Overview

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I've been asked by Erkki Liikanen to give you a few words on Latin America. Vittorio Corbo provided a good introduction, so I will give a quick summary before I move on to the other interesting themes that were discussed over the last couple of days.

A quick summary would go as follows. First, Latin America has come a long way from the disastrous years of the so-called Lost Decade of the 1980s. This was a period in history of negative per capita growth for most countries, defaults, hyperinflations, etc. Most countries in the region have spent the 1990s and the last few years trying to overcome the challenges posted by that big failure.

And we have done a lot better and have been growing. The dispersion across the region is substantial. Chile is the star and has shown fast rates of growth, but there are countries at the other end of the spectrum, such as Venezuela, where there has been no per capita growth in 30 years.

The fact, though, is still that the numbers are good but not great. If you take the last *World Economic Outlook*, you will see that the Western Hemisphere has grown slower than, say, Africa. Like most of the conference participants, I was impressed and fascinated by Paul

Collier's presentation and somewhat frustrated when I look at my own region to see that, even though we have done better, we haven't grown. The question is, Why? I have four explanations.

The number one reason is macro instability. Guillermo Ortíz mentioned earlier that he did a simulation as to what would have happened to Mexico had the multiple crises of the last couple of decades been avoided. He came up with an extra 66 percent of cumulative growth. If you did the same exercise to just about every country in the region, you would find the same results. The good news is that the lesson is reasonably well-understood in most of the region. We need to be careful about budgets, we need to let the central bank take care of the inflation, and so on.

A second reason for the mediocre performance we have seen has to be the low savings and investment rates over the years. That, in turn, makes us think of institutions, the rule of law, and all the things the World Bank has put under the umbrella of "Doing Business" surveys. If you haven't had a chance to look, I strongly recommend them. This is a survey that is done every year and covers a variety of aspects that range from labor market issues to how hard it is to open or close a business. If you look at Latin America, it ranks quite low. My own country, Brazil, for instance, ranks 125 out of 175. Of course, the good news is there is plenty of room for improvement.

A third element in understanding this phenomenon of low growth has to be education. It is a topic we didn't address much here this morning. But it is crucial. Some 25 years ago, Brazil and Korea had similar per capita incomes. In fact, Brazil was *higher* than Korea. Since then, Korea has moved ahead and now has per capita income about two and a half times greater than Brazil.

At the same time, the average schooling in Brazil is six years, whereas the average schooling in Korea is 13 years. Moreover, the education that children receive in Brazil is of poor quality, whereas the education that children in Korea receive is of top-notch quality. I could almost stop here. This tells us just about everything.

There is one more element that is important. It has to do with governance—a point Doug Irwin alluded to in his comments. The question is, Is populism back in Latin America? I don't know the answer. There are dangerous signs. The presence of someone like President Chavez in Venezuela with his pockets full of black gold is scary. The boom in commodities, coming with the global boom we have been experiencing, makes our ground fertile for populism and is something we need to be vigilant about.

In this context, Brazil is a key test. Some years ago, we were all very scared of what would have happened had someone like Luiz Inácio Lula da Silva become president. It turns out he has been pragmatic and conservative. These are words that are rarely applied to him. We have here from Brazil, Afonso Bevilaqua from the central bank, who could speak with more authority, being inside the government. But it is clear to me that the Lula government has it mostly right on the macro front. It has particularly gotten it right as far as allowing the central bank to do what it had to do to deal with inflation. And the results are impressive, with interest rates coming down to the lowest levels we've seen in decades in Brazil and with inflation below target.

The question is, What will Lula the "Second Version" do if he is reelected? And he seems likely to be reelected at this point. Will he address the supply side issues that have been a barrier to growth? We just don't know. I am hopeful he will surprise us again, but it may not happen.

Brazil is key because there are other countries in the region that seem to be wobbling a bit in their commitment to price stability, macro stability, and even the rule of law in some cases. So, there is more to come. I hope the future news is good, but I don't know for sure.

Moving on to the challenge to summarize the conference and having benefited from having Marty Feldstein speak before me, I will make a few remarks about some of the issues. Like Marty, I had planned to talk about global imbalances. Let me start with a few remarks on the first sessions.

We started out with a fascinating opening speech by Ben Bernanke, giving us a historical tour of the forces that have led to surges in global integration, but also reminding us of the always-present social tensions and political risks that have to be continuously overcome. I am afraid that the recent failure of the Doha Round must be highlighted. I hope that can be turned around.

One direct consequence of traditional trade and growth theories is that we should see convergence over time of several things, including living standards and factor prices. In many ways, the topic of the first session was a wonderful lecture by Tony Venables on the new economic geography. This was an explanation of why we don't quite see smooth convergence and why the geographic distribution of progress is so uneven. It was a fascinating discussion, and it talked about externalities, scale economies, distortions, and so on.

A controversial point that caught my attention had to do with industrial policy, which was addressed by Doug Irwin during his commentary. My own experience, coming from a developing country that has tried just about every possible intervention you can imagine, is of deep skepticism about industrial policies, particularly the targeted types. Venables made it clear that wasn't what he meant, but a word of caution never hurts. In my view, based on theory and experience, this is something on which we have to be somewhat skeptical.

The next paper by Gene Grossman and Esteban Rossi-Hansberg also dealt with convergence, but took another angle, thinking about it with fear. The fear was and is still that convergence will lead to lower wages in the developed countries. This is a point that Marty addressed, and John Taylor did as well in his interesting comments. So, I'll skip what I had to say.

The only thing I want to mention comes from a quick chat with Paul McCulley. It is something I had thought about, and he expressed it clearly. The actual news on low-skill wages in the United States is not bad, and the news in the countries that are at the receiving end of the offshoring is terrific. This is something John mentioned many times in his period at the Treasury. But the intriguing point is we are now seeing

the share of profits to gross domestic product (GDP) in this country and in others around the world at a 50-year high. Thus, as far as the distribution of income is concerned, maybe we are not going in the right direction.

Raghu Rajan and his co-authors gave us another thought-provoking paper, pointing out that, in addition to the Lucas paradox of money not flowing to, say, the poor countries, it does not flow to the fastest-growing countries either. They introduce the notion that developing countries have difficulties with absorbing foreign capital because of poorly developed financial systems and fear of currency overvaluation (and high volatility). While these are good explanations, we must not disregard plain, old mercantilism as an alternative explanation, as pointed out by Allan Meltzer.

In her comments, Sue Collins raised a number of good points, including the need to identify causal relationships to allow us to provide policy recommendations. One fascinating implication of Raghu's work is the possibility that global imbalances may be an equilibrium response, given deep structural deficiencies, he was careful to write and say.

Turning now to the issue of global imbalances, like Marty, I fear that the first few years of global imbalances seemed like a natural response, driven by an increase in investment in the United States. But what we see right now is perhaps not so natural, as the United States is drawing on foreign savings to finance consumption and budget deficits. It may in the end lead to a bit of a disappointment. The story is much the one that Marty presented, so I am not going to repeat my own poorer version of it.

The only point I want to make here is that right now we seem to have arrived at a situation where, despite the fact the dollar has come down a bit, we still see—to use Ken Rogoff's written words—"the humongous U.S. current account deficit." A lot of the burden of global economic activity still seems to be placed on the shoulders of the U.S. consumer. The U.S. consumer now has to deal with higher interest rates, higher oil, and perhaps now oil prices not being driven exclusively

by global demand. There is an element of risk and, therefore, an element of a supply shock imbedded in these prices. At this point, as we see a clear slowdown in housing, the U.S. consumer will be less able to draw on accumulated savings by borrowing against home equity, and a decline in consumption may ensue. My question is then, Can the world make up for what is likely to be a U.S. slowdown?

Alternatively, will mercantilism be at least partially dropped in Asia gradually? The work by Dooley, Garber, and Folkers-Landau in explaining this Bretton Woods II situation is not in conflict with the notion that we may see a gradual change going forward. Will we see it?

My last macro point has to do with another of Ken's topics—that is, inflation and how different countries in the world have dealt with terms of trade shocks. It is interesting to compare and contrast the behavior of inflation in the United States with the behavior of inflation in the European Union.

In the United States, the central bank, the Fed, has been focusing on core inflation. Core personal consumption expenditure has been reasonably stable, moving up toward or a little higher than 2 percent, while the headline inflation measures—be it the Consumer Price Index or the personal consumption deflator—have been moving up quite strongly.

In Europe, the central bank focuses on inflation—plain headline inflation. What you have seen in Europe is a steady headline inflation at around 2 percent and a declining core inflation.

If you look at Ken's paper, maybe what we saw in Europe is exactly what he posed. That is, with positive terms of trade shock provided by *China*, one should have expected to see lower headline inflation for a while. It also raises the question of whether, from a global standpoint, central banks collectively did not overaccommodate this combination of positive terms of trade shock coming from China and the negative shock of oil.

I have one more comment about growth and development. It is fascinating to listen to all the debates and, in particular, to see comments

about the importance of central bank independence. I want to throw in a word of caution. The emphasis on institution building is key, but some care must be taken. The reason I say that is because we in Latin America had in the early 1990s quite a few important independent central banks. We had one in Mexico in 1994 and a good one. Still, the 1995 crisis did happen, and changes took place. Venezuela had an independent central bank, with a wonderful governor in Ruth de Krivoy in the mid- to late 1990s. She somehow was kicked out of office. Also, Argentina had an independent central bank, and Pedro Pou was expelled out of his job at that point. So, I want to say, "Sure, let's make all the central banks independent, but let's not be fooled. This has to happen as a given society matures. As a deep understanding comes to the minds of most people, so that we don't waste a great idea on paper—that is, to make central banks independent—and then all of a sudden we go back." So, the technology to undo central bank independence, unfortunately, is well-known. The important thing is to create a tradition of sound behavior and stick with it.