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## P R O C E E D I N G S

MR. TALVI: Okay. Well, Good afternoon, thank you all for joining us today for this discussion. Thank you to my good friends, the panelists. Hector Schamis is probably going to show up a little bit late hopefully, so we are expecting him. I'm going to introduce the panel first and do a very small, very short comments to set up the stage for the discussion. And for today's discussion, we have José Luis. José Luis is a national from Chile. He is the chief investment officer and co-founder of QFR Capital Management, a hedge fund. And he has had a very large, important experience in the hedge fund industry. But also he was the global head for emerging markets strategy at Deutsche Bank and the head of emerging markets research at JP Morgan, and he has several recognitions as the best global market strategist and institutional investors and other recognitions by Latin Finance and he did his graduate work at Georgetown University.

MR. DAZA: Let me say just one thing, my most important achievement, I was a high school classmate of Ernesto in Uruguay, 1970.

MR. TALVI: When his father was ambassador at (inaudible) it used to be, the prior agreement to the (inaudible) so we went to school together and we now are, and this is our second reincarnation I think.

MR. DAZA: That's when my knowledge peaked, when I sat next to him and he taught me everything in high school. Since then it has been depreciation.

MR. TALVI: Well, Monica is Brazilian, a Brazilian national, she's a senior fellow at the Peterson Institute for International Economics here across the street. She is also a professor, actually a very prolific professor. She teaches a lot of courses at the School of Advanced International Studies at John Hopkins University. She was named as Honored Economist in 2014 by the Order of Brazilian Economists for her contributions to the Brazilian policy debate and she's not only a very good economist, a very courageous one. So, and she earned her Ph.D. at the London School of Economics.

MS. de BOLLE: I'll also make a disclaimer. I did not go to high school with Ernesto, but I did meet him many, many years ago at another incarnation when I was working at the IMF. So it's a pleasure to be here.

MR. TALVI: We were on the other side of the table negotiating. We started our life

together fighting. So we became good friends, eventually. Now, Hector, and we hope he will show up, is from Argentina. He teaches at Georgetown University Center for Latin America Studies in the Democracy and Governance Program. He's a weekly columnist at the El Pais in Madrid, he has written several books and he has a Ph.D. in political science, so he is the politician on the panel, from Columbia University.

So that's the panel, and I just want to make a short introduction to set the stage and for Latin America, after a decade of bonanzas, we are now somewhere around the generalization of the crisis in the Eurozone, to Spain and Italy, to the big countries, and the temper tantrum in May 2013, we had like a reversal of fortunes. Developed countries never recovered their dynamism, the pre-crisis dynamism, China, which took, took the torch immediately after the (human) crisis, cooled off very significantly. People usually look at GDP, but if you look at imports, they've been declining at 15 percent year on year for a long period of time and that's I think what's relevant for us, fundamentally, because China is a big acquirer of what primary commodities that Latin America actually produces and exports.

As a result of these two, we all know commodity price, if you take them in real terms, they are at the 2004 levels, the pre-boom levels, and that's true for all the groups, foods, metals, and oil. And fourth, let's say feature of the global geography that actually changed very significantly is there is this latent fear of financial disruption and in part, fed by the phenomenal increase in the debt ratios in China and the possibility that they're unrecognized losses in the banking sector that eventually can come back to haunt us. And any spark suddenly creates a lot of noise, and if these factors were not enough, we added a layer of uncertainty after the election in the U.S., I'd say at least in the dimension that we don't know if the cooperative agreements that were predominant in the last 60 or 70 years, I mean peaceful cooperation, relatively peaceful cooperation through free flows of trade, capital and to a lesser extent, but not to a minor extent, even people, if that model, it's still going to prevail.

So what the result of all of these things combined was that the region experienced a very severe outflow of financial capital. In fact, not only the region emerging markets as a category, after a decade in which we were flooded by capital that came to buy land, to buy property, to set up new businesses, to, to buy bonds, stocks, creating the boom that we all know about. And that came associated with a very, very sharp deceleration in the growth rates that are going to be negative when 2016 numbers are known after five percent growth in 2012, and this is I think the important aspect of this.

This has brought about a lot of frustration. And many people ask why are people that frustrated? If you look at income per capita levels after a decade of finance and people are much better off today than they were ten years ago, that's true. But then we had a car that was running at 150 kilometers per hour, and now it's running at ten. And still perhaps advancing in some cases, but running at ten.

But people, households, took on commitments, took on debt, to buy houses, to buy cars, et cetera, on the basis of that the car was running at 100, not at ten. And firms took on commitments to invest, to increase productive capacity, to take on employees, on the basis of a growth in demand that actually did not materialize.

So, it's very harsh. That's why Rudi Dornbusch used to say it's not speed that kills you, it's only sudden stops. Sudden stops, to the extent that people took commitments based on a velocity that is no longer there, create a lot of pain and a lot of frustration. And people, somehow feel that the future is not like it used to be and feel cheated because in part, the elite have convinced them that it was their own, the bonanza, the bonanza was of their own making, and not because we had a very exceptional external environment.

But people are not only frustrated, they're also angry. And the anger is essentially fed because of the corruption scandals that have popped here and there, that people, and we all suddenly discovered, maybe some of us were a little bit naïve, that this was not incidental, isolated cases, were not incidental isolated cases that an organization can have. But this was institutionalized corruption, it was a regime, a way of operating, in which there was like corporate political conflicts in which the private sector funding campaigns and perhaps a few of the leftovers went into the pockets of the politicians as well. And the fact that not only was this unveiled, but the fact that it was so generalized and that the tentacles of the problems in Brazil, the epicenter, are so large and affect so many countries in the region, that people are really, really angry.

So frustration and anger are not a very promising combination when you need elites to be, to produce and to perform and face very important challenges. I mean the region has macro challenges, I mean fiscal deficits have grown very large in many countries, Argentina, Brazil, Ecuador, Venezuela, we have the challenge of rekindling wealth and for that purpose, we are going to need to do some kind of reform and we have also the challenge of somehow protecting the network, the social

protection network that was created during the bonanza. And all of these are very big challenges that we have to undertake at a time when the political elites have been severely weakened because of the frustration and anger in their ability to perform.

So I think I'm not answering any question because I want the panel to answer these questions and so I'm going to pass on first the word to José Luis, and so he can give us the market perspective of all of this, and if you disagree with some of what I said, José Luis, you are welcome to--

MR. DAZA: Perfect, thanks. I am going to put a timer here, because if not, I am going to speak for an hour.

MR. TALVI: If Hector doesn't show up, we have a little bit more time.

MR. DAZA: Okay, I'll take his time. Okay. So, I'll try, thank you very much, thanks for coming on this beautiful day. You have some degree of masochism to come and listen to us and not be outside with this gorgeous weather. Let me, as Ernesto said, I'm going to try to give you a little bit of perspective from financial markets, how we look at the region, how we look at countries and what is it that we look at. And it's a combination of external factors, the global economy, global financial markets, the region, individual countries. So let me tell you what the first sort of a very, very big, big high level.

We find that the most important, if you had one factor to describe the cycles in Latin America, political cycles, economic cycles, et cetera, the one factor model is terms of trade, it's commodities. You can pretty much explain all of the ups and downs and the twists and turns of politicians, et cetera, there's always a story, a good politician comes about, but the underlying force is commodities. Commodities, this has been for the last 50 years. And we do quantitative work to try to estimate this, to look at this, and to try to extract risk (inaudible) what is the, what are the bonds pricing, et cetera. So, number one, commodity, cycles. And we are obviously, we have just come to the end of a big, big commodity cycle. As Ernesto said, 2013, 2014, commodity prices started to turn down.

What had happened before to try to explain the situation before? Sorry, I'm going to do it, very, very quickly. So the period '98 to 2002, essentially marked the period of lower commodity cycles in almost 100 years. It was really devastating for emerging markets, in particular, for Latin America, whether you looked at oil, whether you looked at copper, whether you looked at soybeans. And during that period, Latin America faced one after another, a huge succession of crises. These crises during this

period, was instrumental to all the world. And let me tell you why something that is having a big impact today. As we entered 1998, and in 1998, the year Chávez comes to power, oil prices reached \$8 per barrel, okay.

As we entered 1998, as you probably recall, that's the year of the Russian crisis, all of the world was in fixed exchange rates, you know. The crisis started actually in '97. It started in Thailand. All of Asia, in Thailand, Philippines, Indonesia, Malaysia, Korea, all of those countries had fixed exchange rates. And one by one, started to see their exchange rate regimes blow up. Then the crisis moved on to Europe and you had Poland, Czech, Turkey one by one, and eventually Russia (inaudible) and then the crisis moved to Latin America.

By 1998, pretty much all of the countries in Latin America had moved to fixed exchange rates or (some) effects. Mexico had already exited, was the only one. And we started to see this phenomena of country after country. And it's interesting, the biggest one of all, the (inaudible) one was in Brazil, 1999. Brazil goes to IMF, and I see somebody very important in this room who led the program that stabilized Brazil and is Teresa Ter-Minassian, who is sitting here with us. And, and, and Brazil essentially devalues. And then you have Argentina and then you have, and what you saw was all of the continent moved to free floating exchange rates. And today, all the world has exchange rates now floating too.

Now, this is very, very important. Why is it important? Because during the period after '98 to 2003 we go from a period where commodities goes from the lowest prices in history to essentially the highest prices in history, the highest. So the terms of trade, the positive bonanza for Latin America was extraordinary. And what you saw in country after country, you saw, during the period, during the period of crisis, all the governments who have implemented reform, have tried to do reasonable things, they were kicked out of office. And coinciding with this crisis, you saw the populist left of Latin America come to power. So Chávez comes to power with oil at \$8 per barrel and see oil go all the way to \$140. Argentina, soybeans, the lowest essentially in history and they see the biggest turnaround in terms of trade in their history, country after country.

And most of these governments, what do they do? They say this is a wonderful, permanent bonanza. So you start to embark in programs, spending programs across all of the continent

under the assumption that these are spending, permanent spending programs, and you see dramatic increases in the size of the public sector. In Argentina, I went from 22, 23 percent of (GB) to 45. Ecuador doubled, and Chile that had been very, very disciplined in terms of maintaining government spending under, below 18 percent of GDP sees the first government virtually increase it by six percent points, and then another.

So you have a continent that assumed that these terms of trade were permanent, they increased government spending dramatically, and then commodities turn around, and we start to see the crisis. Not a crisis, because this time what we see is exchange rates doing their jobs, floating exchange rates are across all of the continents that started to weaken. So we saw a massive, a very significant depreciation of the currencies around the region.

Now, as I told you before, commodity prices determine the cycles. With this down cycles, when the economy couldn't grow anymore, when we couldn't continue expanding government programs, as a matter of fact, we need to start to retrench, we saw all the politicians that had come to office start to lose power. So off went de Kirchner, eventually off went (inaudible). In Peru, we have a shift to the center right, and what you see in Latin America today is you see a group of sort of center-ish right-ish governments, market friendly governments trying to cope with over bloated states, that they have trouble in financing and they are choking the capacity of growth of these economies.

The problem for them is that unlike the previous cycles, it doesn't seem obvious that commodities are going to turn around and going to come up very significantly again. So we are facing with sort of center-ish, right-ish governments across the region who are trying to do the right thing in an environment of low-growth, low investments.

There's one thing that is in there that is helping them and this is very important, is the level of interest rates across the worlds. As we look at investment opportunities across the world, what you find is a very difficult to understand phenomenon. Investment, fixed capital formation, new plans, new equipment, new factories across the world has been in a steady decline now for almost a decade. It went up during the mining year booms, but now it's gone down. And what you see is large pools of savings. What is more important, growing pools of savings as people start to contemplate retirement, looking for investment opportunities and there are not that many. So interest rates in the world are

extremely low. Japan has negative interest rates. Germany, ten year interest rates in Germany are negative, five year interest rates are negative. So the world is looking for investment opportunities and this is helping Latin America.

So, let me see, before I -- so Latin America has this, there's one positive external factor, and there are negative external factors. The positive external factor is financial conditions in capital markets are the most friendly that we have had almost in a generation. The Federal Reserve's increase in interest rates is going to be very mild. And to reflect what a different world, this world with free floating exchange rates, we have something that we have not had before. So the Federal Reserve started to raise rates last year, right, as a matter of fact, more than a year ago.

This year, we've had two increases in rates. And what you see is countries across the region lowering interest rates. Brazil is cutting interest rates dramatically, Colombia is cutting interest rates, Chile is cutting interest rates. Argentina has had to raise them because they have an inflation problem. But you see the role of exchange rates, the role that they're playing, the role of the local capital markets that are allowing countries to have their own monetary policy. This is completely new. So let me, go, so we have flush liquidity, floating exchange rates, hyper bloated governments that absorb most of the savings of the economy, so there's very little room for investment and very low growth.

Now, let me tell you very quickly, I'm going to mention a few countries as to how we see them and what we are doing from the point of view of the market. Let me start with Brazil. Brazil had an (original signature) constitution they implemented in 1988. So in 1988, Brazil spent about 22 percent of GDP, the government and it indexed a lot of social programs and a lot of, there were a lot of mandates to the states, not to GDP growth, but to other factors, minimum wage and other factors. And what you saw was the size of the government of Brazil grows steadily from 22, 23, 25, 26, 28, 40 something percent of GDP.

In a country that saves little, so the government sucks off all of the savings of the economy, and the investment rate in Brazil is very low, invest 17 percent of GDP in new machines, in new (inaudible). So they cannot grow. Brazil cannot grow, compared to China, it invests close to 50. So the solution for Brazil went through changing the constitution. The constitution is one mandate spending, you have to change it. And they, they're making essentially two changes to the constitution that are very, very



tricky to implement into one thing. Number one, they are fixing government spending to zero real growth for the next 20 years, zero. Now, I think that is very difficult and I want to hear from you what you think later. I think it's very difficult not to increase government spending, I think it's unrealistic.

The second one is they are making important changes to the constitution, to the constitution on social security. The pension system of Brazil is absolutely unsustainable. It is the most, when we look at the world, you have Greece and then you have Brazil as the most unsustainable social security systems in the world. Brazil spends more in retirees today than Japan, it has less than a third of the retired people, in proportion. So they're changing the social security system. Both are extremely important reforms. So, in the near term, the markets are giving the benefit of the doubt, to some extent, to the Brazil government as they implement these reforms. But, the question is will they do the social security reform, is it going to pass. It already has been watered down by about 40 percent of the initial intent.

And the question is will it survive politically. There's an election next year in Brazil. I'm going to let you talk about the election. But the markets right now see Brazil as doing an extraordinary effort to create the conditions that would eventually would allow Brazil to grow. If they want to eliminate poverty, et cetera, et cetera. So that's number one.

Quickly, let me go to the neighbors. I hope we have time to discuss and argue and fight later, not fight but argue.

MR. TALVI: We will, we will.

MR. DAZA: Argentina. I think that similar story, Argentina was one step away from the precipice. They were really on their way to becoming Venezuela. It was a completely, completely distorted, mismanaged economy, closed, et cetera. It was really, really. The new authorities coming, they have an extraordinary amount of success in the first six months. They did things that were extremely difficult to do. I thought they would be very difficult and very close to the people who renegotiated the debt and they did a phenomenal job renegotiating the debt, bringing Argentina back to capital markets, they eliminated capital controls, they started to restore order in the fiscal.

Now, they set inflation targets for the Central Bank, they recreated the National Institute of Statistics. Argentina stopped having a national statistics institute, they started to lie, just simply,

whatever number they wanted to publish, they would publish. The damage that was done in Argentina was extraordinary. But there's enormous goodwill with respect to Argentina in the world, from the center left to the center right. Look, Obama went there, to Trump, who received Macri two weeks ago here. So there's an enormous amount of goodwill.

But the weakness of Argentina historically has been the fiscal accounts. And once again, they're not tackling their fiscal problem. They say the expected growth will generate more revenue, and (indulgently) close the budget deficit. But once again there, I think that that's a very optimistic and very risky strategy. We will see if it works, but Argentina, they actually look -- if you look at the public sector deficit, last year, '16 was higher than during the last year of Kirchner.

So they, essentially Argentina, you know what they did, they had a large budget deficit under de Kirchner, which was funded via international reserves of the Central Bank. They funded, they used them to fund and they run them to zero and printing money. The new offers come in, and they maintain the budget deficit and they say we're going to fund it mostly with external dollars, with external dollars, with external savings. So this strategy that this government chose was to appreciate the currency. So they have a very, very strong currency. I'm optimistic, I know -- I think that politically, they were in a very weak position. I mean they came, barely won the election, they had a minority in both chambers of congress, and I think that they've gained political capital. But Argentina still has a big, big task ahead in terms of not only reducing the budget deficit, bringing down overall spending.

Let me quickly jump to their neighbor, Chile. Chile I think faces the most important election since the return to democracy, and it is at a bifurcation. The second government of Bachelet was campaigned on many of the code words, symbolisms, signals of the populist Latin American left. They implemented a set of reforms that was catastrophic, but I mean is remarkable and they don't know how to undo it, how to unwind. And now we have a division. You can either have Piñera or a reformation with this gentleman Guillier. I think it's the most important election in Chile, and it will determine whether Chile continues in the path it was for 30 years or it makes a turn à la Latin classical styles.

Finally, a word on Venezuela because I'm going to finish. We operate in the debt markets, we have been in investing in Venezuelan debt markets for a long period of time, particularly in PDVSA debt market. But let me tell you something. Venezuela is a failed state. Venezuela is like

Somalia, Venezuela is like -- there's no institutionality function. You can go in the street and kill people, you can go to rob, you can go kidnap, nothing happens to you, nothing. The paradox is that the government has enormous incentive to continue to pay the external debt, enormous incentive to continue to pay the external debt, especially of PDVSA, the oil company, because if they stop paying the bonds of the oil company, international investors will attach those assets. They couldn't do it in Argentina because Argentina didn't have external assets. But PDVSA the oil company does, and they're going to go.

Furthermore, last year, PDVSA issued a bond that is collateralized with one half of the equity in the biggest asset they have in the United States, which is CITGO, the refinery that sells gasoline. So if they default, they lose half of CITGO, they're going to see their assets attached, they're not going to be able to sell their oil, and it's the end of the government for sure. So if they're going try to continue to pay the debt, but this is one of the human tragedies most nasty that I have seen in my lifetime. Let me stop there and let the other panelists.

MR. TALVI: Would you be willing to in one minute, possibly say a word about Mexico?

MR. DAZA: Yes, sorry. Look, Mexico, in 1994, I was at JP Morgan when NAFTA was passed. And to me, this was one of the most extraordinary opportunities that world had seen. We had never seen two countries as different in factory endowments as Mexico and United States, essentially merge, eliminate all barriers to trade and to financial flows. To me, this was a country that had all the opportunities of convergence, you know, invest, export, et cetera. And do you know what is the rate of growth of Mexico since that time? 2.2 percent, in the last ten years, 2.2 percent, last five years, two percent. Mexico has serious problems beyond Trump. I mean you can take away the Trump story, the NAFTA, which I think is going to go away by itself, and I really think that is, it's -- there's not going to be much happening on that front. It's, there's not going to be much happening on that front. It's in the best interests of both, they have an understanding, there are a lot of discussions. So I think that is not -- but Mexico is a country that cannot grow, has not been able to grow. They have -- I don't have enough time, but I think that now on top of this, we have a country that as you said is very angry. The population are frustrated, the population feels in addition to the insults and their grievances from this gentleman from over here, they feel the elites have completely defrauded them. And at this stage, Amlo looks like the most likely candidate in Mexico, so I think that markets are not focusing on that yet. We are all paying

attention to Trump, what is Trump going to do, what is Trump going to do, what did he say, what does, blah, blah, blah.

But I think that Mexico has serious structure problems and that frankly, I think that from the point of view from the economy of making the labor market more flexible, more (inaudible) attracted, it's not going to -- (inaudible) Amló, I doubt that he's going to be the solution to that.

MR. TALVI: José Luis, thank you so much. You, I mean one, two, three, four, five points that you left us to discuss. I'm going to take advantage of Monica and then, Hector, thank you for -- I know you had a slight problem, so thank you for being with us, and immediately after Monica, I'll settle you into the tone of the discussion so you can, you can join immediately. But Brazil, Monica, because I was interested in, in the remark by (José Luis) that he said since we now have floating exchange rates, we have no crises. And I think that what Brazil is going through is even worse than what we saw in 2002 or 1999, so I don't think that for a Brazilian, no crisis would resonate.

MR. DAZA: No balance of pay-, no balance sheet crisis from (inaudible).

MR. TALVI: No balance of payment (inaudible).

MR. DAZA: You are absolutely right. The GDP, this is worst recession they've had in history.

MR. TALVI: In history.

MR. DAZA: In history. No, I agree.

MR. TALVI: And we agree on the definition of that. I understood. I was trying to play a little bit--

MR. DAZA: No, no, absolutely.

MR. TALVI: But you didn't let me. So, Monica, two things that José Luis said. One, this about the definition of crisis. Two, is the Temer government realistically addressing the -- do you agree that the problem is over bloated public spending, because I think you have other things to say about (inaudible) and this and that, and over bloated public spending, maybe high interest rates, is Temer actually taking the bulls by the horn, and will he be successful. And third, I would like you to address the question that I posited at the beginning. Is the frustration and anger and the loss of prestige and respect of the political elites going to send Brazil and this is a question I would also like to pose to Hector, into

uncharted territory in terms of politics. Are they going to choose an outsider that is completely, I mean, and so we don't know exactly what the future brings for us in terms of the key country of the region.

MS. de BOLLE: Absolutely. So thank you Ernesto very much for inviting me to speak here. Thank you José Luis, for your very cogent remarks. Let me try to address all of your questions to the best of my ability. But before I do that, let me begin with something that I think is a, for me, the starting point or the reference point to think about Latin America and Brazil in particular at this specific point in time, but not just. I mean over the years I think this is a starting point that characterizes the region very well.

In 1991 Rudi Dornbusch and Sebastian Edwards wrote a book called "The Macroeconomics of Populism in Latin America." I believe most of you in the room, or some of you in the room are familiar with that. I also realize that the term populism, given the political scientists in the room is not something that has, you know a very sort of well defined definition or understanding. But that book specifically kind of laid out, you know, how boom bust cycles have happened in Latin America. And it took a few case studies, it looked at Brazil, it looked at Peru, it looked at Argentina, and it tried to sort of draw parallels between these different countries experiences, and sort of put it into a macroeconomic framework.

So in other words, it's a book about unsustainable macroeconomic policies and what they entail. Now, of course, when they were writing the book, this was a time of fixed exchange rates, as was José Luis was saying before, which basically meant that boom bust cycles were not just for that reason but others too, very short lived. So whenever you had these boom bust cycles in Latin America propagated by regimes that were completely, you know, ignorant of, and ignorant because they wanted to be ignorant of budget constraints or any other type of constraint, they would just, you know, run the fiscal to the ground, run credit policies to the ground, do whatever they had to do to institute a boom and then all of it ended in tears because of course at some point, investors found the situation unsustainable and pulled their money out.

So this is very much the story of Latin America in the '70s and the '80s and the '90s, even before that, if we go back to the time of Getulio Vargas in Brazil, it's been long running in Latin America and it keeps repeating itself over and over again. I would argue that we did see that happen again in the

2000s with the difference that we had a starting point which was a little bit more solid for a lot of these countries so they had, you know, macroeconomic frameworks. They were starting from macroeconomic frameworks that were more solid. They were started from flexible exchange rates. They did face the external bonanza that, you know, happened to, to these countries during the 2000s, and yet you know, all of these governments in the region or at least a good portion of them, and Brazil was no exception. It was perhaps the, not as bad as -- it was certainly not as bad as Venezuela, almost not as bad as Argentina, but nonetheless pretty bad.

But we saw all of these governments basically doing the same things that they did in the past, the difference being that, you know, there was a, there was a different type of scenario in place, and they had a little bit more room for maneuver, given the kind of house cleanup that they had done in the years before. So I think that book, that 1991 book is still very, very useful for thinking about Latin America these days and what these countries are currently going through.

In the case of Brazil specifically, the -- let's call it the experience of the PT government, which actually started out really well under the first Lula administration, so the first Lula administration was actually relatively responsible fiscally speaking. It did keep in place the macroeconomic framework that had been in place under the previous administration, which did all the cleanup and introduced the Real Plan and did all the things that it needed to do to clean up house. So it kept all of that in place. You know, there was the external bonanza which also allowed that first Lula administration to start ramping up the social programs and therefore, you know, doing several things which were actually long lasting in Brazil, so there was social transformation that happened in Brazil.

But things started to deteriorate after that. So under the second Lula administration, there were already some very clear signs of corruption, which naturally pops out of these, you know, kinds of unsustainable policies and the cozying up between the private sector and the public sector that usually exists, having public sector financial institutions like BNDS to be used in a way that shouldn't be used certainly helps that to happen, which we saw indeed happen in Brazil.

And then things took a turn for the worst in, in the Dilma years. And the Dilma years were especially bad because they lost a bit of the pragmatism that was present during the Lula government which were leftist, populist in ideology but had a lot of pragmatism to kind of balance that out

on the other hand. The pragmatism was gone under the Dilma years and we were left with the ideology. And that basically meant, you know, just doing a lot of the things that had been done in the past, again, ramping up credit, using a lot of public banks. For these reasons, BNDS in particular, which was widely used to lend to companies and to do things that were not necessarily good for the economy. In fact, I have a paper that shows it had a very bad impact on productivity and growth during this period. It also served to push interest rates up, real interest rates, making the cost of capital very high, reducing investment in the country and having all of these nefarious impacts.

But there was also a lot of micromanaging. So the broad macroeconomic framework was gone. A lot of unsustainable macro policies were put in place. Yes, the 1988 constitution in Brazil is certainly a problem. But it had been a problem for years, and it was a problem that was made a lot worse by the policies that were implemented during the Dilma years. So I would risk saying that had we not seen the same sort of reversal to previous boom bust experiences of the past during the Dilma government, we might have been able to live a little longer with the constitution as it is, without having to go into the massive changes that we're being forced to go into.

So I really do think that the Dilma years were very dramatic for Brazil. And I wrote a book about it. It's only in Portuguese. So for those of you who read Portuguese, I can give you the name of that book. It actually did very well in Brazil as an analysis--

MR. TALVI: What's the name?

MS. de BOLLE: It's called, "How to Overcome the Blue Butterfly, A Chronicle of the Dilma Years."

MR. TALVI: In Portuguese?

MS. de BOLLE: (Portuguese).

MR. TALVI: Okay.

MS. de BOLLE: So this was a book basically about why Brazil, and it came out right after Dilma's impeachment, which was really good timing for the book. But it was basically a book about how, you know, the deconstruction that happened during the Dilma years led to this very dramatic situation in Brazil where the country's been in a massive recession for about three years now almost. You know, per capita GDP has fallen by more than ten percent within this time period. A lot of the so-called ascension to

the middle class of a good portion of the population has regressed. That middle class story is still there, but there's been a regression in terms of a lot of people who were so-called vulnerable middle class are now back in poverty.

The level of anger and frustration that exists therefore reflect exactly the situation in the country and a bit the lack of understanding of how certain policy combinations led to this and these policy combinations, as I said before, included a number of things, price controls and a number of things that have been done in the past that really just didn't work and were tried again and didn't work again, and made the economy into a mess.

And then we are having, what we are going through now is the typical phase that you always get after a bust. You get another government in place. In this case, you know, you had a president ousted and there are question marks about how that ousting happened, but leaving that aside, we had a president ousted, another government put in place, our current president was the previous vice president. But he's trying to, or he has been trying to put in place a so-called center right agenda and a center right reformist agenda, trying to, to address all of these medium term problems, fiscal problems and other problems, other structural problems, because his agenda is not only confined to social security reform and spending caps, but it also envisages a substantial overhauls of Brazil's labor laws, which have been long in the making, since Brazilian labor legislation is indeed in need of a massive revamp.

But nonetheless, he has this very ambitious views of government with a very ambitious agenda, facing a population that is very frustrated, very angered, a country that's completely polarized because there is part of the population that simply doesn't view the process of what happened politically to Dilma as something so called quote unquote legitimate. We have to say that. It was followed to the constitutional letter of law. So constitutionally speaking, it's a legitimate process But there are many people in the country who question its actual legitimacy given that the government that's in place, a third of its cabinet is under corruption investigations or has allegedly had some participation in the corruption scandal that's grown out of Brazil.

So you have, you know, the whole of the corruption scandal encompasses all of the political parties, PT, PMDB, PSDB and a whole bunch of other political parties in the country. And no one is really unscathed, and especially the current government is not. In the middle of all this, they are trying



to implement this very ambitious agenda. Speaking of the agenda a little bit, so the spending cap on the one hand and the social security reforms on the other, I agree with José Luis the spending cap is completely unrealistic. It tries to really keep government spending from growing in this 20 year period, which is not likely to happen, especially in a country like Brazil which is so unequal, which needs the social protection structure, and where, with the kind of -- with the way that politics still operates in the country, the kind of special groups that you still have in the country, the fights over the budget that will begin to take place in 2019.

So this government, the way that they structured the spending cap, it doesn't actually affect the tenure of the current government, which ends in October of 2018, but it does bite the next government. So the next government will be faced with this very tight spending cap and there is this naïve discussion in Brazil where people tend to think oh, this is great, because now we have this very strict restriction and this will make politicians rationally argue over the budget.

I have never seen politicians rationally argue over the budget anywhere, in particular not in Brazil. It just doesn't happen. And in the end, what's likely to happen is that areas that do need government attention, public investment, to some extent education, to some extent health, social programs in general, these are the areas that are going to get hit if the spending tax stays in place, which is a big if. It's possible that it might not. So that's on the spending cap.

On the social security reform is actually rather crucial to make the spending cap work. Since a lot of government spending is actual on social security and on social security benefits, José Luis described some of the indexation mechanisms that exist in Brazil. There's an additional one because in 2006, the government created an indexation mechanism for the minimum wage itself, which is based on lag GDP, so the minimum wage indexes benefits and the minimum wage itself is indexed by a host of other variables, inflation and GDP growth.

So that means that the whole system is just structured in such a way that spending keeps on growing irrespective of what's happening to the economy, which is obviously a situation that becomes completely unsustainable over time. So unless you fix that aspect of things, which is what initially the social security reform proposed to do, the spending cap really has not bite because one thing is completely, you know, it has to be completely coordinated with the other.

On the social security reform, what has happened is exactly what one would have expected to see in a country that's been undergoing a very massive recession and under a very big corruption scandal. All of the original proposals under the first blueprint of the social security reform have been more or less abandoned. The, the proposal has been significantly diluted. Those parts of the public sector which currently actually get the most benefits and the most out of social security in terms of spending have been left untouched. This was needed in order to get approval in Congress for the social security reform, which by the way is still not guaranteed.

So what all of this means is that we're doing a half-baked social security reform that is taking away benefits from people. Yes, there's no way to this but to take benefits away from people except that if it's being done by a government that has some legitimacy concerns on the part of the population, and in circumstances such as the ones that Brazil is facing right now, one can kind of, you know, see this situation as not being very fortunate going forward.

And one can even say one other thing which then goes to Ernesto's last question, you know, how does this all play out in the 2018 elections. I mean what is the kind of backlash that one would expect to see when voters actually go to their polling stations in 2018. And that's my greatest fear when I look at Brazil. Because not too long ago, about two weeks ago, a poll was released showing the level of popular support for the social security reform. It won't surprise you to know that it's practically non-existent. People do not support the social security reform as it's been presented. People do not support the labor reform as it's been presented. People did not support the spending cap as it was presented, and yet it passed because you had a congress that was in combination with the government, trying to protect itself from all the spillovers from the Lava Jato investigation.

So there's a complete disconnect. If there is one place in the world where you can say the disconnect is complete between the population and the political class and I think we see this everywhere. But nowhere is that more stark I think than in Brazil. The disconnect is just complete. And there's this echo chamber between the avenues in Sao Paulo where the financial markets are and the avenues in Brasília where the ministries are. They talk to each other and the rest of the population is left out. So the anger, the frustration, all of this leads me to think that in 2018, we might see an extremist out of the polls, you know, an outsider, an extremist. We don't know exactly who that person might be. It

could even be Lula himself. Lula has the capacity to sell himself as the outsider in Brazil if these things happen in Latin America.

Lula also has the capacity to say it was under my government that things were working rather well and look what's happened since I left power. So despite the fact that he's so implicated in the corruption scandals, it's no wonder that he is, as of the polls right now, and we're a long way from the election still, but as of the polls right now, he's in first place. We will see what happens from here.

MR. TALVI: Monica, thank you so much extremely interesting remarks on that note on politics. Hector, I want to bring you into the fore. I was surprised. I'm not that surprised by the Brazilian story that Monica just told us. But I was surprised by José Luis saying, I don't know if you were able to hear him but saying this is the most important election for Chile, and in fact, depending on the result, we might continue building on the project that was launched 30 years ago, we might revert back to the old Latin America ways.

You can do your points, but I would like you, if you can, Hector, to answer that question. Is the political dynamics today, the fear, the anger, the toxicity of it all risking the possibility of Latin America reverting back to the bad old ways?

MR. SCHAMIS: Okay. Well first of all, thank you, apologies for being late, and I guess that's the punishment for being late. You know, I have my own game plan here and you throw me more things. But I think it's pertinent Ernesto because in this story of the boom bust cycles and this sort of historical political economy of the resource curse that we've had in Latin America, regardless of whether we had the resource or not, because typically the resource curse political economy is about oil or copper in the case of Chile, but when interest rates were low, they did the same job, like appreciating the currency, financing a current account, deficit and so on and so forth. But and then one of the constant dramas of the Latin America economic policy has been the incapacity to save in terms fat years and to have reserves for the lean years.

And Chile is relevant precisely because Chile had been perhaps the only one to save during the fat years because of some institutions that were locked in place partly after the Pinochet government but also in the first few (inaudible) administrations that they, you know, (solidified) those institutions from the (inaudible) an so on and so forth, but now that may have been gone done in the

second Bachelet administration. One of the dramatic debates, it didn't seem like Chile when you would go to Chile ten years ago, it was like, you know, macroeconomics seminar, the debate, but then all of a sudden it became like, you know, well, very lone wolves were saying how do you finance the reforms, have you guys thought about how to finance the reforms and many people in the (new mazaria) had not thought how to finance the reforms.

One more thing about Chile is that when Monica was talking about the Dornbusch Edwards book, which many of us political scientists criticized brutally because, you know, what's your definition of populism, well fiscal spending. The definition of a concept with one characteristic is like, you know, well Ronald Reagan was a populist as well, and so many big spenders would have been populists. And populism was a lot more and perhaps is, a lot more than just that. But the one thing that reminded me was that in one of the chapters is written by Patricio Meller, the chapter on Chile, who used to say the (non-economists) I guess it's fair to say I learned economics from Patricio Meller and he used to say the problem of Latin America development is very simple, the U.S. dollar, too little when we most need it, too much when we don't.

And that speaks to the issue of the boom bust cycles, because how international prices affected our macroeconomic management is the historical, the economic history of Latin America, right. I mean, which in the past, it was easier to manage under fixed exchange rates, but also under closed capital accounts, we have to remember that. I mean the boom bust was moderated by fixed exchange rates and in closed capital accounts, which began to open in the '70s and '80s gradually until it opened fully in the '90s. And then the bust phase of these cycles tended to be more explosive, most notably, Argentina, but then some hyperinflationary episodes in Brazil and Peru and so on and so forth.

So, for maybe too much time I focused on the effects of this political economy of boom and bust on the politics of Latin America because there is a pattern. When in the years of the boom, there was a propensity for governments to stay a little longer. Let's put it that way, historically speaking, '70s, '80s and so on and so forth. But in the bust years, that affected the politics in dramatic ways. It's like almost like a constant repetition of a political system unable to be autonomous from the economic cycles. When the political cycle almost mimicked, followed, the economic cycle. And that was also, well that was the source of dramatic political instability, which became more critical after the '80s with the

democratic systems pretty much all over. All of this to say that the cycles were well known, the indebtedness of the '70s, the shrinkage of the '80s, it did the adjustment, privatization of the '90s would open capital accounts, the countries borrow, there was investment. And then the adjustment early -- in the late '90s and early in the 21st Century, but then the price boom of the 21st Century.

In terms of trade Latin America didn't have in history, and many countries and even those, you know, Peru, Bolivia, Venezuela, Ecuador, enjoyed terms of trade that they hadn't seen in their history. Argentina had had sort of similar terms of trade in 1945, in the post war period. But overall, it was this super cycle that began to (call it) the tailwind, that yet again affected the politics because what we see in this context is that a wave of constitutional reforms to stay in office longer than expected, longer than it was meant to be, if not to perpetrate themselves in office.

Country by country in this century, you see a pattern of constitutional reforms to stay in office longer than when the president arrived in office, Bolivia, Ecuador, of course Venezuela, Argentina in the '90s. But not for indefinite reelection. But that was the (cry a while) but there was a pattern that again it was given the magnitude of the super cycle of prices, that affected the magnitude of the attempt to stay in office longer than expected. When the cycle was normal, improvement in terms of trade, well, it was a normal attempt to stay in office. But when the cycle was super cycle, when the terms of trade were the best that they ever enjoyed, then the attempt to stay in office became super attempt to stay in office in the form of (perpetration).

There was another element that was briefly mentioned here that added to this, that held big time with this cycle, these political cycles accompanying the economic cycles, which was corruptions. A new phenomenon, new in the following sense. In Latin America, there was always the practice of private accumulation at the expense of public monies, Mr. Ten Percent, right. Public works, public procurement et cetera, et cetera. This has changed dramatically and we call it now (inaudible) Lava Jato, but you know, the (inaudible) because corruption became a power structure. It wasn't anymore I go with ten percent, you know, that public official who in the public works ministry who was you know, Mr. Ten Percent. Now it became as something else. It became a system of domination. It became the means by which campaigns were financed, candidates were selected, governmental teams were put together, and down the road, governments were formed. It became some sort of corruption as a regime, as a strategy

of domination in (variant) terms one would say. And then it became more complicated because it made the politics a bit more authoritarian for the most part, to the extent that it attempted -- it was meant to perpetrate an individual in office, or like in Venezuela or like in Bolivia, or it was meant to perpetrate a party in office, like the PT in Brazil.

But it became a toxic, a very toxic element for political stability in a context of by 2012, 2013, the cycle began to change. And when the cycle prices began to change some countries began to face all these macroeconomic constraints that yet again repeated those patterns, although in a less dramatic way I would say than during the debt crisis or during the hyperinflationary episodes of late 20th Century. And that is an important thing having to do with two things I would say. One is a change of cycle together with the Trump Administration in the U.S. with renewed protectionism in the U.S., we don't, it may well be that it's all talk. But nonetheless, there is enough worries down there as to what will happen. Pretty much Macri's trip to Washington was a great success, they went back with the ability to export lemons again, by the way.

MR. TALVI: Cristina was going to build him a statue, she said.

MR. SCHAMIS: Right. But I mean, as a big foreign economic policy accomplishment, well now Argentina is going to export lemons again, I mean this is you take what you can. But that tells you quite a bit of the climate, of international economic policies that the countries in Latin America are trying to put together in the face of perhaps a new protectionism. By the way, those without preferential trade agreements are waiting, drooling because they will be the great beneficiaries, Brazil, for example, right. They beat Colombia, they beat Mexico, they beat Central America, they beat Peru, they beat Chile. They have no preferential trade agreements. If there are no more NAFTA and the like, well, it's all for them, it's the biggest boy on the block, in addition, right.

So we don't know very well but we know that already that there is a lot of uncertainty. There is a lot of uncertainty here. Well, you were saying well, there is no worse disconnect than in Brazilian politics between the public and the government. Well, outside of Washington, you may want to say. But that's a different thing.

One more thing, I think this is the uncertainty is also dramatically important in terms of the future of democracy in Latin America, as simple as it sounds, and as dramatic as it sounds, because of a

very peculiar change of cycle, which is the foreign policy change of cycle. Here there was a deal that the previous administration put together, which was opening in Cuba, peace in Colombia and for that, Venezuela played a role. And under the Maduro government, first the Chávez government and then the Maduro government later it played a significant role in all three things -- in both things. It was a triangular relationship, it wasn't the other triangle of the North Atlantic, the Northern triangle wasn't that. The Northern triangle was opening in Cuba, peace in Colombia, for that Venezuela is the broker, Venezuela was the broker, and if Maduro is still in power, it is to a great extent because of that, because of having brokered those two deals.

And when Maduro opens his mouth and says well, what (inaudible) if I release the tapes that I have, I mean he also uses that and (figure) everybody shakes, in Bogotá, in Havana, everywhere else. And that is critical because I think, and I, and Ernesto, because in our world of unstable and fragile democracies, the way the Venezuelan crisis is resolved will have impact for the rest of (inaudible) will be a dramatically important teaching lesson on the viability of democracy and on our democratic faith in the region.

It's very simple. If Venezuela Cubanizes itself, there's a new constitution in the making that we'll see if the streets are emptied tomorrow because how long can people be on the street, then you know, I get really pessimistic their constitutional project may move forward and there will be a Cubanization of Venezuela. If Venezuela Cubanizes itself, then all the old things that we learned about the transitions of the '80s and the human rights, (inaudible) system of human rights and all the things we benefited great from and we contributed to and that we fed and supported may very well go down the drain.

In the face of additionally this setting, this international setting of great uncertainty because there is great uncertainty in the U.S. in terms of government, I mean who is governing. My main fear here is not so much what's going to happen with NAFTA, not so much what's going to happen with trade in general, but who's in charge. And the two things together may be this is a defining moment. And in the rescuing of Venezuelan democracy may have a beneficial impact for all of us, otherwise, it will have the opposite. Thank you.

MR. TALVI: José Luis, you wanted to say something and then we'll open it up for

questions.

MR. DAZA: Yes, my impression is that we Latin Americans are very creative in terms of blaming others for our poor outcomes. Whether it is the dollar, whether it is, there's always you know, the empire, whether it is. I mean I think that the poor outcomes of Brazil are the consequence of the institutional arrangements in Brazil. The poor outcomes in -- just a simple example, I call Latin America the stupid continent. I mean we have extraordinary natural resources. We have extraordinary human capital. Look at the human capital of a country like Argentina, in all sort of dimensions. We have land, we have water, we have relative peace. We don't have religious wars, we're not killing each other. We have all the conditions to succeed and in the last 40 years, 50 years, we have not been able to reduce the per capita income difference with the United States. And as a matter of fact, over the last five years, we're going backwards. And there's only one country that managed to do it significantly, substantially, and that is Chile.

And it faced all the same, it have the dollar, have the commodities, have the interest rate. Chile in 1985 had a lower per capita income, lower than Mexico, Venezuela, Colombia, Ecuador. It was a very poor country. They focused on growth, on investment, opening up the economy, rules, no discretion, sustainable. What happened, you grew. We abandoned that path, look what happens, you start to stagnate, you start to have conflict, you have to start, all the social problems that start to emerge. So I think, look, Brazil -- Brazil to me is fascinating. Brazil, similar territory expansion as the United States, a mixture of races, a mixture of cultures, it's an extraordinary, rich, wealthy country, beautiful weather, water, et cetera. You know, the constitution of the United States has maybe five pages. Their constitution has like 8,000 pages. I mean how you going to govern that? They mandate what the real interest rate is. That has nothing to do with (sorry to tell)(inaudible) with the U.S. dollar.

So I think that we need to focus on Latin America to solve the Latin problems and stop to blame other people. And as long as we do not grow, social problems are going to get only worse. And the demand for social service is going to get worse. I think this lack of focus on growth and on efficiency is at the bottom of our problems with poverty.

MR. TALVI: I'm going to open it up to the floor, but I want to -- we're going to run a little bit over, ten minutes, I apologize. We started a little bit late. So, I have the chance of making the last



question to the panel, but Peter, you were first, and then you. Peter Hakim.

MR. HAKIM: Let me say that one of the problems that all of us who work on Latin America over many years, we want to find an answer to Latin America. We want to find the commonalities, the cycles, the boom and bust, the populist, the anti-populist, the reform, the military. We all try to find these, you know, the pink tie, these things that -- and you know, one can go country by country, and unfortunately, I don't have time overtime do that. And each country looks like they're doing what they've always done. Mexico, NAFTA, reforms, doesn't grow, doesn't enter into the great crisis of Brazil, Venezuela, Argentina, but it grows at its minimal way.

You turn to Brazil. Brazil has always been a big spender. I love Al Fishlow's comments, they spend, spend, spend, then they tax, tax, tax. And that's the way, that's Brazil over many years. Argentina's crisis hardly started with the Kirchners and Cristina. I mean if you go back to Menem, de la Rúa, you go back to Alfonsín, the military and then the (inaudible) again. So, you know, and Argentina, in a certain sense acts like Argentina. And you know you go country by country and you keep seeing this.

And you know, Chile has gone on a good path, but you know, I remember back when I first went to Latin America in the '60s and '70s, you would to Brazil, it was disorganized. You go outside the major cities, there were a few services. You would go to Chile and you would find in every small town, a health service, a little school, et cetera. In other words, countries and in fact, take Venezuela. You know the country that grew the least for the 25 years before Chávez, you know the country that was the most corrupt when Transparency International started its survey? Venezuela. So it may be the problem is that we're trying to aggregate too much and find the big solution when really each country is sort of operating like they have historically. And the way to look is linearly rather than horizontally.

MR. TALVI: Very interesting what you say, Peter, so--

MS. de BOLLE: Let me just make a comment back to that.

MR. TALVI: Yes, go.

MS. de BOLLE: So, Peter, very quickly, you are right, Peter. But as a Brazilian, I can tell you that we don't look at Latin America. We look at Brazil. So we do the country by country thing, because we're the big guys in the region.

MR. HAKIM: That's the problem with Brazil.

MS. de BOLLE: And that's also the problem with Brazil, which I was going to add. So, you know, the country, you're right. We're not going to solve Latin America's problems, but neither is you know, just looking at your own navel going to resolve anything. And Brazil has been, for 30 years, looking at its own navel and it's not going anywhere.

MR. TALVI: I would say, I would add, Peter to what José Luis said, we are all Brazilians now because during the boom we all became big spenders, big time spenders and I'm going to leave as the question for the panel to answer after your questions is if the environment that made that possible is not going to be with us anytime soon, I mean the usual way in which we diluted that unfinanceable spending was through inflation, and that was the way we did it, and I'm going to revert back to you eventually, but you have a question there, Josh (inaudible).

MS. BOURBON: Hi, my name is Contessa Bourbon, from the New York Times. I would like to thank the panel for this informative forum. I would like to ask what are your thoughts on global sustainable tourism and how global sustainable tourism, how is it being done in Brazil or Ecuador, other Latin America countries, what should be its impact or implications economically?

MR. TALVI: Why don't we take a few more questions, and then we'll wrap it up.

SPEAKER: My question is for Monica. I mean, you know Brazil very well, and you know all the problems. But if you were in the government now, what would you do, given sort of the environment, I mean the political context in which it finds itself. Because we all can criticize a lot of what they're doing obviously, but the question is, what's the alternative, not doing anything, not try to do any reforms at this point? That's my question. My second point is on, it's of course, more comment on Schamis' point on Venezuela. Well, I don't think that the Cubanization of Venezuela would necessarily bring sort of a demonstration effect in other countries in the region. I think that in fact, it might make it, especially if it is accompanied by a lot of sort of violation of human rights and so on and so forth which you would have to be, given the size of the opposition and the vehemence of the opposition in the continent. It might have quite the opposite effect, I mean because I think there is still a lot of resistance to that kind of a model in the Latin American society. I am more worried, frankly, about the spillover effects in economic terms from a Venezuela disaster. I mean in terms of migration, in terms of, you know, basically refugee and possibly even a civil war. So I think that is among the challenges that face the

region now, I believe Venezuela is a very big challenge.

MR. TALVI: Thank you, Teresa, very interesting. As usual, we have a question here, a question there, just on the opposite end, in back and I think we have to (inaudible) the questions with this last (tape).

MR. ASHOUR: Thank you, Kareem Ashour from the U.S. Agency for International Development. Would y'all mind discussing a little bit about the dollarization, for lack of a better word, that El Salvador, Ecuador, for example has undertaken. And is that instill any confidence at all in foreign direction investment, pros, cons of that policy? Thank you.

MR. TALVI: Josh, and then there at the back.

SPEAKER: When I came here, also that economic and social policy in Latin America was also include Central America and I noticed that it's only South America. Nothing has been said about Central America even though they are small countries. They are the most -- they have the biggest problem, governments who are corruptive, governments that they don't care about their people. We have a lot of delinquency. They don't know how to handle that. So it should be an economic and social policy in South America initiative. Thank you. I'm sorry.

MR. TALVI: I mentioned Nicaragua, but you are right, just for the record.

SPEAKER: Thank you. I have two questions for Monica regarding the (first general) election this year. This first one is do you think that according to the characteristics of the policy in Brazil, it will be difficult for an outsider to run for elections due to the strong control that elites of the party have in nomination of candidates, and the second question is do you think that the fact that Lula has been charged with some criminal, he's going to go to a trial soon, do you think he's going to be condemned. In other words, you think he's going to go to jail and be able, he's not going to be able to run for the elections? Thank you.

MR. TALVI: Okay. I'm going to let the panel wrap it up, two minutes each. I'll do it in reserve order, Hector, Monica and José Luis. Please include my question on the over bloated public spending and are we going to be able to solve that within the realms of the normal, political economic operations, or are we going to have to do things that revert us back to the bad old ways? Okay.

MR. SCHAMIS: Okay. Let me address Venezuela. I mean something very similar to

you. I didn't mean to say there would be a massive run to a Cuban type constitution to a Soviet type constitution, right. (inaudible) maybe will, I meant the spillover effects, in terms of refugees, which already started. Roraima has 50,000 Venezuelans and they are closing the border, that wasn't Brazilians, that's, you know, a northern state in Brazil, the humanitarian crisis. Civil war, civil war is not even the worst outcome here. The outcome is the state that has collapsed in a total (inaudible) anarchy and civil war may potentially have an outcome, but (inaudible) anarchy without a state may last for a very long time.

So regarding the bloated public sector, well that is if you want to add a super cycle, a super perpetration, super bloating of the fiscal sector, of the public sector. Your question is whether in Latin America with or without Central America, we're going to be able to resolve that conundrum within the boundaries of political democracy. Well, one would hope so, nobody has a crystal ball, but painful decisions will have to be made. The example of Argentina is telling because if nothing else, it's a definition of the political cycles of Argentina or the electoral cycles of Argentina, the government came with a different idea of how to handle the economy and its relationship with the state and so on and so forth. It's center right you might say, market friendly, (inaudible) coalition. But very early on was facing the election that takes place now next October, midterm election, and then nobody wanted to run the risk of negative outcome and negative reaction by rationalizing the bloated public sector.

And in fact, some numbers now are showing that in fact it has grown, some people are saying, which remains to be seen, but anyway, nonetheless, it's clear that it hasn't been shrunk. Now, the question comes down again to well, economic performance. All of that is easier to be even tried in a context of good economic performance, and that's what is not clear, the countries will be -- the countries in Latin America will be facing. Although the IMF corrected its initial forecast to less negative projection. I understand, I don't know, that the change of prices has happened, but it has apparently slowed down in terms of duration, in terms of trade for Latin America. I don't know, you tell me about that. But, yeah, painful decisions that will represent a challenge for whoever is in government.

MR. TALVI: Even if you do it within the bounds of political democracy, painful decisions mean either you're going to have to resort to higher taxes, which we don't have the space, higher inflation or repudiation of debt. Those are the traditional avenues. I don't see any (inaudible) so Monica.

MS. de BOLLE: So let me start with the question on Central America and thank you very

much for asking that question because we indeed make that failure many times when we're discussing Latin America. And Central America has been, for me at least, ultimately very fascinating in the whole context of North American integration and what it means for the region, what the current administration's policies mean for the region. So the aspect of, you know, deportations, what does that do to the region, the aspect of potentially not having as much remittance flows which are so crucial to the region, what does it do to those countries, which have been, as you've pointed out, very affected by extremely corrupt governments and violence and very, very serious issues that unfortunately we tend to overlook when we focus too much on these bigger economies. So I just want to reassure you that there is thinking going on between these two sides of the street here, Brookings and the Peterson Institute on Central American issues. And they're quite crucial to this whole North American integration discussion.

On to Teresa, what would I have done? I would have done basically what I wrote in January 2016, which was around the time that we pretty much knew that Dilma was going to be impeached, the procedures were ongoing. She was first removed from office, as all of you know, in May 2016, she was finally removed definitively in August 2016. But in January 2016, everybody already saw the whole process coming. It was pretty evident that was what was coming down. And at that point in time, what I said were two things. I said we need to balance, and I thought of it from a very IMF perspective. I mean if I were an IMF mission member going to Brazil and giving some kind of advice as to what the country should do at that particular point in time, there obviously should be a balance between short term policies and medium term reforms.

And I think what happened in Brazil is that the whole discussion went towards medium term reforms without focusing any effort on short term policies, and by short term policies. And by short term policies, I mean run of the mill macroeconomic policies. There was a lot of stuff done on BNDS, there was a lot of stuff done on microeconomic reforms, particularly in the oil and gas sector. So these things were done. But on the overall macroeconomic strategy for the short term, there was nothing. And there was a lot that could have been done. To start with, one should have eliminated completely the tax breaks that Dilma put in place that were so distortionary, and which in the end had such a big effect on the fallen revenues that we saw throughout this entire period. And the government simply didn't want to bite that particular bullet because they would lose, or that was the argument, they would lose political

capital for their medium term reforms.

I think there was a bit of a strange way of looking at medium term reforms versus short term reforms in that context. Things should have been better balanced. In the same vein, I think the Central Bank took way too long to lower interest rates. And I think we're seeing that now. I mean if you look at the behavior of interest rates in Brazil, nominal and real, they continue to be very high. Inflation is tanking as a result of the recession and you know, it basically tells you that the Central Bank is very much behind the curve.

So back in January, February of 2016, my argument was well, the new government is going to come in with a new economic team with a whole bunch of credibility because everybody is going to see that there is now a path out of this situation, or at least this is what people want to believe. That's the time to use that credibility to put these short term policies to work. So you could tighten the fiscal on the one hand through the removal of these tax breaks which were so onerous and did nothing to spur growth. And on the other, do a little bit more monetary flexibility to counteract the fiscal, the short term fiscal policy. So I think the government got that balance wrong. In the end, it put all its chips on the medium term reforms and now that's all it's left with and it has nothing else to deliver, which makes the whole situation more dramatic. So that's how I view this problem.

As for your question in the back, is it difficult for an outsider to come out in 2018, five years ago, I would have said yes, these days with social media, and in the way that things play out, no. One of the key people running, or at least who is way up there in the polls is a guy called Bolsonaro. He's the representation of the alt right in Brazil. He's a complete outsider, he's running with a very, very small political party and a very small apparatus, nonetheless he's way up there in the polls running neck and neck with Lula. So I don't think that in these days of a lot of social media that really you do need this huge political apparatus in Brazil to make things work. I'm not going to make any comparisons to France because they're not warranted here.

As for Lula, who knows? I mean it's, nobody knows. There are a number of things that are happening. Last week, he was deposing in Curitiba, no one knows what's going to happen. The big question is whether or not, you know, whatever happens allows him to be a candidate in 2018 or not. That's the question. And because of the way that things are processed in Brazil and because of the way

that things work, you know, there is a time limit beyond which if he's not indicted seriously or he's not -- or something else doesn't happen to him, he can conceivably run in 2018. So that's really the question. Are things going to happen fast enough, in order to, if they are to happen, are they going to happen fast enough to prevent him from running or not. And nobody has the answer to that question.

MR. TALVI: José Luis, as my classmate from school, you have the last word.

MR. DAZA: Thank you very much. In terms of your question, I think that we tend to be very focused on deficits, on how we fund and whether it's through taxes or it's through debt. My impression is that the biggest issue for Latin America has to do with the overall size of the public sector. And aside from the deficit, whether you have a public sector deficit when you're spending 22 percent of GDP, or when you're spending 48 percent of GDP, it's quite different. I think that this has led to a structure problem of lack of saving, as you were saying. I mean, and how do you correct it. It's extremely difficult. First of all, I think it's very difficult in the political process, in the democracy because you, you, you, if you were to see to ways to alleviate the social problems that society is confronting, one is let's create the conditions that are going to facilitate investment, growth, flexibility in markets, et cetera, or a social network, you're going to have these pressures to maintain, keep the social network, even if you're not creating employment, you're not creating growth. And I think that that is very difficult to solve politically. It's a very, very difficult knot. Chile managed to do it, and did it in a very harsh dictatorship, right, under Pinochet. It was brutal how it happened, but Chile did it.

And Peru managed to do it under Fujimori, also with all the political connotations that that has. And you see, what is most interesting is when you have moved the states to these new equilibriums, new political dynamic (inaudible) where the economies can grow, you see in Peru, you see leftist government, rightist government, whatever government, they maintain the policy. There are incentives. The equilibrium is such that it is self-reinforcing. The same happened in Chile for a long period of time. That equilibrium in Chile is gone.

So I think that, my hopes for Latin America are not that fantastic. I think that we were in a low growth, mediocre growth and we're going to with the cycles, we're not going to have balance of payments crisis. But there's not a lot of -- I don't see a lot of hope. I do think that the Venezuelan crisis is of proportions that we have not seen recently on the continent. I agree with you. I think that the worst

that could happen in Venezuela is simply devolve into complete chaos where people are killing on the streets to eat from the garbage cans. I mean it's simply traumatic in there.

Let me just say I think with respect to Brazil, one issue on that. I commend the authorities. I commend the authorities for their audacity of trying to break the equilibrium in Brazil of what has been a 30 year trajectory of, you know, of trying to manage this institutional apparatus that was leading towards lack of growth, poverty, mediocrity and unsustainability. I think that I commend them. It is extremely difficult, because as you said, they don't have the political support to do it. Of course, people are not going to desire unpopular measures but from us in the markets, when you look at the indicators of financial tension, when they indeed look at the indicators of potential insolvency, everything was flashing red. In Brazil, by the time that Dilma left office. I think that you were in a very fragile equilibrium where without a signal that you are going to address the roots of the dynamics of the debt of Brazil, you would have entered a very difficult crisis.

It's difficult to see the alternative, but I personally actually commend them for what they are doing. And I think that the technical competence of the team you have in place is extraordinary, whether it is in the Central Bank, whether it's in the Minister of Finance, what have done with Petrobras. I think that I commend them. Is it sustainable, is it political feasible, I don't know. But they rescued the country from what was very, very clear crisis dynamics that I don't know where they would have ended.

MS. de BOLLE: As a Brazilian, I agree and disagree with you. And on the specifics of the debt sustainability aspect, I don't think we have any guarantees that we're there, especially with the reforms having been diluted in the way that they have. So I think markets are due for reckoning at some point. If what I fear will likely happen, which is you know, these reforms get passed, they're diluted, people are not going to be too concerned at the moment, 2018 comes around, a huge backlash because if there's one aspect that markets don't look at is the social pressure points and those alarm bells that are sounding in Brazil. Somebody steps in, they're an anti-reformist, they undo a lot of the things that have been done. So I think there's a big risk, this administration took a big gamble in trying to do certain things. I think some of them they pushed without properly having the kind of support from the population that they needed, and it's risky. It's a very risky strategy.

MR. DAZA: Yes, it's -- let me tell you one thing. First of all, I would say that markets are



extremely focused on social dynamics because they see what happens in countries where they end up. So a lot of this come unraveling because of lack of social support. Look at the case of Argentina, your country. Your country is a tragedy. Argentina in 2001 needed to implement a fiscal adjustment that was 0.7 percent of GDP, maybe one percent (inaudible). The whole country and elite, no, we cannot do it, we cannot do it, this is too much, one percent of GDP.

Argentina today could have been a developed country, the first developed country on the continent. They didn't have the guts to implement the one percent fiscal adjustment. And it was a social manifestation. So we're very aware of this. But I think, you know, Brazil (inaudible) much better than I do. What I can tell you from our perspective in the markets, the pressures that they were facing were horrendous. They shocked it, they bought some time. I agree with you, I'm not sure that this is the panacea. I am not sure that they are over it.

In fact, if you look at the interest rate covering Brazil, it's very interesting. Because as you said, they could have done this before start cutting rates. It's not clear. The interest rate curve in Brazil when you have a Central Bank that has credibility, the interest rate curve is very inverted. That's what observe in Russia, for example. The interest rate curve in Russia is very, very inverted, all the way from the overnight rate to essentially the 20 year rate, very inverted. In Brazil, you see the interest rate curve. It comes down for two years, and then it starts to go up again. so the markets have many of the questions that you posed. I think they are there.

MS. de BOLLE: They should.

MR. TALVI: Hector, I apologize that this has become a Latin panel in terms of the times, but Hector has been -- so Hector, I will give you the last word and this is truly the last word because we run severely overtime.

MR. SCHAMIS: I'm going to root for Brazil as well, not only on the set of policies that they put together to circumvent a big crisis, but also on some institutional dimensions that maybe Brazilians don't see as well. I mean when you go to Brasília, you feel that's the only state you can see in Latin America first of all, right. Where else would you imagine a judge from a provincial town to bring the whole political (inaudible)--

MR. TALVI: Absolutely.

MR. SCHAMIS: -- to trial and put so many people in jail, you know, bring down another president and so on and so forth. And it's not bad. I mean actually, it's quite good. If you read The New York Times and The Washington Post this morning, in particular.

MS. de BOLLE: And the FT.

MR. SCHAMIS: We're going also in the direction in Latin America, there is an old debate, you know, I was a part of, you know, (inaudible) and so many others, on provincial versus parliamentary democracy in Latin America. And that debate is dated, because where we are going to in Latin America is coalition presidentialism because the party systems are fragmented, parties don't last very long and on the other hand, the divided government is quite the norm these days.

It's a little bit -- look at France today, well France is going to be (inaudible). Brazil has a lot of experience with coalition residentialism, that's what they've been doing all along all of these years. And I think that the institutional cards are there for them to pull through from that perspective. The PMDB cannot govern, cannot get the presidency, but it has the last veto power, it's been doing it forever, since 1985, since they recovered democracy.

In that sense, I think the case to look at, I agree with the issue about Peru, the comment about Peru, Peru is a country with a fragmented party systems with parties that don't last. And no president since after Fujimori, and we're talking about '92, no president has had control of congress. Every president has been in minority. It is the pragmatic example of a healthy coalition presidentialism. And they have done a wonderful, wonderful job. I mean with managing the economy. Look at the (inaudible) since 2000, look at GDP growth, and that is the art of managing an economy in a political system that looks like that. And in spite Peter Hakin, who didn't like it, well these are the commonalities of Latin America politics these days, fragmented party systems with parties that don't last. Every Peruvian president has had his own party pretty much that disappeared (inaudible) Toledo (Humala) their parties, (opera) is gone. And they managed to figure out a way to of institutional adaptation to that in an incredible way that is paying off. It should be imitated because the rest of political systems in Latin America are very much like that.

MR. TALVI: Not the other (inaudible) part of it, no?

MS. de BOLLE: Yes, not that part.

MR. TALVI: And I mean of the (inaudible).

MS. de BOLLE: No, not that part.

MR. DAZA: You mean the Toledo?

MR. TALVI: Toledo (inaudible) all the (inaudible).

MR. DAZA: Well, that applies to everybody pretty much. I mean that's (inaudible).

MR. TALVI: Is that part of the reason why the system work?

MR. DAZA: No, that is the--

MR. SHAMIS: I think that that -- can I, just one? I think that all of this highlights also that we don't have institutional manners to finance politics in Latin America, right. Politics is an expensive business and we have never been able to get it right. And it's a reality even if you forbid, you will have to find a way to finance politics to avoid this type of problem, because politicians will continue to get funding.

MR. TALVI: Monica, the last word.

MS. de BOLLE: Very quickly, let me just say something positive about my country in view of what you've said, but not positive about the government. So the Car Wash Operation, there's a special that the Financial Times is running all through this week on the Car Wash Operation in Brazil, Lava Jato in Portuguese. It is extraordinary. It is quite amazing what's been done under the Lava Jato over these last three years. That being said though, the only reason, and it was a very smart move by the prosecutors and the (ministerio publico), the interior ministry in Brazil, what they did, and these are all young, you know, and sort of non, very apartisan people, what they have actually done was to get public opinion on their side.

So when you ask people in Brazil whether they support the Car Wash Operation, and if you ask them specifically a question like, if you think, if the recession is -- if you were to say that the recession is a result of the Car Wash Operation, would you still support it? And a friend of mine who runs a pollster in Brazil has done these kinds of surveys and has been doing them on an ongoing basis for the last three years, and he always asks that question. And the answer is an overwhelming yes for 90 percent of the respondents of these surveys that he conducts.

So what that tells you is that there is a huge, you know, what the Car Wash Operation managed to create was this huge popular support that politicians have not been able to undo, believe me,

they've tried. Both under the Dilma government and under the Temer administration. They've done their best to kill it off, and they haven't been able to do anything about it because of popular support.

MR. TALVI: Okay. Thank you to the panelists. This was a great discussion and I am sorry for running overtime. Thank you.

(Applause)

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