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P R O C E E D I N G S

DR. KHARAS: Good morning, everybody. If we can get started, I would like to welcome all of you here to Brookings. My name is Homi Kharas. I'm the Deputy Director of the Global Economy and Development Program here at Brookings, and I really thank you all for thank you all for coming here to participate in the launch of our new report on the "Latin American Macroeconomic Outlook: A Global Perspective." Before we get started, could I ask you all to do the -- with your cell phones if possible. I'd also like to welcome all of those who are watching this live. I believe this is being webcast and it also there are online conversations happening under the Twitter hash tag #LAImacro and I hope that you enjoy this.

This report is the work and the product of the Latin America Initiative's director, Dr. Ernesto Talvi and his team at CERES. CERES is the Centro de Estudios de la Realidad Economica y Social, or the Center for the Study of Economic and Social Affairs, and Ernesto serves as the Academic Director of that, but he is also more importantly for us now the director of the initiative at Brookings. He only just started in the end of June or July and he has hit the ground running in producing this major report already. Ernesto has a long and very distinguished career. He was a Special Adviser to the Research Department of the Inter-American Development Bank on Global and Regional Macroeconomic and Financial Affairs. He also served as the Chief Economist and Head of Research at the Central Bank of Uruguay, and he has a long track record of publications which you can easily find on the website and his expert page at Brookings.

We really hope that reports of this kind will help inform policymakers on the opportunities and risks that the new global economic geography poses to national and regional economies, and we have a series of regional initiatives in global, and Latin America is one very important part of that. So to discuss this report, we also have a real star-studded panel this morning. I would like to first introduce Professor Carmen Reinhart, wanting to really get started fast with her comments, but Professor Reinhart of course as you all know is an expert on financial crises. She was at the Research Department at the IMF, she's been at the University of Maryland, the Peterson Institute, the Council on Foreign Relations and she has a very now I think definitive work with Ken Rogoff called "This Time is Different: Eight Centuries of Financial Folly," 800 years, 66 countries, five continents and still the Europeans can't learn. So I hope at least today that Professor Reinhart will be talking more about Europe perhaps than Latin America. Next we have Professor Guillermo Calvo, Professor at Columbia University, Director of the Program in Economic Policy Management. For those of us who've worked in development, Professor Calvo has been the person that we have always turned to when thinking about the macroeconomics of development countries and so it's a particular personal pleasure of mine to be able to introduce him here at Brookings. He is somebody who's been extremely influential in shaping my own thinking. He has been the Chief Economist at the Inter-American Development Bank; he's headed the Latin American and Caribbean Economic Association, the International Economic Association. He has many, many honors including the King Juan Carlos Prize in Economics, the LACEA Carlos Diaz-Alejandro Prize; he is a Fellow of the Econometric Society and the American Academy of Arts and Sciences. It's going to take too long to go through his full bio, so you have it in front of you. Then we also have a very distinguished moderator. Her name is Indira Lakshmanan. She is the Senior Correspondent for Bloomberg News. Her main focus has also been on Latin America. She started her career living in Santiago, Chile, at the time of the transition from Pinochet to the new democratic regime. She then served as the "Boston Globe's Latin America Bureau Chief based on Bogota. But in keeping with the global spirit of this event and of our program, she has covered the

Taliban, she has covered the death of Deng Xiaoping, she has covered the war in Afghanistan, she has been around the world, so I really welcome Indira here. With that as a brief introduction, I'd like to bring Ernesto Talvi up to the podium to introduce his new report. Ernesto?

DR. TALVI: Homi, thank you very much for that very kind introduction. This is my first public event since I took over just a few weeks ago as Director of the Brookings' Latin American Initiative and it is really a privilege to be associated with an institution that I discovered that not only has very hard working and talented professional staff but also a very humane and collegial working atmosphere which is really rare in larger organizations. So I'm very happy to be here, Homi.

Before starting, I would like to really thank very, very much my professor, my mentor and my dear friend Guillermo Calvo and my colleague and also very dear friend Carmen Reinhart for being here with us on such a short notice. And also my new friend, Indira who also accepted to moderate this on a very, very short notice. Thanks to you all very much. I would also like to thank the Global Communications team, very especially Mao-Lin Shen, Stephen Magneson and Christine **Golubski** for their invaluable support. I mean they are responsible for organizing the event and getting the report published on time. Finally, I would like to thank also the CERES team in Uruguay. My co-authors, the research assistants, the management team, they were exceptional and wonderful partners in this joint venture. Obviously thank you all very much for being here both to those of you who are physically here and those who are joining us through the live webcast to be with us and share some thoughts on the global economy and I hope we will have a very productive discussion today.

Let me start. The report essentially makes four points and I'm going to go through them in order. The first one is that a new global economic geography, that's how we like to call it, has emerged in the aftermath of the global financial crisis where economic vitality has migrated from advanced economies to a very specific subset of emerging markets that we will see in due course. Let us start looking at the U.S. where it all started. What we saw in the immediate aftermath of the financial crisis was a very, very severe credit crunch that was associated with an equally severe and persistent decline in output. In fact, if we look at output relative to pre-crisis trends, the U.S. is still significantly below pre-crisis trends together with very high unemployment and this is what we define as an anemic recovery.

Should we be surprised at this? This has been the deepest recession after World War II. It has been the longest, six quarters compared to an average of three quarters. It has taken the longest to recovery to pre-crisis levels of output. And moreover, according to historical standards of World War II recessions, we should have already recovered to pre-crisis trends which we saw has not yet happened and we are still far away from that happening. Should this be a surprise? Not for those of us who are used to or were trained to analyze financial crises. As I like to say, Latin Americans were trained in trauma centers, not even emergency rooms, trauma centers where people really come in after being run over by a truck and have to be reconstructed. So we know a lot about this or we think we know a lot about this.

Financial crises are very, very special in the sense that economies go through a very long and protracted period of deleveraging, i.e., you have contraction in consumption, a contraction in investment, and the other side of the coin is a rise in both household and corporate savings in order for people to undo the high levels of debt that precede every financial crisis. What we've seen is that the U.S. is entering into its fourth year of financial deleveraging and we've seen persistently high levels of unemployment together with these very depressed levels of investment and consumption that are the other side of the coin of deleveraging. This is something that we looked at with Guillermo and -- who is somewhere here. I can see him. In the paper it's called "Phoenix Miracles," recovering without credit from financial crises like 33 episodes of financial crises and it takes a lot of time for the deleveraging process to be undone, like 6 or 7 years. But we wanted to look at a developed market example just to compare it to what's happening in the U.S. In Sweden after its early 1990s financial crisis had a 7-year period of financial deleveraging. And in fact, while deleveraging was taking place, unemployment remained persistently high. It was only after consumers and firms started to deleverage their balance sheets and therefore consumption and investment started to pick up at stronger rates that actually unemployment started to drop very significantly. And I want to retain this concept of deleveraging in the North because that's going to be very important as a transmission mechanism of what eventually ended in happening in emerging markets which at least from our perspective was very surprising.

If you look at the other advanced economies, we see exactly the same picture, a very severe credit crunch followed by a severe and persistent decline in output that is still substantially below pre-crisis trends. If we were asked the question before the fact, if 65 percent of the world economy is going to go into a severe crisis, into a deep recession, what's going to happen to the rest of the world, I think most of us would have answered probably and most likely the rest of the world would also be in deep trouble and would enter into at least a recession, perhaps not severe, but a recession. That's not exactly what happened. If we look at the emerging markets and in particular we look at China, what we saw immediately after the financial crisis is a boom on credit, a boom in domestic demand that not only accelerated very significantly but compensated the fall in exports due to the recession in advanced economies to a point in which actually output is running and it's still running in spite of the cooling off since mid-2011 above pre-crisis trend levels. And if we look at the second major economy in Asia, India, we see exactly the same picture, booming domestic demand, output above pre-crisis trends and that's something you can see all over Asia. If you look at the largest economy in emerging Europe, and this is Russia, what we see is a pattern of behavior of output that is reminiscent of what we saw in advanced economies, a very sharp and very significant decline and persistent through times since they are substantially below pre-crisis trends. In fact, with the exception of Poland and more recently Turkey, most of emerging Europe is exactly in the same situation as Russia.

And when we go to Latin America, the fortunes are divided. If we look at Brazil we see again a situation in which output being fueled by domestic demand is running above pre-crisis trends. And if we look at Mexico, we get a picture that is reminiscent of the U.S. and other advanced economies, a very persistent and severe contraction where output remains today even though Brazil is cooling off and Mexico is picking up and we are going to talk about that at the end of the presentation, output still remains substantially below pre-crisis trends. So this was really a surprising fact that a financial crisis that crippled advanced economies, that represents 65 percent of world's GDP, nonetheless left both winners and losers in emerging markets. And in order to measure this in a systematic way because we only presented examples, we came up with an index that we call the Post-Financial Crisis Global Index of Economic Performers. This index covers the advanced economies and all the key emerging economies in every relevant region. What we do is we look at six macro variables and try to compute whether an economy for each of these variables is behavior better than would have been expected by pre-crisis trends or it's behaving worse.

What we did is we averaged out these six performance indicators for every country in the sample and we normalized it as an index going from minus 100 to plus 100, so a positive number would indicate that you are doing better than what you would have been expected to do given the trends prevailing prior to the financial crisis. If you have a negative number, then you are worse than you had been expected to do, given the trends prevailing prior to the financial crisis. The more negative the worse, the more positive the better. And this is what we get. Not surprisingly, advanced economies have very negative numbers and emerging economies that are tightly connected to advanced economies, i.e., emerging Europe and the Mexican and Central American region tightly connected to the U.S. also have negative numbers and we defined this universe of negative numbers as the anemic economies or the losers in the aftermath of the global financial crisis.

The positive numbers appear in South America, Sub-Saharan Africa, emerging Asia and to a lesser extent Middle East and North Africa. In fact, when we look at the countries individually, eight out of the first 15 according to this index are located in Latin America. So essentially what we've seen is a migration, a new global economic geography that emerged in the aftermath of the global financial crisis where economic vitality migrated from advanced economies and a subset of emerging economies tightly connected to them to a different subset of emerging economies mostly located in South America, Asia and Sub-Saharan Africa.

What we would like to understand, and this is the second point, is why. Why did this happen? It was not in principle meant to be that way and we'd like to understand why were there winners and losers in the emerging market world while we should have expected that most of the countries in the emerging market world should have been losers due to the crisis that crippled a large chunk of the world economy. For that we need to basically come up with the key features of the new global economic geography and these are four and very important. The first is that in the aftermath of the global financial crisis we've seen historically low yields and massive inflows to a subset of emerging markets. In fact, if we look at Latin America, capital inflows have tripled in the aftermath of the financial crisis. And they came to our shores and to every emerging market shore to buy land, to buy property, to buy companies, to buy stock, to buy bonds, to buy deposits, creating in most cases an asset boom, a credit boom, a domestic demand boom and an acceleration in output growth. It is very important to keep in mind that this phenomena is tightly connected and I would say casually connected to the crisis in the advanced economies. It is the fact that the depression in consumption and investment and the very significant rise in savings that happened in the U.S. and Europe created a huge mass of financial and capital resources that were made available at very cheap rates for as I say a subset of emerging economies.

The second significant and important feature is that there was a very important change in the composition of world demand. Economic vitality migrated from advanced economies to emerging countries that have a much higher propensity to consume primary commodities that most of Latin America produces and exports, and as a result of one and two, a low interest rate environment and high liquidity and change in the composition of world demand, we've seen record high commodity prices in the aftermath of the global financial crisis. So who would have thought? If we were asked the question what is going to happen to commodity prices if 65 percent of the world economy gets into recession in advanced economies we would have guessed that they will have declined in price. Exactly the opposite happened. We've seen record high commodity prices in all categories of commodity groups.

Finally, the last and very important key feature of the new global economic geography is that remittances from advanced economies due to high unemployment rates of migrant groups in advanced economies came to a sudden stop.

They stopped actually growing and declined a little bit. If these are the key features of the new global economic geography, who are the likely winners and losers of these features? First, net commodity exporters that benefit from historically high commodity prices, and there just focusing on Latin America we can see that there's a big difference between the commodity producing and exporting South American region relative to the mainly commodity importing Mexico and Central American region, countries with a large share of exports to dynamic economies, and as we can see again, a big difference between Mexico and the Central American region tightly connected to the U.S. and the South American region that is more diversified and more connected to the now very dynamic emerging world. Third, countries with low dependence on remittances from advanced economies, and as we can see, a huge contrast again between the South American region with a very low dependence on remittances as opposed to the Mexico-Central American region where there is a very high dependence on remittances. I think finally and most importantly, who would be the beneficiaries of the new global economic geography, countries that are highly integrated to global capital markets and therefore tend to benefit from these very abundant financial capital resources that were freed up because of the recession in the North at very cheap rates.

What we basically did is we put these characteristics following our methodology we developed with Alejandro Izquierdoand I in work we did for the IDB 2 years ago and tried to cluster all the emerging markets into potential winners and potential losers according to their structural characteristics. Basically what the method produces is two groups, one of potential likely winners, one of likely losers, and what's very interesting is that there is a huge correlation and matching between likely winners as identified by the structural characteristics of the country through -- analysis and the winners that we actually identified through macroeconomic outcomes through the global index of macroeconomic performance. We think that this high correlation in a sense allows us to say that we have something here, that we found the key underlying country characteristics that interacting with the new global economic geography produced winners and losers in the emerging world.

What we did is we grouped together what the method identified as likely winners and likely losers and tracked the economic performance, and it is very interesting that likely winners did much better during the Lehman crisis and according to consensus forecasts are expected to perform better in the foreseeable future when these two groups prior to the crisis had rates of growth that were very, very similar. In fact, and this is where we square the circle, capital flows have taken notice. I mean capital inflows to the countries that were identified and turned out to be likely winners are now higher than they were prior to the financial crisis, while capital flows to countries that were identified and turned out to be likely losers in the aftermath of the financial crisis now have much lower levels of capital inflows. So it is interesting that these financial and capital resources that were freed up because of the substantial increase in savings rates in the advanced economies did not flow indiscriminately to all emerging economies, but only to those emerging economies that according to their structural characteristics were bound to be the high performers in the post-crisis world.

The third point we would like to make has to do with the fact that this reallocation of world savings, of world financial resources in capital, is key in keeping emerging economies moving as advanced economies behave in an anemic way and therefore keeping world growth and world demand at certain reasonable levels. Anything that creates a situation of panic in the way the Lehman crisis did will interrupt this process because capital will stop flowing and will go to the safe havens, I mean not to emerging economies. So this is a key aspect for the world economy and we think, and maybe we'll have an interesting discussion on this with Carmen and Guillermo, that the most serious threat to global financial stability is the Euro Zone crisis and that the Gordian Knot what we like to call the combination of overvaluation with debt overhang or excessive debt, in our view the Gordian Knot is far from being untied. Let me just get into a little bit of detail here because I think this is very key. If we look at the Euro Zone as a single political entity and compare the levels of public debt to those of the U.S., they are very similar. They were very similar prior to the crisis, they are very similar today. However, we know that the perceptions of risk of national countries within the Euro Zone have diverged very significantly in the aftermath of the global financial crisis, very high for peripheral European countries and very low for most of the rest of the countries. What happened? We know that the Euro Zone is an economic union, free movement of goods, capital and people. It is a monetary union, but it is not a political union, and in at least two senses that's very important. It is not a fiscal union so in principle countries are responsible for repaying their own debts with their own resources. It's not a banking union, so in principle countries are responsible for the health of their own banks with their own resources. That's not the case in the U.S. which is a different kind of federation. Under those conditions, what happened in 2007 in our view is that essentially capital initially to the private sector but then also to the public sector came to a sudden stop. Who were the countries that were bound to make the largest adjustment given that now capital flows were made very scarce and very expensive? Those countries that were running very large current account deficits. In fact, those were essentially the peripheral Euro Zone countries. Germany was running a very huge current account surplus and in fact this was a relatively new phenomenon. In the mid-1990s basically these two groups of Germany and peripheral Europe were running balanced current accounts and they diverged through time in a very short period. In fact, we've seen a very severe adjustment of the current account, 5 percent of GDP in peripheral European countries in spite of the fact that the fiscal position deteriorated on average by more than 3 points of GDP, so the private sector adjustment was really humongous.

What we've learned from the sudden stop literature and we have two of the major experts here on our panel, both Guillermo and Carmen, is that when you have a sudden stop in capital inflows and you have to go through a large adjustment in current accounts, they always come associated with a very large depreciation of the real exchange rate and the nominal exchange rate. If you are part of a monetary union that doesn't allow you to depreciate your currency, that's going to make things pretty complicated because although having the ability to depreciate your currency will not avoid the impact effect of the sudden stop, it will allow you to export your way back into recovery. According to our estimates, and we used two different methodologies that you can see in the report, peripheral Europe's currencies are overvalued to a rate of 30 to 40 percent so we should have seen depreciations of that order of magnitude in order to accommodate the sudden stop in capital flows, the shrinking of the current account without going into a very severe and mostly persistent decline in output and rise in unemployment. On the other hand, Germany is highly undervalued, and the results are very clear. When we look at output in peripheral Europe, it has declined very significantly and it's still declining, unemployment shot up very significantly and it's still rising, while when we look at undervalued Germany, it actually recovered to pre-crisis levels relatively quickly and unemployment actually is below pre-crisis levels. So this is a pretty odd marriage that we have here, and this is the way I think we need to frame this growth versus austerity debate, the way we look at it is we have huge overvaluations in peripheral Europe. Therefore you have huge deflationary pressures because you cannot devalue your currency. Therefore you are trapped in a depressed economy, high unemployment equilibrium. A depressed economy means depressed revenues, depressed revenues means high fiscal deficits not because there was a spending binge, since 2010 peripheral Europe has reduced expenditures in real terms by 14 percent, but because revenues are tremendously depressed. So fiscal deficits and unsustainable debts are not the root cause of the problem, they are in our view the outcome of severe overvaluation that puts deflationary pressures that cannot be corrected through nominal devaluation. But that problem is not only a problem of the public sector; it is a problem of the private sector too. The private sector is exactly in the same position in a depressed economy environment, the private sector that's maybe come on so unsustainable. And in fact, Spain and Greece have approximately a total private private-public sector debt of 300 percent of GDP but the split is different. Greece has a lot of public debt, Spain has a lot of private debt, but the qualitative underlying problem is conceptually the same although the fiscal discipline that Spain had was much stronger than that of Greece. We need to solve the overvaluation problem and we need to solve the overhang problem and we can't have it both ways.

The overvaluation problem could in principle be solved through a more relaxed monetary policy by the ECB that depreciates substantially the euro to a point at which they pull out peripheral Europe from deflationary pressures. That probably implies inflationary pressures for a protracted period of time in Germany and other Northern countries and therefore it's politically very difficult. Now then if that's politically unfeasible, we need to get a hold of the overhang problem. If you make some back-of-the-envelope calculations on the implicit default probabilities in secondary market prices and the delinquency rates in the banking system, dealing with the overhang problem of the whole of peripheral Europe would cost Germany around 40 percent of GDP. I think that that's politically and probably economically unfeasible for Germany. In my opinion this has ceased to be a European problem. It's too big to handle if it's not going to be handled by a central bank, too big to handle by Germany only and therefore if we are going to go the route of dealing with the overhang problem and not with the overvaluation problem, this has to be coordinated at the international level. Dealing with the overhang problem at the international level means that the overhang problem is equivalent to 5 percent of the combined GDP of the U.S., Germany, Japan and China. So a problem that is basically unmanageable at the European level could be manageable understanding that there are a lot of political difficulties in the process at the international level.

The last point I want to make is the following. If there is a chance that the European situation is not handled in the appropriate way and that we go into a new phase of global financial turmoil and maybe emerging markets are going to be shut out of capital markets for a protracted period of time, who are the countries or the regions and how are emerging countries positioned to confront a new episode of turmoil? There we developed two indicators. A liquidity indicator that is very simple. It measures how much international liquidity a given country has relative to the debts coming due, external, private and public debt, and domestic public debt coming due in the next 12 months. And in that sense emerging economies in principle look relatively well positioned although countries that are today dynamic look better positioned than countries that were losers in the aftermath of the financial crisis. But this is a stock phenomenon. Liquidity means we are looking at the stock of reserves that you have available to deal with the stock of debts coming due, but even if you are okay from a liquidity perspective, you could still have a very severe macroeconomic impact of a sudden stop in the inflows of capital if you are running excess spending over income or a substantial current account deficit. So the second indicator tries to measure what would be the reduction in domestic spending that would be necessary to bring back the current account deficit to balance. And in fact, what we found is a very interesting paradox, that it is the more dynamic countries that are more vulnerable from a macroeconomic perspective because it is to those countries that we've seen capital has flown, asset and credit booms have occurred, domestic booms have occurred and those are the countries where current accounts deteriorated very significantly and therefore are going to have to make the largest adjustments if there is a sudden stop in capital inflows. In fact, we've had a test of that when we had these global tensions in the aftermath of the generalization of the European crisis in 2011 to Spain and Italy. We saw spreads going up, commodity prices falling by 13 percent, a substantial revision downwards in the growth forecasts for advanced economies, a cooling off in all activity indicators with China since mid-2011, and when we compare what happened to countries in the second semester of 2011 relative to the first on an annualized basis, the countries that actually suffered the most severe growth reversals were the countries that had been identified by our index as the dynamic performers and that happened in the emerging market world and happened in Latin America particularly. And in fact, in Latin America it was up to July 2011 exuberant Brazil and Argentina that were the hardest hit. In fact, we've seen in Brazil since then a very large depreciation of the real, a very significant deterioration of fiscal accounts and we've seen the same in Argentina, although in Argentina it was multiplied, the impact was larger on outputs, on the exchange rate and on the fiscal accounts and we attribute that to the reaction of the authorities to the adverse effect of global tensions that added insult to injury in the sense that it added a domestic crisis of confidence to an otherwise already complicated global environment therefore precipitating a massive capital flight and a substantial loss of international reserves. So I'll finish with this, and I'd like to finish with an epigram by the magnificent Irish playwright Oscar Wilde who said that truth is rarely pure and never simple and this is the complex world we live in. Under normal circumstances, and under normal circumstances we define occasional bouts of global financial tensions that fall short of panic, then it is the dynamic economies, the beneficiaries of the new global economic geography, that are expected to do best. But if we happen to have a situation in which we go into panic mode, then it is the dynamic economies that are bound to probably be the hardest hit. As my dear Professor Michael Mousa said, in life there are no solutions, only tradeoffs and hopefully we will be discussing these tradeoffs from a policy perspective during the debate. So I would like to invite Guillermo to the podium. Thank you.

DR. CALVO: Thank you very much for inviting me. It's a great pleasure to be here, to be surrounded by friends, to be surrounded by former students. I'm very proud to have students of that caliber. It's good to be a teacher.

This is a very, very interesting report. When I read it, it came to my mind the expression of Michel Camdessus after the tequila crisis he said that that was the first of the 21st century crises and he was actually right. And I'm thinking that this report is really one of the first 21st century macro reports. That's the way I feel about it. Then it happens sometimes that you react to things and then you have to ask yourself why did I think that way? I think that way I believe because it's amazing how the certainties that we had especially in this town in the 1980s for example have changed so much, and even though we do a very careful analysis, we end up like in this presentation recognizing that there are certain factors that are very hard to assess and there is a lot of uncertainty in front of us. So you can be a very serious researcher and still recognize that there are certain things that can happen to countries that behave very well, however are hit by a sudden stop or something like that.

What are the factors that came up now? What's the big difference between the macro here and the macro in the 1980s and the way we thought about macro in this country until very recently because the emerging market crisis not touch the intellectual atmosphere dominant, intellectual atmosphere in the U.S. or in Europe until it hit them? Something very similar. Because that macro was a macro of the word credibility was taken for granted, where liquidity was not an issue, and if you ask those questions they will say that cannot be an issue. The issue is solvency, not liquidity. Where there is an important shock, the shock comes from nature not from the markets. The markets don't misbehave. The markets are there to help you and if they don't help you, it's because you have misbehaved. So I think that's a sea change in the way of thinking about these issues and is reflected in this 21st century report. So I really recommend that you read it.

I will leave now the general comments and focus on my presentation because I only have 10 minutes. I thought what I would do here is to add to the narrative if you wish in this essay by bringing in features that are in line where the emphasis is on liquidity or credibility or vulnerability. Vulnerability I think is kind of a new concept. Before we talked a lot about sustainability which is very close, but vulnerability is something related but you can be vulnerable, you can be in very good shape, but if you miss a step you can break a leg. So that's what happens. Vulnerabilities, I will speak a little bit about those, and then some skeptical conclusions. I must anticipate that I cannot be very optimistic about Latin America if the situation in Europe deteriorates this time around I mean in comparison to what we saw before.

First of all, if you look at Latin America now, Ernesto has highlighted the fact that we have seen in many papers that the current account is a key variable, sometimes a key predictor of the probability of a sudden stop. In the first place, external factors continue playing a big role and that comes out from the paper. But what you see is that the current account being a key variable and also fiscal imbalance have deteriorated even though external conditions have not deteriorated. So there seems to be a tendency to going back to some sort of long-term equilibrium or long-term disequilibrium rather. Here are the terms of trade for Latin America and you see clearly that they improved substantially beginning in 2003, but when you look at the current account, in the first place it's interesting to note that that improvement in the current account that many people mention as key in explaining the resiliency of the region in 2008 and after that, that variable only became positive during the boom period and now it's going back again. So is this a virtue or this is just luck? I don't have to go into that. Has the region learned the lessons or there's a lot of luck in all of this? And now the luck is still there, however, deterioration. I will not talk about this because it will take too much time. That sort of throws a little bit of cold water to the view that the region has learned the lesson.

Second, this time around after Lehman, we had central banks that were not available before. Typically when people compare Lehman to something else, they go back to 1998, the Russian crisis, so obviously in the Russian crisis the region fared much worse. It took many years for recovery. So the view is you see now they've learned the lesson and everything is going to be all right. But they forget if you just look at what we have had in the Lehman crisis is the presence of very strong central banks that partly caused the problem by withdrawing too soon, but then once they realized that they had made a big mistake, they came back and they are still coming back now with QE3, and what Mr. Draghi is doing there in Europe. That emerging market did not have. So when you look at the performance, for example, this is the emerging market -- the green line is emerging market bond index, it's a spread, you see that in Latin America and emerging markets actually the situation prior to Lehman was doing quite well, was quite good and it brought up the notion that maybe there was a decoupling of emerging markets with respect to advanced economies. But as you see, when Lehman happens which is an accident in the North, it immediately deteriorates conditions in emerging markets, but quite remarkably too the recovery is very, very fast. So there is something there to the emerging markets in general and Latin America in particular that they benefited from having a sort of lender of last resort that was not available in the prior crisis that was -- they were confined to emerging markets. And the other point that is in line with this what in the paper they call exuberance vulnerability paradox, I prefer to call it tradeoff, is that when you look at Chile and see what happens to domestic credit, this is credit flows in Chile, and these two lines, the first line is one standard deviation, the second line is two standard deviation, and it means if it falls beyond that it's a very big crunch. You see that in the case of Chile the star performer the credit crunch was enormous, three standard deviation, also one of the largest in Latin America and actually output leaving out Mexico fell by the most in Chile. So that's a case study of precisely what this report is claiming, that very dynamic economies are also very subject to big shocks. That doesn't mean that I'm not trying to draw the conclusion that Latin America is bound to fall into another big recession, but I cannot be very sanguine about the prospects given that I see the region going back to previous conditions. Actually, if you look at the fiscal deficit the same picture comes up. So it's like the region is going back getting accustomed to the good conditions and creating vulnerability. It's as if vulnerability is an equilibrium level where you go back there is something that characterizes you. If you are lucky and you stop being as vulnerable in the past, you will do something in order to go back there. So that's what I sense by looking at these numbers.

Also in a recent study with Alejandro Izquierdo and Rudy Loo-Kung both of whom are here, we did a study about optimal reserves which play an important role as pointed out also in the report. And here you have the vertical axis is optimal reserves according to our study and the horizontal axis is actual international reserves, so the points are above the 45 line it means that actual reserves are below optimal reserves. And what you see comparing 2007 and 2010, for all emerging markets they have been pushed up which means the shortfall has increased and especially when you look at the blue dot there, that's Latin America, all of the countries in Latin America are now above the 45 degree line. So this suggests that also the safeguards actually worked very well. I mean international reserves in the past are now kind of loosening.

So I will end with some skeptical conclusions given this, well what about LAC policymaker making? I think that these are studies that Ernesto and Alejandro at the IDB have done and show in very careful ways and very convincing ways that the whole region I mean with the exception of Chile has a tendency to spend in the boom years and then have to adjust very starkly in the lean years. So it seemed to me that you may get the impression as I mentioned before that they moved out of that sort of cycle, but I think much of it has been luck and help from central banks in the North so the situation has not changed very much. In addition, one has a sense that populism is on the rise. What worries me the most about populism as I assess Latin America is that it doesn't have a clear framework, probably populism never does, but there is no -- before populism was associated with Marxism. At least you have something there. You know what these people are up to. And now it's very hard to know and I cannot enter into that. That's a big topic, but I'm just expressing my feelings about it. And besides they are not accompanied by market friendly ideology if there is any ideology. So I have the feeling that, and here is where the credibility issue comes up, that policies likely going forward are to be highly discretionary and unpredictable. I really don't know if you ask me. What's your gut feeling? What's going to happen? Does the situation deteriorate all of a sudden in Latin America? What's going to happen in your country Uruguay? You see the left governing there and here we are applauding all the good macro policies. What's going to happen if you really feel the squeeze? I have serious doubts because you hear what they say and it's very easy to be virtuous when you don't really attest it. So I have my doubts. Or it could be just -- counterproductive as shown in the case of Argentina in the report. And with this I finish with the LAC's and Europe's debacle if there is such a thing, as the report says and everybody would agree, the epicenter has shifted to Europe. That's a problem. It's already a problem because it's not the same kind of federation so it's likely to be a big mess. One can see that the ECB is the only active and apparently effective so far policy institution, but there are big tensions with Germany for example for the reasons that are reported. They have very different stakes in this game and they are not real brothers. It is because they fear that otherwise they will kill each other a third time. So there they are looking at each other in the eye. It's kind of a risky situation. So it's very hard to know how much further –Mr. Draghi and the ECB can go if necessary and I doubt it, unless the Fed comes up, again. Let's not forget about the big currency swap. It's an amazingly large currency swap with Europe and other countries to prevent that the euro will deteriorate and to allow the ECB to lend in terms of tolerance to local markets and so on. So the Fed may be, but you be the judge. I don't know. But one has the sense that given the political situation in the U.S., Bernanke doesn't a lot of muscle going forward.

So this is to finish. The interaction between Europe's predicaments and LAC populists and discretionary policymaker seems to me is a dangerous mix. With this I hope I'm not predicting or helping to generate the situation where the region goes into a tailspin, very far from that, but I guess the signals are quite clear in my mind that we cannot be very relaxed. Policymakers should be on the lookout for these vulnerability credibility issues. They have to work on that front. That's what Latin America has to do.

I realize that so far they have been very, very, very, very lucky for things that they have nothing, nothing, nothing to do. Thank you.

DR. REINHART: It's a real pleasure to be here and to comment on this very thought-provoking report. I would say that the report which I enjoyed very much reading does present a very integrated picture which is often a departure from reports on Latin America in which Latin America seems somewhere as an appendix or that alternatively the report is entirely focused on Latin America and tends to ignore or downplay the external setting. I think this report offers a very important analytical mix of the global picture.

Contrary to how this may appear to all of you, Guillermo and I did not coordinate, even though because he is my old professor I am about to continue along some of the same issues that Guillermo raised perhaps from a somewhat different angle but some of the same concerns about vulnerability are the things that I'd like to focus on. But let me divide my remarks into four brief segments, where we are, initial conditions, what were the initial conditions at the outset of the crisis? I'm only going to focus on those initial conditions that I think have a bearing for the future so it's not a retroactive, it's not a postmortem, it's initial conditions that have a bearing on where we're going. Third, on the why of capital inflows to emerging markets which have played such a role as Guillermo highlighted in this episode of very ebullient performance in Latin America and emerging markets in general. And then on the future it's really right in the spirit of Guillermo's remarks, what about the vulnerabilities, but not just about external vulnerabilities. What are some of the home-grown vulnerabilities that we are seeing emerge? That's my roadmap.

On where we are, I would like to take the opportunity of course to never miss an opportunity to advertise your own work. I would say that it should hardly be a surprise that the advanced economies have had long and protracted recessions. That is the norm not during the common run-of-the-mill business cycle, but it is the norm after severe financial crises that involve the breakdown of the financial system and the breakdown of credit. And those crises, not just my work with Ken Rogoff, Vincent Reinhart and I did a paper 2 years ago for the Federal Reserve called "After the Fall" which looked at the decade after severe financial crises and a common finding in that study, the common finding is that despite differences in monetary and fiscal policies, despite different exchange rate arrangements, despite different institutional settings, the common long protracted period of deleveraging that we are seeing, deleveraging which lasts between 7 and 10 years, exerts a huge downward pressure on growth and upward pressure on unemployment and this is the situation that we are in in the advanced economies. But more germane to the outlook, it is the situation where we're likely to remain for some time because one of the things that I would flag to Ernesto to be careful in his interpretation of U.S. deleveraging, I actually mentioned this when in this very same venue I discussed the McKenzie Report on deleveraging, is that if you look at the U.S., the superficial numbers look a lot better than they actually are and that's in part because Fannie and Freddy, the two mortgage giants which were on the private sector balance sheet before the crises were transferred to the public sector balance sheet after the crises. What am I saying? I am saying deleveraging, yes, has taken place in the U.S., but it is not as big as the numbers would suggest. And in the aggregate, public plus private debt in the U.S. and in the advanced economies continue to be way off the charts. So that's it from where we are.

But what about initial conditions? I think this report does a fabulous job in also explaining the very favorable environment that emerging markets have found, high commodity prices, low international interest rates, and the report I think however perhaps underplays stocks. What do I mean by that? I think there is much more emphasis on what has happened to flows. I found illuminating, no less illuminating how the remittance cycle particularly those emerging markets that are connected to the advanced economies has played a big role in separating emerging market winners from emerging market losers. But however I would suggest that if you go back to the eve of the crisis in 2007, stocks tell a huge story of who's going to be the winner and who's going to be the loser. What do I mean? If you look at external debt for example, public plus private external debt, I'm not a big believer in that we should be making artificial distinctions. Historically especially after World War I what are private debts before the crisis often become public debts afterwards. So looking at the total external debt picture, who do we see? We see that the advanced economies notably European economies, are off the charts in terms of their stock, their very high stock of external public plus private debt. We see that next in line in terms of external debt is emerging Europe which in this report understandably comes out as a loser. We see that at the other extreme emerging Latin America, emerging Asia, emerging Africa, not only have low levels of external debt by their own historic standards but also cross-sectionally. This is not a small point when we look to the future because it is I think if you ask yourself what position were these countries in to withstand the massive shocks from the meltdown of the fall of 2008 and into 2009, these countries were well poised because not only had they been through purgatory for many years of deleveraging every kind of debt, domestic debt, external debt, public debt, private debt, as Guillermo mentioned, they were running current account surpluses, a very rare occurrence, and so the ability to withstand a big adverse shock was really in many dimensions largely unprecedented for the Latin American region as a whole.

We are seeing the undoing of that in recent years and I'm going to go back to that at the tail end of my presentation. But again if you look at who has done the best in terms of resilience, in terms of actually flourishing after the global meltdown of 2008-2009 and the recession in the advanced economies, you really have to say those countries that, number one, had a low level of initial public debt, private debt, external debt, and number two, those countries that had actually already set in motion well into deleveraging territory. That of course notably left emerging Europe out of the picture altogether. Emerging Europe in effect looks in many dimensions more like an advanced economy right now.

On a brief point but I think an important one, Guillermo in his commentary talked about vulnerabilities that remain in the region and a lot of the external vulnerabilities that were highlighted in both the report and Guillermo's comment, I very much agree with what was said. I would note, however, that large capital inflows to the advanced economies isn't just about savings being freed up to quote Ernesto in the advanced economies, it is about massive monetary policy easing in the North. That massive monetary policy easing which I have no problems with, I think it's very appropriate and germane to the over indebtedness situation that we're in, that massive monetary policy easing is also a way to try to accommodate the very huge historically high levels of public debt that we have in the advanced economies. So negative real interest rates in the advanced economies are a way of helping debtors cope with their debt overhang.

I have the sense that really savings in the advanced economies, the savings that have been generated by the private sector in the advanced economies, have been eaten up by the public sector and that an important source of the capital inflow is the very aggressive monetary easing which one can expect will last but it certainly can be reversed at a future date although I think that future date is still distant.

Let me conclude with the vulnerability theme that Guillermo raised. During the course of the last few years, the Latin American economies and many emerging markets have seen their current account deteriorate, have seen a buildup in debt and the debts are perhaps more palatable in that they're not entirely of an external debt. But let's not forget that to have a real banking crisis you don't need the debt to be external. You just need it to be debt. You need it to be poor lending. Brazil has had quite a lending boom, a steady increase in domestic credit. Part of the domestic credit boom that we are seeing in many of the higher performers has been associated with rising property prices, with overvaluation signs. Those are if you go back to the work that Grasila Kominsky and I did many years ago, key indicators of financial vulnerability. So apart from all the potential sources of risk that could come from aboard from Europe coming to a bad end, from China slowing down and with it commodity prices tumbling. That's another big risk. China also we have to internalize has had a massive credit boom, has had a massive increase in property prices, which could -- again nobody is predicting an external crisis for China, but that doesn't preclude them from having a very severe domestic financial crisis.

The point that I'd like to leave you all with is that let us not declare victory prematurely. This has always been a very big problem. Vulnerabilities that are home grown remain and we can shift from being in the winner's category to the loser's category very quickly. I think that the amount given the very favorable interest rate environment, the very favorable commodity price environment, the amount of public savings we should have seen during this period should have been much higher than we've actually seen. And so I know I'm being somewhat of a wet rag in ending this on a -- but I think emerging markets no question have weathered this storm beautifully. Latin America has weathered the storm on the whole beautifully. But I think a word of caution in declaring victory and declaring that this time is different is a very dangerous proposition for the region especially because to get into trouble in terms of having a banking crisis, it doesn't always have to come from aboard. It doesn't always have to come from external debt. And internal debt including the internal debts in places like Brazil of the nonfederal government are a big unknown and a big source of vulnerability and let me stop there.

DR. LAKSHMANAN: I know that many of you are going to have questions, so I want to make sure I leave plenty of time for the audience. But I also wanted to start out with a couple of points that were made that I thought were quite interesting if maybe some of the speakers could build on them. There was one point that Guillermo made talking about populism being on the rise in Latin America and the question about whether sometimes it is devoid of market friendly ideology. I wonder if, Guillermo, maybe you could start us off linking the macroeconomic picture to the political picture and perhaps Ernesto and Carmen could also follow-up. But give us a little bit more of a picture of how you see populism being a factor here and how you see that connecting back with the economics.

DR. CALVO: Let me say I'm an economist so my comments you can take them in that spirit. But the feeling I get looking at how policymaking is done in the region especially when you compare say the discussion in the U.S. with the discussion down there, it's very, very different. There has never been a conviction it seems to me that capitalism is the way to go. I see Latin America as still in a pre-capitalist stage. There is a sense that that's why the role of the government is always there, the government has to do something for you and the costs of having to live in a capitalist environment where there are losers and winners is something that is very hard to take for those societies. So whenever there is a chance that things improve a little bit, there are all kinds of gripes potential there that the politician senses that he has to do something about. And he does something about it and there is no -- have a sense that there is no counterbalancing factor. There is no group that says, a la Romney, we believe in certain basic principles of capitalism, creativity, et cetera. You can mention several things like that. That's not an issue that comes up. It's not central issue at all. It's always that we are talking about the poor, although income distribution is one of the worst in the world. So you pay lip service to important issues but that's why I said in my presentation I don't think there is an ideology. It's not that you're a Marxist and want the factors of production to be in the hands of the government, you want to nationalize the banks. No. It's something in between. And I guess we are in between because we are going through a relatively pleasant period, but how this is going to change going forward is difficult to predict. Why I'm worried? Leave aside the pure political issues as an economist, because that's what the investor looks at. How sustainable is that? What is the framework? Do these people believe or they are doing this because this is just a cycle and they will turn around once the cycles goes off?

MS. LAKSHMANAN: To be clear, when you're referring to the ideology here and the populism, you're not just talking about Venezuela, Ecuador, Bolivia, you're referring to all of Latin America that you've seen these kinds of attitudes?

DR. CALVO: Right. Yes, those countries you mentioned are more extreme. In a certain sense they have some ideology. They understand a little better what they are trying to do. I may not like it, but understand a little better what they are trying to do as compared to other countries that we see as more pro-market and so on. Yes, so it's a general comment on the region.

MS. LAKSHMANAN: Carmen?

DR. REINHART: Just very, very briefly I would like to add that one danger, and this isn't just a Latin America issue at all, this is an issue with advanced economies as well, that during economic downturns especially protracted economy downturns, the return of protectionism is something one has to be on the lookout for. We are seeing some degree of financial deglobalization right now and I think there have been signs that one should keep on the lookout for the buy domestic trends that we are seeing increasing. This is not populism per se, but it often has done hand in hand with it.

DR. TALVI: I think that's a very important aspect of the current boom that some of the countries have gone through. I like to call it paraphrasing Jean-François Revel the populist temptation. These are booms in a subset of our economies in Latin America that are being fed by cheap capital and financial resources and high commodity prices. So essentially unless you have a state monopoly on the commodity producing, these benefits will essentially accrue to the owners of land and to the owners of capital whether physical or human. And when you superimpose that on very highly unequal societies, and I would go even beyond inequality, very fragmented societies in the sense that there is a large portion of the population that is essentially condemned to informality that is that essentially doesn't have the minimum skills to be employed by the formal markets, then you will have a huge demand to redistribute that wealth that is accruing to certain centers or accruing directly to the state in favor of these very large segments of the population that represent a very large number of votes. So to me it was never a question of whether redistribution will happen or will not happen. It will happen and it is happening everywhere as Guillermo says, and there are two ways you can do this. Either through populist redistributive policies essentially do not ask you for anything in return and are not trying to build future capacities of the people that are the recipients and beneficiaries of this program, but essentially you are buying votes and degrading the institutional setups and some countries that are probably more institutional, that would be the difference I would make that although the temptation is there and the weaknesses are there, they are trying to do it in a way that is not simply buying votes but building future capacities. And I think that you might make a clear distinction in Latin America by looking at what some countries are doing in this respect and some others what I call intelligent redistribution versus simply outright populism.

MS. LAKSHMANAN: Do we have any audience questions? We've got a microphone here. If you could stand up and identify yourself when you get the microphone at the beginning of your question.

SPEAKER: I'm -- formerly from the IMF. First of all, congratulations to the panel for really terrific presentations. My question is to Ernesto. I'm a little bit puzzled why you say that -- your model so to speak of winners and losers applies well to Latin America, but worldwide it doesn't apply well because the most dynamic emerging economies are the Asian economies and they are not either commodity producers, many of them are not very financially open, so how do you explain? Would you say that that was different? I think that you are underplaying the role that policies played and the fact that these countries had -- certainly China had a lot of degrees of freedom, the point of the stocks, the initial position that Carmen made in giving them the room to counteract the adverse winds from the advanced markets with expansionary domestic policies. And this to some extent was true also in Latin America. Let's not forget that both -- most of the countries in Latin America that could afford it had pretty expansionary macroeconomic policies.

DR. TALVI: You're right. Not every country or region benefits from the same things, but I think that the driving force has a lot to do with the large inflows of capital and Asia is a very large recipient of this new wave of massive inflows that we've seen to some of the emerging economies that we identified as likely winners. And you're also right on one thing, and we did some testing on this. It's not easy to come up with indicators of what you can call good policies. But we actually did some complementary work. It's still in the process because we had more limited information. But the preliminary results indicate that among the likely winners, those who had good policies tended to benefit more than those who had worse policies, but even those whose policies in absolute terms were not very good also benefited. And among the likely losers, those that had bad polices tend to be hit in a more severe way than those who had bad policies. So I agree that policies do play a role, but let us not forget that this is not for Latin America, it is a massive capital inflow, high commodity price, story. But the driver to me has to do with the capital inflows and we can have a discussion with Carmen whether the main driver is the change in the net savings in industrial countries or whether it is easy money, but that's I think the key driving force behind the new global economic geography.

DR. REINHART: I would note that within Asia on the issue of initial conditions, all the Asian countries after the 1997-1998 crisis sharply deleveraged on the external side. It is very noteworthy that Korea which is one of your losers within the region is one that actually continued to build up domestic leverage, and so if you look at initial conditions, also domestic debt, public and private domestic credit in Korea never de-levered from the 1997-1998 crisis contrary to what happened in Thailand, Malaysia, Indonesia and the Philippines. So I would think that that would also capture some of the issue that you raised.

MS. LAKSHMANAN: If we have a couple of more questions, if we could just try to keep the questions short so more people can get in.

SPEAKER: Peter -- from the German Institute of Global and Area Studies. Two quick questions. Number one, do we have some numbers comparing the importance of capital inflows, Latin America versus the domestic current expansion? And

Brazil is a case where indeed the public sector banks did massively increase credit to counteract the crisis and so did China both in combination with big public deficits. And I think there should be at least some rough numbers, and I think as you know they're probably as important. The number two question is obviously a broad one issue, Europe and world economy -- acceptable that one says for the sake of the world economy it's more important to have flexibility than a euro as a world currency.

MS. LAKSHMANAN: Ernesto?

DR. REINHART: Let me first begin. I did a paper for a conference in China earlier this year and if you look at a comparative analysis of domestic credit, domestic credit -- among the emerging markets, the large increases by far in domestic credit are China which is actually on a league of its own and then Brazil. It's very different from the patterns. And this is consistent with a policy of trying to stimulate domestic demand via credit creation during the external credit crunch. I think those factors are important in maintaining the resilience to the external shock, but they're also important factors in creating possible future vulnerabilities. Let me also say that the problem with those numbers that I -- and again I'd be happy to send you the table. It does huge comparisons. The credit to GDP in an emerging market at above the 100 percent which is modest by advanced economy standards is huge and that's already the territory where China is at at present. And I would also observe that both in the case of China and in the case of Brazil to a lesser extent, those domestic credit numbers, these are the ones collected by the IMF, underestimate the broader domestic debt buildup because the state, these subfederal states, have issued a huge amount of debt. I completely subscribe to the importance of capital inflows. I think that's been critical to emerging markets. But I do think that the domestic credit buildup in those two countries had a lot to do with maintaining their raising their floor during the bad states of nature.

DR. TALVI: It's interesting just to complement that in the cases -- I agree with Carmen because I cannot disagree with the numbers. Domestic credit buildup was a factor in Brazil and China. At the same time, in Brazil capital inflows trickled relative to 2006, so there was a domestic credit buildup in the context of massive inflows. But in some other countries and my own is one example but there are some others where actually credit was tightened very severely, you had the massive inflows and the huge boom in asset prices and domestic demand, and in fact when you look at through June 2001 Uruguay, Brazil and Argentina, very different compositions but very similar in the case of Uruguay and Brazil inflows of capital, very similar real appreciations of the currencies, very similar asset booms, very similar booms in domestic demand. So I wonder. Is it domestic demand per se or is it the fact that it is easy to do the job of fueling domestic demand when you are being flooded by very cheap money? So this is the only caveat I would --

DR. CALVO: And the question rises too whether -- there is the business of fear of floating. So some of these increases in domestic credit could be prompted by the central banks being concerned about the appreciation of their currencies.

DR. TALVI: that is a direct effect of capital inflows.

DR. CALVO: Right, so it could be --

MS. LAKSHMANAN: How many more questions do we have left? Shall we take two questions together so we can get them both answered?

MR. SCHIFF: I'll make the comments if I can find them very quickly. One is of course that Maurice Schiff, no longer from the World Bank. Just to mention one thing about the capital, there was credit constraint and so it moved to emerging markets, but I imagine one might add the policy of the Fed, very low interest rates gave incentives maybe to move money to other parts of the world, so that's number one. The other is --

what the lady said there, the issue of policies. When you have these winners and losers, I wonder how -- and you have the trends of the past, other things are happening whether it's populism in Latin America more or whatever it is, it might be interesting to try to see whether -- it's hard I guess, where is the counterfactual really? Where would it have been and does it affect anything in your conclusions? And then another thing maybe a bit -- well, I don't know, let me say, the -- is the lesson, I'm going to be the devil's advocate, that it's good to have bad policies because then you don't have these high fluctuations, booms and then busts, et cetera? What does it say about the long term?

MS. LAKSHMANAN: An interesting question and we'll couple it with the other gentleman.

DR. ELSON: Anthony Elson Johns Hopkins CSIS. My question is for Ernesto and building on a comment from Carmen, shouldn't more weight be given to the role of China both before and in the future for Latin America before in the sense of already creating this bifurcation between South America and the rest of Latin America because of terms of trade shocks, and looking to the future as creating a tremendous risk because of the transition going on there and the weakening economy and how that will reduce possible beneficial terms of trade for Latin America?

DR, CALVO: Second best. That's what you're saying. With incomplete markets maybe bad policies are good and the right thing and I have some colleagues -- be very happy to expand on that if you know what I mean. But the problem with bad policies is that we don't have the theory to know whether they will work or not, but when you look at the case of Argentina at some point, for example in 2008 and compare it with Chile, the credit crunch in Argentina was less pronounced than in Chile partly because there were all of these controls going around, so that's my answer.

DR. TALVI: I could like to complement on that, Maurice, because it's very interesting. Argentina in the aftermath of the global financial crisis and even before that, did whatever it took to basically be hostile to foreign and domestic investment. And in fact, we've seen capital outflows throughout this extraordinary boom period that they went through between -- let's forget about the rebound from the deep recession, 2005, 2006, 2007 through 2011. So in spite of having delivered really bad policies not on the macro side because they had a fiscal surplus during Kirchner's -- but in being hostile to foreign investors and saying I don't want your capital coming in and they were successful. And you could construe that in your terms saying I don't want that capital because that capital is going to -- it's money that is going to put me through a boom and then through a bust, I don't want it. Nonetheless, in spite of that and perhaps due to the commodity price boom, they went through a tremendous expansion. In fact, my counterfactual to my Argentinean friends was that if they had had good policies that would have attracted capital on top of the commodity boom, Argentina would have been the largest growing economy in the world. So I know I'm not answering exactly your question, but it's very difficult when you have these external shocks to decide on your own whether you want to have -- just on your own to have bad policies and try to prevent these external shocks from feeding into your economy anyway.

MS. LAKSHMANAN: Carmen, is there anything you'd like to add to that as well as the question about China and Latin America?

DR. REINHART: Very briefly. On bad policies I think it depends on your time horizon. The shorter your time horizon, the better bad policies can look. You can always take a boom and make it boomier by acting procyclically. We seem to do that on a recurring basis in the advanced economies and in the emerging markets. Over the short run you look like a genius, over the longer haul when you look at income per capita measured over 100 years it is difficult to come up with arguments that core policies over time do not leave their traces. On the China question, I do think we have to rethink very much the role -- the increasing role -- very briefly, I mentioned the fact that China's growth is importantly tied to the fate of commodity prices, but I think one area that also is becoming increasingly important for Latin America from China is looking at China as a source of finance for Latin America despite very -- despite a nonconvertible currency and very controlled capital markets. I think a lot of the source of finance that the West, especially the U.S., has traditionally played for Latin America, I think China is stepping into those boundaries so I do think it's very important to factor that in looking forward, and you begin to see that with bilateral arrangements and bilateral FDI and so on.

DR. CALVO: An appendix referring to the YPF deeper -- Argentina is having problems finding investors and so there is the argument going around which I think has some weight that all of a sudden countries like China could have a comparative advantage as a partner because China is also a big trade partner for Latin America, for Argentina in this case, so if Argentina does not behave, they have some countervailing power that is not available to the individual investor. So that could be another reason why China may start playing a bigger role particularly in countries where institutions are weak.

MS. LAKSHMANAN: We have time for just one last question. The gentleman there has been patient.

SPEAKER: You all say that poverty rates in Latin America have decreased. Poverty rates in Latin America generally have decreased -- suggest that they have in fact increased, but Peru for example has done a good job in decreasing poverty, extent and degree as well.

MS. LAKSHMANAN: The question was about whether poverty rates in Latin America have risen or decreased.

SPEAKER: Decreased.

MS. LAKSHMANAN: Let me just tack onto the end of that on behalf of any journalists who are listening and watching who may want some bit of a news peg, I was struck by how interesting it is that we're talking about a fiscal crisis now in the news and we're not talking about Latin America. So Latin America has been through its own financial crisis in the past and I wonder if any of you have any brief thoughts on any lessons for the Euro Zone that might be learned from Latin America's financial crisis.

DR. CALVO: On your question, the best way to have a food fiscal stance is to grow. That's the easy way and that's what Latin America did for a while, but now partly because of commodity prices in some places -- but now even though the conditions are still quite favorable, they are spending the bonanza. So that's why it doesn't apply to -- certainly to Europe because first you have to grow. That makes it easy. And I think that's the way that Latin America has been able to have a stronger fiscal position, and I think they've been taken by surprise because prices went up much faster than in the past so I think it's not only that things got better, but the rate at which they got better was much higher than in the past and that's how they succeeded in improving their financial conditions -- fiscal conditions.

DR. REINHART: I really don't have much to say. I leave the poverty question to you. Let me just say that I think that Latin America being out of the news is more a statement about Europe than a statement about Latin America. And in that vein, let me say what is a -- restructure. I think the whole idea that restructuring is something that emerging markets did but advanced economies didn't show a complete ignorance of pre-World War I debt resolution. Most of the advanced economies in their histories have restructured debt, sometimes private debt only, sometimes public debt, sometimes both. And I think the insistence that Europe is going to solve this problem entirely through austerity -- and I am all for the austerity. I think it's necessary. I just don't think it's sufficient when you're dealing with levels of debt of where they are and I think the restructuring word has to be put in the plate.

DR. TALVI: I would like since -- so we'll complement each other perfectly on the lessons. Guillermo mentioned and it's factually true that Latin American countries after the crises in part grew out of their high indebtedness by depreciating very dramatically the exchange rate and exporting their way out into recovery. Carmen mentioned the second way in which we many times solve our problems which is through restructuring and many times that restructuring when it involved the private sector involved also protecting depositors to avoid or impede bank runs that could be -- we know how they start, but it's difficult to know how and when they end. And there's a third instrument that we used in that very often in order to ease the fiscal adjustment and the realignment of -- prices to promote growth and it is inflation. And in that sense, although I'm not recommending the ECB using the humongous inflationary spikes that we used to dilute the real value of nominal commitments, an easier monetary policy that would imply higher inflation rates for the Northern countries for the next 5 or 7 years would make it a lot easier for peripheral Europe to adjust to the new situation and this is something we've very often used. I don't know if we have time in here to address the poverty question.

DR. CALVO: I wanted to add one additional twist in the case of Latin America and restructuring in Latin America compared to the restructuring in Europe, and that is that Latin American international debt was vis-à-vis countries outside the region, whereas in Europe it's countries inside the European Union. It's debt vis-à-vis Germans or debt vis-à-vis the Nordic countries, the Swedes and Finland and so on. So that politically seems to me much more complicated. It is a way out, but all I'm saying is that politically it's complicated especially in the midst of a situation where you are trying to unify the situation there and you have to start by -- them actually. It's going to be hard.

MS. LAKSHMANAN: I don't want to abuse people's time, but does anyone have a one line answer on the poverty question?

DR. CALVO: There is a study by -- on poverty and income distribution. I'm not an expert on that, but they claim that there has been an improvement in the conditions.

DR. TALVI: I have a one liner on the poverty. There has been a reduction, a very substantial reduction actually, in the poverty rates and what we call the -- how do you say -- indigence rates. But this is the take we have on this. When the prices of the products that you see are going up, commodities, and when the capital and the financial resources that you're using then to produce them is going down, your income is going to improve and therefore poverty rates and indigence rates are going to go down. But it is not the same to reduce poverty and indigence because your income increased. Then because your ability to generate income has improved. And when you look at the ability to generate income, and my favorite indicator is look at the quality of education and achievement, except for Chile, the problems in Latin America in the last 8 years has been null. In fact, in two countries, and one of them I'm not going to mention, the other is Argentina, we actually deteriorated the quality of education. So I wonder whether these income gains that have reduced poverty based on good luck are sustainable if you are not improving deep down your ability to generate income.

MS. LAKSHMANAN: Thank you so much to the terrific speakers. A very compelling discussion. And thank you to the audience for staying later.

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