrate.

So, talking about integration and lowering barriers, and making it easier for your rivals and competitors to export to you, given the macro setting, is very hard. And so the surprise would have been that, in this context, they would have a lot of integration happening. That's the surprising thing. So the report just confirms that the conditions were not there for integration.

But then let's talk -- that's at the global level. Then at the regional level, we need to talk about the fact that there is a massive region-wide Dutch disease.

The region has experienced for a long time the effects of a Dutch disease. And others have written it. Barclays, Alejandro Grisanti, the IADB, and others, have noted that this is a region-wide situation in which the Dutch disease is affecting the region in a variety of ways that are well known. It essentially inhibits the diversification of exports, the diversification of the economy, and inhibits -- it emphasizes the commodity-based economy, and de-emphasizes, and makes life very, very hard for those that are not directly associated with the commodities production and exporting. So that is happening throughout the region.

It also concentrates economic activity, it concentrates income, it, of course, distorts the exchange rate, and adds volatility. It's essentially an added volatility, and an accident prone kind of economy that's there.

But one of the more corrosive effects is, of course, the de-industrialization of the reason. So we're talking about a region that is rapidly losing industrial capacity. And all the indicators are there, I think, that, with the small exception of Mexico, most of the countries have seen their industrial infrastructure, their industrial capabilities, their industrial output decline.

So, if you are talking about integration, and you want to integrate and export intra-regionally non-commodities, you're left with exporting services and manufactures. And there you have two problems. One is that you have little of that, and declining. And then everybody does more or less the same things.

So, in the region, there is a lot of economic overlapping. There is not a lot of complementarity. So if each one of the countries more or less has the same exports of non-commodities, and the same non-commodity production and structure, then it's very hard to trade with people that are doing exactly the same thing as you do. And that is a very important point. And the more you de-industrialize, the more that becomes a problem.

And then one of the consequences is at the industry level. So I have gone from the global level, to the regional level, and now I want to talk about the industry level.

One of the things that's happening at the industrial level is an amazing degree of concentration. De-industrialization is creating concentration. And concentration means that only the big multinational are players, increasingly. If you are a small, even large, uni-national company, you have a very, very hard life competing with the big multinationals that does the same things that you do, but regionally or globally.

So, you know, that's an old story, but it's worth reminding ourselves that competing against global, multinationals that have global sourcing, global access to capital, capital costs and capital structures and scales that are quite competitive, it's very hard. And so the multinationals are essentially dominating whatever there is in Latin America that is non-commodities.

And they trade within themselves. That's why a lot of the numbers that you show that are very interesting have to do with intra-company trades. These are trades that are not arms-length, they are not between unrelated buyers and sellers, they are companies selling to themselves, and deciding at what price and where do they capture the profits and the margins.

And they increasingly decide where to locate the different companies. That's where the transportation costs and other logistical aspects -- and defects -- that Latin America has, you know, they are very, very critical.

So in many ways, the multinationals are developing the industrial infrastructure of the region according to their own strategic plans, and on the basis of where they find opportunities to avoid, evade, or exploit the difficulties that we have in transport costs and other factors. And tax structures.

Which brings me to -- you know, I had the point, but you made it much better than I, about infrastructure. It's very hard to have -- one of the things I missed in the report is that there's almost no reference to infrastructure and bottlenecks. How can -- you know, it is an important factor, and it's becoming an even larger problem. So, I think Santiago already discussed it quite well.

Then, despite the physical infrastructure, we have the issue of social infrastructure, which we like to call "domestic demand." The idea here is that integration will also depend on how successful these countries are at stimulating domestic demand. And that includes how successful they are at expanding the consumer base.

And some of them have been quite successful. Chile, Brazil, and Mexico, and others, have now a consuming class that is far larger than it was before. And that bodes well, in terms of creating capabilities domestically that perhaps can be linked to trade. But there is no evidence that that expansion of the middle class is nurturing and fueling an expansion of integration. Perhaps in services, but I'm not sure, and I don't have the data.

Then I also had a comment about the FLAR, and the Latin American Reserves Fund. And I sympathize and agree with the intuition and the insight underlying the proposal, the notion that you will have a pool of resources and reserves -- all of these countries that are accumulating reserves -- so let's pool them in some way, in some proportion, and have them ready for rainy days. And that can be a very interesting anchor for volatility, it can be a very powerful tool, additional tool.

So, it's a very good idea that I support. But the problem is that its original seeds are not very good.

I used to be a trade minister. And also, at some point, I was the governor, on the board of governors of the central bank of my country. So I can imagine -- imagine that you are on the board of a central bank, and somebody comes and says, you know, we'd like to take part of the reserves and give them to Evo Morales, Hugo Chavez, and Rafael Correa. (Laughter.) That's the fund. You know, those are the countries of the fund -- plus, of course, Colombia, Costa Rica, Peru, and Uruguay -- you know, the financial powerhouses of the region.

So, you know, do you imagine -- you know, "Vote." Would you support that proposal? It's a good idea. But would you support that proposal? No. No. And it's not going to happen.

That doesn't mean that it's not a good idea to generate a system that can stabilize and create anchors, and fight with the volatility embedded in what you call the "primarization" of the economy -- you know, the continuous trend towards relying on primary exports in the region.

And, finally, all we needed to know about the prospects of integration -- and you mentioned about the geopolitics of it all -- we could see it recently, in the spat between Mexico and Brazil concerning the auto sector. If you look at the details of that, and then you say, you know, if this is what's happening between -- these two countries, by the way, ought to be the leaders of any integration movement. You know, if Brazil and Mexico don't take the integration banner, no one will. Or others will, but it will become important (inaudible 01:38:04). In order for something to happen, Brazil and Mexico, and the U.S. by the way, ought to be a central player in whatever initiative there is.

And just look -- I don't know, and I don't think this is the time or the moment, or the point to make details of that friction, that escalated in ways that were disproportionate and unnecessary, but it happened. And that's what happens when you have exchange rates that are misaligned, and when you have a lot of trade frictions that are associated with that, and exchange rate misalignments that fuel protectionist instincts, and then countermeasures, and all that.

So, central message is let's bring back the conversation about what is the model of growth that ought to be pursued in the next decade, when the winds are not going to be as favorable as they have been recently. And what are the kinds of ideas and initiatives that ought to be at the center of conversations? I like very much the productivity, bringing back productivity as a central theme. If that happens, then there may be some trickle-down effects or, you know, some contagion to the trade and integration agenda.

But I welcome and celebrate the notion, the powerful idea, that it's time to start thinking about what happens next, when the winds stop being on our backs, and start coming from the front.

Thank you very much.

MR. WERNER: Thank you.

So, I think it's the best time to open the floor for questions from the audience.

Teresa?

SPEAKER: (Inaudible 01:40:03) -- in the region that are going for more and more protectionism, whether inside or outside. You know, the way forward is not by closing their economies, but, you know, by opening and competing, with the improvements in productivity, with the changes in -- you know, addressing some of the bottlenecks, whether they are in the labor market, or whether they are in infrastructure.

One specific comment that, sort of just from the report, isn't there a contradiction between asking for more regional integration, and then asking for more pooling of reserves? Because, I mean, the more integrated you are, the more your risks are correlated, and therefore, the less the capacity of the region to face these, you know, a shock when it comes?

MR. HURTADO: Thank you. Carlos Hurtado, from the IADB.

I have a comment-slash-question for Eduardo. And I haven't read the report, so I only saw the presentation. And, that said, I think I have a problem with the message. Because I think it's clear for everyone that -- leaving aside the question of regional physical integration, roads and so on -- but, you know, regarding trade and financial backstop arrangements and development banks, it seemed to me that you were suggesting -- and this is the question -- that more regional integration in those areas is better than more global integration. And if that is the case -- and that's part of the comment, that I do not agree with that.

So I think, you know, it's nice that everyone is doing well now, and seems to being doing more or less well in Latin America to be more integrated in trade, rather than being integrated in trade with the European Union nowadays, or with the U.S. two years back. Yes, but I think this is a situation which is specific.

I think, in general, the more trade is better when it is more globalized, because it's safer to be like that, because of the pooling of the risks.

The same thing happens, in my view -- but Santiago said it very clearly -- with the IMF and the FLAR, and so on. I don't know why, you know, the FLAR is a better arrangement than the IMF. It may be institutional. The problem is that the IMF may have a lot of problems, and so on, but then the question is to fix it, not to create another thing which is, in my view, inferior.

And the same thing, in my view, happens with development banks. As you were saying, yes, CAF is better than funding themselves, the countries. But CAF is more expensive than the IADB. And the IADB is more expensive than the World Bank for these countries.

Now, it may be something that has to do with how you access the funds to these places. And I'm sure it is more difficult to do it through the IADB, or through the World Bank. But then, that's again an institutional problem of those institutions. And again, you know, I mean, you

So the question is whether the message is that it's better to have more regional integration vis-a-vis global integration?

MR. WERNER: Yes, we have a question on the back, and then we'll come back here.

MS. CHON: Hi, my name is Julie Chon. I'm a non-resident fellow at the Atlantic Council. I focus mostly on European-U.S. financial and economic issues.

But, I would really like to take advantage of the presences of Moisés Naim, and some others on the panel, to comment on the Repsol-YPF situation.

You know, first of all, if you can explain, as a former trade minister, why this situation kind of turned out the way it did? I think there was still hope until the very end that the Kirchner administration would not take the action.

And, secondly, what type of response could possibly come out of the EU and Spain, now that this has happened? Apparently the EU Parliament today will pass a declaration of action urging the European Commission to kick the Argentinian government out of the G-20, to impose trade sanctions, and take other measures. And I would like to know what the possible menu of responses may be.

MR. WERNER: Yes.

SPEAKER: Good morning. Charles (inaudible 01:45:27), with the Embassy of Honduras. This is a question for Alejandro.

With your presentation, I was given the impression that Mexico is sort of being given a choice between looking north towards the U.S., or looking south towards Latin America for more economic integration. And I was wondering what your thoughts are on an integration between CAFTA and NAFTA, and opening up the way for Mexico -- and the United States -- to sort of turn their attention south, as opposed to across the Pacific?

MR. WERNER: And we have a question here.

SPEAKER: Thank you. Good morning and thank you for your presentation and all of your inputs. I actually have two questions. One would expand --

oh, my name is Victoria, sorry, from the OAS.

One is kind of expanding on the question of Repsol and YPF of Argentina. Along with that, in the context that there has been a lot of decision-makers that may have been poor from the government, didn't receive the support it wanted from the Summit of the Americas, it left early, the debunking of Argentina from the privileged trade with the United States, and the declarations made to the international trade organization, the World Trade Organization.

What is the future for Argentina? How is it going to be in the future?

And my second question is of the Dominican Republic. I know -- I was actually hoping Mr. Kaufmann was going to stay. I know that he was here; he was in the Dominican Republic recently. But I was wondering about the future of the Dominican Republic, as well.

Hipólito Mejia, the ex-president and one of the current candidates, he doesn't have a very good relationship with Chavez, who is very important for the energy sector of the Dominican Republic. And he just started off on the wrong foot with Barack Obama, since he was here recently giving remarks, and racial remarks.

So I was wondering what would happen in the scenario that Hipólito Mejia wins the presidential race, and what could that mean for the country in trade?

Thank you.

MR. WERNER: Well, we have -- yeah, two questions there in the back. Okay.

MR. CORDELLA: Tito Cordella, World Bank. This is a question for Eduardo regarding regional integration.

And my question is, to what extent do you think that the existing trade agreements favor, or may be the culprit for the lack of financial integration? (Inaudible

01:48:13) integration that had agreements that fostered trade diversion, and in fostering trade diversion, the existing, this may be the ultimate reason why we do not have enough trade integration.

So I would like you to elaborate on this.

MR. ROMEU: Hi. Rafael Romeu, from the IMF.

I want to say something in favor of integration (laughter) -- I think there's been a lot of negative views on the panel -- and, in particular, in favor of the productivity argument and the growth. I think behind that productivity story, there's always kind of an institutional story, and a rent-seeking story.

And there's a little bit in this report, but perhaps it could be expanded on, in terms of the benefits of improving institutions through free trade agreements, and through multinational institutions. And I wonder if the panel could comment on that. Of course, it's been a success story for Europe, in spite of the recent crisis. Institutions have improved in southern Europe and in the periphery, relatively to 20, 30 years ago.

And, of course, on the other hand we have a great example of regional trade and integration between Cuba and Venezuela in the region which is, I think, not what you guys have in mind. But it's there, and it's also a good example of exporting institutions.

MS. GRIFFITH-JONES: Thank you very much. Stephany Griffith-Jones, ICD Colombia, and ODI. I really enjoyed the presentation. I'm sorry I was late.

I wanted to ask about this idea of funding, regionally, infrastructure, and also other measures to improve productivity, like scientific collaboration and research. It follows a little bit on the previous question.

It's true that reserves have to be used for self-insurance. If the origins are either capital flows, potentially reversible capital flows, and temporary current account surpluses due to, say, high commodity prices. But there may be a part of reserves now in Latin America which, a bit like Asia, may be a more kind of resilient surplus. Obviously not as large as China and so on, but there is, I think an emerging current account surplus which is more permanent.

And would it not make -- which is sort of the basis for sovereign wealth funds -- would it not make sense to pool more of that in kind of regional development banks, like the (inaudible 01:50:51), or an expanded (inaudible). Probably not the Bancosur.

But -- and to expand the role of these regional institutions for regional public goods -- again, along the European model of what the European Investment Bank did in the initial phases of European growth and integration. It is quite tough to use Europe as a model now, but there are good lessons there, as well. And it was very successful

So I was just wondering about whether there's appetite in the region, also for this (inaudible 01:51:30).

But I think it would be an interesting moment to do this, at a time when the BRICs, for example, are talking about a development bank, that there would be an intra-Latin American (inaudible 01:51:45).

MR. WERNER: Let's --

MR. PERINA: Thank you very much. Juan Perina, from Georgetown University. I enjoyed the presentations, even though I'm not an economist. But I would like -- and thank you for bringing back the subject from the '60s and '70s, I guess.

But I'd like to see whether you can discuss the question posed at the beginning, whether Latin America is really a region? And where do we go from there?

MR. WERNER: Okay. Eduardo, please.

MR. LEVY-YEYATI: All right. Well, first of all, thanks for all the comments, particularly from the panel. I would have liked to receive the comments previously, because some of these issues, I think, are implicit there, but they have not been spelled out in the report. So I need to correct that now. But I would have liked to introduce those concepts in the report itself.

Santiago, education and productivity -- I mean, we cannot repeat ourselves every single report, but, you know, those are at the time of the agenda, for sure. And we have said that many times.

I think that we have to be a little more specific about productivity, though, although I also tend to repeat this in a broad sense when I write about, you know, the agenda, the Latin American agenda. I mean, what do we really mean about "productivity"? Of course, we're talking about human capital, location, health, you know, social development. That all we know, and we will be also lagging behind, but we know that we have to put more effort there.

But there are other issues that are less generally discussed, and one of them is infrastructure and the building of regional goods that you mentioned, which is something that's (inaudible 01:53:39), the thing that the IADB has been trying to push forward but that they have been finding problems, as the ones you mentioned as an example.

I think when we talk about -- when I talk about regional trade integration, I'm not talking about lowering barriers, I'm talking about the building of regional goods. I'm talking about facilitating the integration between activities, companies in the region. I think that through doing that, and through exploiting the economies of scale and specialization, that can actually lead to increases in productivity.

And, here, I have to be very specific. Let me give you an example, for instance. We have Mercosur in Latin America, South America, right? Mercosur is essentially a traditional free trade agreement, except for the car industry -- and some others, particularly the automobile industry. The automobile industry is the only one in which we have actually built up some productivity gains, because it's the exception to the rule.

So what is the exception? It's a particular regime that is oriented to fostering specialization, so that you can actually build something in one country, and some part in the other, and you can, through gains of scale, you know, build up suppliers. That's a key issue in our countries, lack of suppliers. Suppliers are essentially the ones that are receiving the spillovers, the innovation and technological gains from the big car companies.

So this is industrial policy, essentially, associated with trade integration. And it's generating the minimal economies of scale so that you can actually produce these with some spillover that ultimately permeates other industry, because its suppliers actually acquire some skills, technological skills, human skills, that can be used to improve some other areas, not only to the automobile industry.

That type of integration is directly geared towards gains in productivity.

José mentioned wine. When I'm talking about natural-resource intensive exports, I don't mean wine. Wine is actually, it uses higher skills. It has elaboration, added value. And there are a number of spillovers in other different industries and services that actually, you know, foster productivity.

When I think about natural-resource intensive exports, I think about (inaudible 01:56:02) very simple. We are not exporting only wine, actually we are exporting wine, but we're mostly importing beans. And beans is not a productivity gaining activity. So that's my concern.

So we have to be very specific about productivity. I think that some degree of integration can actually foster productivity, on top of whatever we need to do with infrastructure and education and such.

Regarding -- but, again, we should have been, I should have been more specific in the report. So it's much, it's very, very welcome, all these comments.

Regarding FLAR, again I'm not thinking about (inaudible 01:56:35). It's kind of weird to defend FLAR here, because the last report, one of our main points was the correlation risk, the fact that everybody, since everybody is correlated, then there is not much diversification gains, risk-pooling gains with FLAR or any other reserve pool. And actually this is part of the report. Because this is (inaudible 01:56:53), the (inaudible) is that we have the correlation risk.

But I think it's interesting, although we have these institutional to tackle, I think it's interesting to see the fact that through multilateralization, some of these countries that in no scenario will have access to the IMF facilities no matter how we push for them -- because half of these FLAR countries will never have access to a liquidity facility, will have access to an IMF program, for sure. But that's a different issue. But they will not have access to the liquidity window.

How this, through the integration of reserves in a multilateral entity, can have access to, for instance, money from the fund, liquidity from the fund. So I see FLAR as a way of channel -- actually, accessing markets for countries that are not the systemic ones, that typically would have, or I expect it to have access to IMF liquidity.

I don't think -- I mean, it's good what you're saying. I mean, I have been writing about the Fund, and the Fund as a center of the global safety net for a decade already. And I have followed these discussions until now.

My impression is this is as far as the Fund can go. In fact, the last proposal still has not been approved because it's too ambitious, the Global Stabilization Mechanism, which I agreed with. It has not been approved by the board because of moral hazard considerations and, you know, the fact that it's giving too much power to the Fund as opposed to the lenders.

I don't think it's going to be -- the chances that we have an actual liquidity facility that is useful for most Latin American countries, and is going to be used by Latin American countries, are very, very low. So, in that context, assuming that the Fund cannot do more than that, and taking their lead in calling the articulation of the operational agreements, I think that FLAR, despite its institutional problems, can give a hand.

Now, of course, if you think that nothing can be done with a country with a country like Venezuela because of Chavez, then most of this discussion is essentially dead on arrival. Because, you know, if we put the institutional obstacles first, and believe that the institutions cannot be improved by, you know, essentially building this institution, or fostering, or strengthening the new institutions and multilateral institutions, then if that's -- I'm sorry, (inaudible 01:59:16) -- integration and multilateralization has no future.

I'm trying to see this from the positive side.

And only one more point, just to answer to Teresa. Because it was a technical point, I wanted to be specific. She asks, whether increasing output correlations through trade integration goes against the fact that you pool reserves.

And my answer to that is no, because these are different sources of risk. There's the shocks that affect reserves in those cases are typically global, external shocks that have no relation with the region. Whereas the correlation that you mentioned is correlation within the region. So these are essentially orthogonal.

So, there are correlations. There are two correlations that are different. I think the second one, the ones with trade, has no bearing on the correlation between reserve (inaudible 02:00:11).

Thank you.

MR. WERNER: Okay, pretty quickly, let's go on in reverse order -- Moisés, Santiago, José.

MR. NAIM: Very quickly, I apologize if I sounded as an anti-integration person. I didn't mean that. It's to the contrary. I do believe -- I hope that we can get more of it. So my comments were more of pointing to the obstacles. And the Skepticism is because we have been talking about this now for a long, long time, and far less has happened as to the numbers.

So I wanted to clarify that integration should be a part of the agenda, and it's surely there -- among other reasons, or some that you mentioned, about strengthening institutions, and creating collective action capabilities, and also stabilizing rules of the game. That is very important. So that's that.

On Argentina, Repsol, I don't have much to say. I have no idea what's going to happen. I wrote a piece yesterday, essentially saying that I think Argentina, collectively, suffers from a learning disability (laughter). That's the central explanation of, well, you know -- because it's not as if they have not tried this before in Argentina, and elsewhere. They know what will happen. They know exactly what will happen. But yet they still do it.

So, you know, we have an Argentinian --

MR. LEVY-YEYATI: I'm not going to comment on it.

MR. NAIM: -- on the table that won't comment. So, that tells you.

But as far as responses on the part of you and others, You know, I don't know that the menu of options is very large. I don't believe that Cristina Kirchner is trembling at the possibility of not being invited at the G-20. I don't think they care.

And the most important thing is that the surveys in Argentina show that something like three-quarters of the people support this decision. So those of you that think it's a bad idea, or of us, we're in the minority in Argentina, you know. Argentinians are very proud of what they're doing. So, you know, democracy is partly about that.

MR. LEVY: Very quickly, I think the point that Eduardo makes is a point well taken, in the sense that, yes, trade could be a source of productivity gains. And I fully agree with that, because you could exploit -- and the sort of productivity we're talking about here is bigger from size, bigger economies of scale, bigger economies of scope, larger markets -- absolutely in agreement. So it was a point well taken there that more integration could, itself, be source of productivity gains. So I agree with that.

And there was an important point made by somebody there in the audience, as integration being a source of improvement of institutions, which themselves could then help with growth. A very good example is what happened in Mexico and NAFTA. As a result of NAFTA, many laws in Mexico were modernized on intellectual property, and there was a kind of an institutional change within Mexico provoked by the free trade agreement that itself helped growth. So those two points, I think, are very well taken.

And, again, as Moisés says, it's not so much that one is against integration. Evidently nobody, I think, is seriously against that. We're all for it. It's just the way of how you go to it more than anything else.

My last comment is on sort of the financial issue. And I understand, Eduardo -- and one could certainly take a view, and there's a lot of merit to the view that says, look, it's extremely unlikely that the IMF will eventually be willing to offer kind of FLCs to all countries in Latin America because of the moral hazard issue, and because of resource issues, and because of the governance issue. So therefore, as a second best, we need to develop mechanisms -- at least for awhile, until that happens. That's a very fair point.

Another view is, my own sense about Latin Americans' view of the IMF is it's like old generals fighting the last war. You know, all the "stigma" stuff, and all this stuff, I think should sort of be put behind, and we, sort of in a globalized world, have to look at an institution in which we should participate more, try to fight for the governance, changing the governance of the institution, empower it more in a globalized sense. And then, carefully thinking about the moral hazard issues, do try to say, "You're as obligated to provide insurance to systemically large countries as you are to provide insurance to Guatemala or to Bolivia." And that might take a while.

The issue is what is the best combination of insurance mechanisms in the transition? And that's a difficult one to call. You can call it one way or the other. I'll stop here.

MR. DE GREGORIO: Okay. Thank you. Just a couple of comments.

I also have to clarify. I'm not against integration. I'm in favor of free trade, and a lot of trade. So what my presentation on that is, it's a sense of frustration of so many agreements. I think there should be a list of all agreements to foster integration. And, as Moisés said, and it takes place despite those agreements.

Now, perhaps a way -- and this is more the conceptual way to approach, Santiago said it at the beginning -- what should be the equilibrium of regional trade? And this is taking, let's say, a trade approach. And how far are we from there, and what we should do. Perhaps it may be infrastructure. When he talked about infrastructure, I though about Asia. Asia is much more problematic, the transportation problem, I think, because it's much larger. And they have a lot of trade.

So I think that then there is the issue about building institutions and creating trust, and trying to develop. But I don't know how to do it, but I think that that's an area we should think more. And how, even, it may help to redirect the efforts in the region.

Then there was another question that Stephany made on funding regional infrastructure, pooling sovereign wealth funds. You know, all these depend, at the end -- governance is so important, how these things are encouraged. I would be very uneasy if I would belong to the Chilean committee -- I won't belong, so don't worry. But there is a Chilean committee -- expert committee -- that decides allocation of the sovereign wealth fund. I would be pretty skeptical, if I don't have an order from the president, to put it in a road project in a small Latin American country. I'd prefer to put it in Apple, I don't know. It's safer. So the way to take the risk, and how we'd really do it in the countries is quite complicated.

And on top of that, I think that, given the current world, and with all the financialization, I think that most projects -- not all of them -- but I think that that could help IADB, we can strengthen CAF. We have the instruments. We don't need to create a new instrument, we have the instruments.

But they should operate more on the guarantee and things like that, because they should pass the private test. I think that that's very important. If a project cannot get funding in the private sector, except that you find some special constraint, the first thing that you have to do is to be a bit skeptical. I think that big countries in the region -- let's say, the big five, six -- they can fund everything in the international markets. That's because they have done well, things in terms of macro source.

So, yes, there may be an area. I wouldn't be so optimistic that we can go so far, because of governance issues.

MR. WERNER: Just very quickly, I think.

Latin America, regarding this FLAR issue, does not even have a common voice in the discussions in the IMF. So, it's very hard, I mean, just having a unified front on where we want to go in the IMF. So, we are starting very far back. And I think that's a backdrop of this discussion.

Regarding Mexico, south versus north, et cetera, I think Mexico should, at this point in time, with so many free trade agreements, definitely should just unilaterally open up the rest of its trade regime. Because we have a lot of restrictions just for 10 percent of our trade. So it's irrelevant, it generates a mess of restrictions.

And regarding this financing issue, I think, of infrastructure, I think maybe with Basel III coming in, and many new restrictions in the financial system, there will be a role for international financial institutions in the region to support infrastructure in the region, given the way the pendulum is going to swing in the other direction, and long-term infrastructure projects will be heavily penalized, at least from the banking, financing side. And eventually there might be a role for projects that in another time would have been financed by the private sector that, in the next few years, might suffer some restrictions in their financing. And I think it's an interesting venue to explore.

Thank you very much.

And, Eduardo?

MR. LEVY-YEYATI: No, just to close this, I don't want to leave the event without thanking Diana, that has been helping us with all the organization. And before leaving, I'll see her. She made a joke about YPF, I think, because I asked her for a piece of paper and she wrote me this agenda that says, "Ecopetrol" here. (Laughter.) I don't know how to take it. I have to check with her.

But I think the story goes that after (inaudible 02:10:34) declined, most of these guys went to build up Ecopetrol into a dynamic company in Colombia. I don't think -

- I hope that we don't have so many guys going to Petrogras anytime soon.

Anyway, thanks Diana. And, of course, thank you all -- all the panelists have been very, very patient, and very enriching in this debate. And I thank you for all your comments, and all you for coming here and being so patient.

Thank you.

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