CENTER FOR GLOBAL DEVELOPMENT

Presents

Maintaining Financial Stability in Latin America in the Midst of the Global Financial Meltdown

December 4, 2008

10:30am—12:00pm

SEIU
Conference Room 1026/28 (lobby level)
1800 Massachusetts Avenue, N.W.
Washington, DC

[TRANSCRIPT PREPARED FROM AUDIO RECORDING]

Liliana Rojas-Suarez: Good morning. Welcome to our 19th annual meeting of the Latin American Shadow Financial Regulatory Committee. Many of you know the nature of this committee and its members just to repeat and make clear to everybody who we are. This is an independent group of researchers from Latin America that write statements, brief statements on policy issues that happen in the region or in the world but affect the region and provide recommendations on independent point of views.

The members sitting in the table today are part but not the whole of the members of the committee. During our meetings over the last three days we had two more members that had to leave. Ricardo Hausmann, professor from Harvard University and Ruth de Krivoy, former President of Central Bank of Venezuela.

With us, right now, most likely you know everybody but Roque Fernandez who was the former Minister of Finance in Argentina and both President of the Central Bank of Argentina. He's telling me I should also add the current position that Mr. Fernandez he is a professor at CEMA, a university in Argentina.

Guillermo Calvo, which of course you all know and is currently a professor at Colombia University also former Chief Economist at the IDB. Ernesto Talvi, who I think in addition of being the head of CERES the most important tank of Uruguay also now has a whole diversity of titles and positions including here with Brookings, the competition for the Center of Global Development here in Washington D.C. Pablo Guidotti who currently is a professor of University at the di Tella in Argentina but also former Secretary, right? Was exact title? Of the treasury in Argentina. Alberto Carrasquilla, currently running an independent business but as you also might know former Minister of Finance of Colombia. And Pedro Carvalho de Mello who is currently a professor of a number of

universities including (Inaudible) in Brazil but associated with many other universities both in Brazil and in the United States.

Okay, without further adieu of the presentation one more thing, if you want to know more about us or you want to read the previous 18 statements written by this committee you can visit us at our webpage which is www.claaf.org it's for the Spanish committee the Latin American (in Spanish).

Okay. We are facing very difficult times and that's an understatement to begin with. This is the shortest statement we've ever produced. Latins are not categorized by writing short this time we did. So I hope you value the content more than the length of the statement. Well the **** statement that we wrote was last May. And it's amazing how the situation has changed dramatically for the worse in the world and for the potential risk that Latin America as a region is facing. So, of course, to begin with the committee is urging the authorities in the region and the official community and by that we mean the multilateral organizations to take preventive measures to address the risk of severe deterioration of the economy conditions. That, of course, is something that we support and we encourage the multilateral organizations to pursue.

Now, if we were going to summarize the risk that the region is facing and the measure of the risk we would say there are three, right? The first one is recessionary pressures coming from the world recession that is being experienced right now in the industrial countries. As you know, it's for prices are folding for the region and that's a major source of finance for many countries. So recessionary pressures is the first risk.

The second one, and one that we are going to focus most of the statement is that both the public sector and the private sector of Latin America are facing roll over problems of their debt. Not because something had happened in the region. Not because some corporations are performing worse than before, but because there has been a freeze up of the international capital market. Even domestic market which have been developed in the past are right now suffering from a pull off of foreign

investors. This is happening from the stock exchanges, you might have been following what is happening in the stock exchanges in Latin America some of them have actually experienced a decline of over 50% and it has mostly been because investors are pulling their sources out.

And the final source of risk is that if there is no credit, policy makers need to react. And there are two ways to react. One is with very painful procyclical fiscal adjustments. You have finance well you have to adjust your expenditure. Or highly distortive measures to deal with the lack of credit. Like controls to capital, like nationalizations, the recent nationalization of pension funds in Argentina is a case in point. So the question is that all the efforts and advances that have been made in the region are at risk under these circumstances.

Now the region right now is strong, relatively speaking, but it is strong. It has been experiencing a period of rapid growth and the macro economic policy in general talking about the region, we are not talking about specific countries have been largely adequate. But because of the complexity of what is happened right now internationally complacency is something that should not be allowed by any reason. And we have listed in the statement what can happen in terms of economic indicators. And we see the potential for a significant drop in the economic activity, loss of jobs, rising poverty, bankruptcies in the private sector, problems in the banking sector and even perhaps payment difficulties by some governments of their public debt. So this is what it at risk. And it's huge.

So rather than going into a huge list of okay, this country should be doing this, this country doing that. We decided to focus our statement in realizing and recognizing that the problem is not unique to a particular country. It is systemic and it is global. So the solution needs to be addressed as a global problem and therefore the solution needs to be focused as a systemic one, okay.

Now, once we recognize that we need to also focus on another stylized fact. In the midst of this huge crisis, investors are

undertaking a flight **** to quality and where are they going? They are going to U.S. treasuries, U.S. treasuries. Right? **** and bonds. Now, there is a clear preference for investors to go there. There's a demand for these kind of assets. So can we, in a way, think of what to do with this revealed preference? Okay. The U.S. government, as you know, has announced a fiscal stimulus that is going to come up in the next month with the next president, with the president-elect. And that's fine, I mean that's the way to encourage in an anticyclical way an expenditure in domestic demand.

But what if the U.S. can also benefit from a prevention of a decline in export growth. Meaning what if the U.S. could rely not only in maintaining or reviving domestic consumption, domestically, but also from helping the rest of the world and in particularly emerging markets not to go under. Because if they go under there is not going to be an increasing in the demand for products produced in the United States. Okay?

And that circumstances the committee believe that the central challenge to be addressed by the international community is to address the simultaneous combination of flight to quality with the freezing up of international credit. So we have two elements happening at the same time. International credits have frozen and at the same time is going to treasuries. Okay? So the proposal of this committee is to find a way of recycle back to the region they demand for U.S. treasury bonds that have flown from the Latin American region out of the stock markets into the United States buying U.S. Treasury bonds. How do we recycle back those flows to the region?

Okay. For that, the committee suggest, proposes a mechanism and that mechanism is called, we call that an EMF, an emerging market fund. Now, this emerging market fund is not a new institution, it's a fund. This is basically recognizing that we have a number of multilateral international organizations already in place. A simple alternative to the fund that I will describe in a second would be to say okay, let's recapitalize all the multi lateral organizations and allow them to extend credit to the different segments in the region, both the private and the

public sector. And we support that. But we don't think that's enough because that takes time. Emerging market fund basically is for the purpose of trying to **** resources very quickly in an expedient way, but with a multilateral organizations having a major role. It's specifically the EMF, emerging market fund, would channel resources through multilaterals by purchasing assets and these assets could be loans and bonds, arising from the following facilities that I'm going to describe now.

And there are three kinds of situations. Okay? Let's talk about the private sector first. Okay? You could have companies that have already gained access to the international capital markets and therefore have passed what we call the market test. They already have proven to the markets that they have the adequate government procedures in place. For those kind of private sector companies that face problems in rolling over their existing debt in international capital markets the committee recommends that multilateral such as the IFC, IIC and CAF, channel EMF resources to provide funding or guarantees directly to these companies.

That is one kind of companies. Now, let's continue in the private sector but focus on another kind of companies. What about those companies that have rollover difficulties, are doing well in terms of their performance not in terms of their capacity to acquire financing, but are not active in international capital markets. Say, they really are more kind of closed firms. And what about the trade credit lines that have been drying up. You know trade credit lines are incredibly important for the operation of a number of companies not only the ones that export directly but for the import of goods and services that are going to be using the production of for their goods.

What about for those kinds of situations in the private sector? In that case the committee recommends swap lines with central funds to rechannel through the local, public, and private banking systems. Because in that particular case you need the activities of the local banking system to determine the qualifications of a particular firm to actually get access to

funding. You cannot rely on the international capital market because they don't' trade in international capital markets. They are not listed there.

So those are the two situations for the private sector. But what if the public sector now is the one that faces problems in rolling over existing majority? Well, in order to address public sector rollover requirement and budgetary support the committee recommends establishing credit lines through the IMF, the IDB and the World Bank. At the minimum we think that the objective of this line is to provide the financing to ensure if neutral fiscal response. But the committee is also aware that there might be a need to get financing to go farther in neutral fiscal policy and maybe what we could also be financing is moderate counter cyclical fiscal policy with the underlying or moderate. To rechannel for example through temporary investment, tax credit, accelerated depreciation regimes, lower tax rate rather than public spending because our concern is increasing public expenditure are much more difficult to make on a temporary basis.

How much is it needed for this facility? Well this is a very difficult question to ask and also it's very important to say at this point in my presentation and I'm sure that several other members are going to stress that we do not think that at this precise moment we have all firms and governments in Latin America running and say okay we need to roll over my debt right now, I am having problems. That is not the role of the committee. The role of the committee is to suggest in advance preventive actions.

So we think that the facility should be ready to be taken so the people, that governments and private firms should actually have access to a facility like a credit line that you only use when you need that you already have the credit line in place. And our estimate is that about $250 billion is a good estimate of what could be required to address the potential roll over needs and budget support that the region might need in 2009. But again, I'm underlining the fact that this is on the preventive not that we are saying okay the region right now is facing a shortage of

250, we are not saying that. It's just this statement is focused on the risk this region is facing, therefore to address the risk that might materialize we are proposing a facility that if you subscribe to the facility and the risks materialize you actually have access to prevent those risks from materializing.

Finally we conclude the statement - and I'm sure that my colleagues are going to compliment what I haven't said or explained clear enough - that in these times, in the past when we issued the statements about Latin America we were focused on Latin America, Latin America. But we are now focusing on global circumstances right. And so the risks of not addressing the kind of issues that we are putting on the table with emphasis on Latin America actually create a significant risk for the global economy. Unless the recycling that we have proposed, the recycling of funds to emerging markets we use Latin America as an example and also because we have the number of 250 that we have in mind for Latin America, right? But this is generally true for all emerging markets.

So unless the recycling of funds to emerging markets is effectively implemented countries may be forced to adopt import restrictions, capital controls in an attempt to reduce external financing needs and impose a **** on capital flight to force domestic residents to save to direct their savings to domestic assets.

The problem with all these is that in the absence of adequate international actions they (inaudible) policy response might be politically inevitable undermining the basis of global cooperation that was established in the aftermath of World War II and that have actually made possible the fast raise of growth and trades and income and the reduction of global poverty. To finalize the message, to just round out the message, the risks are huge. For the region most of them have not yet materialized. But as we are all aware. I mean nobody can say, nobody can say that people are not aware of the risk. That these things are not being taken into consideration if you are facing important risk that could actually lead to a severe problem in the region than the facilities being proposed, an emerging market fund that

actually manages a number of facilities that uses the desires of the world to hold U.S. treasuries. That is a explicit desire that is taking place as we speak.

And the fact that the number of multilateral organizations are in place to find a mechanism to quickly, quickly in a very, very prompt way to allow to offset the lack of financing that could otherwise been available under normal circumstances. Okay, having said that why don't I first ask anybody of the committee that wants to compliment, clarify and then we'll open for questions. Pablo..

Pablo Guidotti: Let me just, I want to summarize what I think are the main messages that we want to transmit, okay? First the fact that the region comes from a relatively long period of rapid growth implies that in many countries we see that authorities have not really understood how serious potentially this situation and the downturn is for the following year. So our first I think strong message is to actually national authorities. To call attention that they have to prepare. Okay? And also to the official community in the sense that we may underestimating the problems I had.

The second main message I think and why we are talking about a global approach that although the region has seen many crisis in the past, the Asian crisis and so on, this one is a little bit different.

First of all, as happened in the past we know that capital account disruptions are particularly serious with very large potential consequences in terms of loss of output. But the situation here is different because in the past, crises were concentrated essentially in emerging markets. But the advanced economies were doing well. Okay? Now we have started with the advanced economies. Many have thought a little bit innocently that there was going to be a decoupling. But now we see what has been the deception of the capital market is rapidly extending to the rest of the world. So we are not going to be sort of a region that is naturally going to balance another region that is going to face a recessionary pressure.

And the fact that the capital account disruption is so central to a problem implies that the typical countercyclical fiscal policy thought mainly on output fluctuations over the cycle in this case is not going to be enough. So it's not – we don't think it's going to be useful to think that for instance, the U.S. can resolve its own situation by simply doing countercyclical fiscal policy at home. Okay? It's not going to be enough if there is not a balanced countercyclical or balanced in other regions of the world that can actually sustain demand. And the third I think general message is that a little bit in the spirit of the unprecedented actions that authorities and governments in advanced economies are taking to deal with a situation in their own countries I think that in this case, we need to stress two things. Scale and agility.

And this is why, first of all, whenever possible in the instruments that we are proposing we want the help or the action of the private sector to be challenged directly without the intervention of our national governments. Okay? There are some cases in which you need to have essentially the participation of the government. But I think the establishment of this emerging market fund is really something that is meant to enhance the roll of existing multilaterals, as essentially the center of expertise and the ones that have capability of management but actually provide them with something that is much more agile in addition of the scale.

Liliana Rojas-Suarez: Anybody else want to add something for clarification? Guillermo?

Guillermo Calvo: Just on the same line, there are two issues, which I think are important on emphasizing. The first one is the fact that the region has been coming from a very good period and there is a feeling which is quite correct that fiscal deficit declined sharply in the region, that inflation has decline, that the region instead of being a net borrower like in the 90's it became a net lender. And so on, it may give the impression that the region will therefore being in a much better position to withstand the current situation.

Now, in general I would agree with that. But the issue is that now we are facing a problem which is of a very special nature. It's a credit market problem. We are not used to this. We haven't seen anything like this from the 1930's. So we don't have that in our recent experience and it's a very different animal. So the things that would work under normal conditions could be counter productive. For example, why do we need to go beyond the United States in order to make sure the expansion in the U.S. which is intended the policy makers are intended for that to happen here and probably they will spend a lot of money for that to happen. Why would that not necessarily translate into something good for emerging markets?

In the medium term, once again, I would agree that that normally will bring about good results for everybody. But in the short run they are lax. The impact of fiscal policy is immediate. Therefore, as a United States grabs the available savings in order to stimulate the U.S. economy, you are not going to see an expansion in the U.S. economy right away. What you are going to see is that the United States is grabbing wealth savings in order to implement the policy. And it could, in the short run, result in a crowding out of emerging markets. Hopefully that's not going to happen but it may happen. So one has to be prepared for a situation where because the north has such a tremendous advantage in the first place because everybody is willing to lend to the treasury here at a zero interest rate. While, the private sector is totally left outside the capital market, not only in emerging markets but also here. So here we can do something for the private sector it can attract those savings and turn them into something which is good for the U.S. economy in principle.

But that advantage is not shared by emerging markets. So that's where we come in. That's why we think that it's important to have something to backstop for an emerging market which is not available. Let me finish with just one comment and let my colleagues continue elaborating on this. But one point is that when you look at the importance of the IFIs, of the World Bank, the IDB and the CAF well the loans in

2007 for the region amounted to less than 3% of the regions investment. And normally when you have these kind of problems and you saw that in the 1997, 1998 episodes you would expect that a situation like this would bring about a fall in investment of about from 20% to 30%. Not only in the region but southern stops in general. That's the impact that they've had on investments. So you see we have started from a very low base and so the funds that we are talking about may look big and they are big. So to make them effective, to bring them to life, it will require very strong political leadership and our intention here is to provide the rationale for that to take place.

Liliana Rojas-Suarez: Thank you, Guillermo. Alberto?

Alberto Carrasquilla: Thank you, Liliana. Very briefly, I just want to emphasize a point that was made very quickly which is the nature of the fund that we are proposing. This is not a fund that will be fed upon new money so to speak. It will be fed by the normal situation in which a former holder of say a Brazilian bond does not want to take the Brazilian risk because of the very difficult circumstances in the financial situation. But would rather have a U.S. Treasury bond so that we would observe the following: The Brazilian government is not able to roll over a particular bond due say, in March of 2009, rather the bond holder, formerly taking a Brazilian paper wants a U.S. Treasury paper. The U.S. Treasury finds itself with an excess demand so to speak for its bonds. What we are proposing is to recycle those resources that were supposed to be rolling over in all rationality the Brazilian bond or the Peruvian bond or the Colombian bond or whatever. There is an excess demand for the U.S. treasury bond and those are the resources that would feed the fund that we are talking about. This is not something that comes out of new money from the taxpayer or something like that. It is money that in normal circumstances would not be needed.

If we are successful there will be absolutely no problem because if everything works fine the former holder of the Brazilian bond will just roll over the Brazilian risk, give the

money to the Brazilian government and there will be no need, there will be no source of funds for the fund that we are proposing and there will be no use of funds for the fund that we are proposing.

So it is very important to highlight the fact that we have given a number here which comes from an estimation of the top maximum needs that the region would need and if everything works well, then every single country in the region will be able to roll over its debt and there will be absolutely no money in the fund and no money deposited in the fund and no money used in the fund. What we are saying is if there is a situation in which people are demanding U.S. treasuries beyond what they would normally demand then those excess demands be recycled and make markets work as if the situation were normal. We want to replicate a normally functioning capital market.

Of course this fund would charge a fee. The U.S. Treasury would charge a fee to the fund and the fund would have to pay it and the Brazilian government would have to pay for these resources because it makes absolutely no sense for the Brazilian government not to pay or the Latin American governments not to pay. As the situation normalizes the fund will be diminished because the rollover situation would be normalized and we expect that if an announcement is made market participants will be aware that the rollover risks are minimized by the existence of this global systemic recycling that we are proposing and we want to emphasize the fact that we are not here asking for new money from the budget or anything like that. What we are saying is there is a anomalous situation in which a Latin American bond holders, because of very special circumstances may want U.S. Treasury bonds and that substitution in there portfolios should be in the interest in the international capital market in the interest of the U.S. economy of the Latin American economy be recycled back to where they would be in normal circumstances.

Liliana Rojas-Suarez: Thank you, Alberto.

Ernesto Talvi: Thank you, Liliana. Since the whole group and the statement has focused on the systemic dimension I am going to take up on something, as Guillermo mentioned and try to look at things from the perspective of Latin America because we have the sense that for the time being in the region there is a little bit, this idea that why do we need all these contingent support if we are now a region that has flexible exchange rates, that has a surplus in the current economy thus it's a lender to world markets rather than net borrower. We have fiscal surpluses in many countries of the region and therefore not a need for fiscal financing and we have abundant reserves to the order of $450 billion for the region as a whole.

So we are not in the situation of many countries in Eastern Europe that are in the need of tapping these kinds of financing simply because we don't need them. And what I would simply like to point to is that this may be a temporary mirage in the sense that although things, when you take the picture, the photograph looked like that as of today and therefore many of the pressures that we are going to see have not yet materialized and are not yet obvious. Once you make some very simply back of the envelope computations you realize first that exchange rates, although they have depreciated significantly countries have now started to experience what Guillermo and Carmen Reinhart have called fear of floating. Countries in the region have spent between 10 and in some cases 20% of their reserves already since the Lehman collapse. So that's a lot.

Second, surpluses in the current account are going to very rapidly become large deficits as commodity prices decline and financing costs start to increase as they did very significantly. And moreover, certain sectors within the economy were already heavily in deficit in their own current accounts that were only disguised by the fact that other sectors, essentially primary producers were having huge surpluses. But one does not necessarily compensate the other if somebody who was tapping international markets runs out of credit I mean it will suffer the consequences and the surplus sectors are not going to come to their rescue.

But on an aggregate basis, what now looks as healthy surpluses are going to very quickly become pretty large deficits, external deficits. The same things happens with the fiscal. I mean what now looks surpluses with the recessionary pressures, the falling commodity prices and rising financial costs, very rapidly those surpluses are going to turn into deficits.

And finally, the **** position, although in gross terms it is very strong, once you start to look at things a little bit more in detail and understand that most of our reserves were acquired through sterilized intervention in exchange rate markets and thus short term Central Bank liabilities were issued in order to purchase those reserves. And that many countries in the regions have heavy amortizations coming due in 2009 and 2010. Then when you compare those reserves with the liabilities that might come due or might come to claim on those reserves in 2009, 2010 they start to look a little bit weaker than they appear at first sight.

So, when you add up all this, I mean, a deteriorating current compensations and the need of external financing, deteriorated in fiscal positions and the need of financing in order to prevent undercutting expenditure programs. Reserves that are not going to be abundant if the credit markets remain closed for the foreseeable future then what today appears to be a strong position in the next few months if things do not change significantly can rapidly unfold into a very, very dangerous scenario. And that's why, and this ties up with our proposal, we think we need to set up this fund in order to enhance, as Pablo said, the capabilities of existing institutions to be able to support a region that perhaps not now, but eventually and perhaps in the near future is going to be in the need of substantial support if things do not change dramatically in the world economy which does not appear to be the case as of today.

Liliana Rojas-Suarez: Anybody else (inaudible)? Okay. (Inaudible) Questions now?

Question #1: You concentrate on the recycled fund. But will it be Latin America, as a region, it has been one of the most unstable financially speaking. It is a region that has come in crisis up and down in the last 30, 40 years. Why in the committee not concentrate on the risk, financial risk analysis of the region? A financial risk analysis to concentrate where the contamination will come from outside via the banks, via the capital markets, via ofcourse trade. And that would make more sense. Because if we are talking about this fund we know very well. The behavior of all the economies, the one with access to capital market will be a different impact than the country who has access to capital market. So the recycle will be very much centered to a very particular number of countries.

So my question is, if the committee as a whole concentrated on why not in risk analysis, in other words to identify very clearly the financial risk that will happen to the region and then propose solutions to the U.S. Treasury, whatever happened, given the fact that we are the more financially unstable region in the world.

Question #2: My name is Delbert Fitchett and I have worked in some of the same places as many of you have. And I really like this idea of emerging markets funds. Now this shows the changes that have taken place in the structure of Latin American economies in the last quarter century or so. It gives an opportunity to support that kind of growth. I would just caution you on the balance between debt and equity in terms of the resources made available for the funds. Because many of these enterprises really need equity support or the debt support they are already in overly indebted situation.

But then when I went on and started reading about the support to the public sector, I have a tremendous sense of déjà vu that I was seeing something written in the 70's during the petro dollar crisis. I think we've learned a lot of lessons out of that whether it be Brady Bonds or HIPC. And I would encourage you to focus also on the opportunities or for guarantees from the multilateral institutions, insurance to public sector debt sector debt by the multilateral institutions. Try to be sure that there

were flows from the developing markets back into their economies. And I think that yea, just you know, think about the experience you went through already. Because I think there is a lot of lessons to be learned. Thank you.

Question #3: A couple of you alluded briefly to the role of the private sector. But then you went onto elaborate on the concept of the EMF, which is of course the centerpiece of the proposal. I was wondering, could you comment further on the role of the private sector? Please elaborate on that. Thank you.

Question #4: I really agree with the committee that we are facing very unusual capital markets these days, not only Latin America but the rest of the world. We are also facing some, not just problems of liquidity we are also facing some problems of solvency. There are many firms that will have to close, there are many adjustments that will have to be made. Not only in the United States, in the rest of the world. So I want to ask the committee whether you have thought about the solvency issues. Why should we, let's say in the United States, why we should finance the building of firms when in fact we have a large number of houses that are not being sold. And many of these firms have to be, have to go to bankruptcy. Have you given any thought to solvency issues?

Another issue that I worry to is that after crisis, if you don't close some firms, you allow firms that are not productive to continue to survive and you don't allow other firms to come up to appear and to really be, so you have a liquidity constraint on other firms. Have you given some thought to that, what is your idea?

Question #5: I have a question about implementing this grand plan. It sounds really great, it sounds very innovative. But it's obviously, the emerging market fund is going to, will have a huge coordinating role in trying to work with IFIs working with the treasury, other central banks in the advanced economies and trying to get the resources to bare. It will obviously have to be done on I guess a volunteer basis. Has there been some discussion on a key actors and how they might respond to this

and how they might see the role for themselves and are you drawing on any precedent, historically in terms of putting this together. I would be curious where the ideas would have germinated from?

Question #6: Gary Kleiman. I wonder if in terms of the de facto recycling impact how expanding the federal reserve swap lines already provided to Brazil and Mexico and the rest of the region would differ from your EMF construct. And I always struck, what is the responsibility of Latin American oversight authorities themselves in this crisis? You seem to indicate that the private sector also would have had access to this window. I guess these will be contingent liabilities absorbed by the government. Yet you know, we find out in retrospect what those of us who are following it closely know that there was a lot of borrowing done abroad particularly by banks that was used to feed credit growth at home. We find out about all sorts of off balance sheet derivatives, arrangements that were in place. Where does the burden sharing lie between some sort of multilateral rescue and you know, the Latin American public sector bodies themselves? Their should be some division of responsibility I would think.

Question #6: My question is you all have laid out a scenario of how to intervene to avoid a negative cascade of events and a new credit-connected global economy. And you alluded to the possibility if that didn't take place that their could be a negative washback into other economies from downturn and imports to Latin America. Could you take a crack at the size of that, could you take an estimate? Because that's part of the argument for why it's imperative. In other words if action is not taken of the character you have proposed, what will be the impact in the rest of the world if there are fewer imports, fewer demand in Latin American region?

Liliana Rojas-Suarez: Okay, let me start and then my colleagues will take what I don't address which is very good questions actually. I think the committee will agree that these are very good questions. Let me start with the implementation issues only because yes, we did address in our discussions. We totally

agree that there is going to be a huge number of coordination issues.

Remember that I first started my presentation saying that this is the shortest statement that we've produced as a committee. We voted against getting into proposing details on how to make this actually happen. Because the first thing, of an idea, is to actually test whether the idea as a whole, make sense or not. Then we will think about how to deal with coordination issues. But we do not address that here on purpose even though we recognize that the whole thing is a coordination problem that we are addressing, right? And so there is going to be an enormous amount of work if this idea flies sufficiently high.

There was the question of why don't we just increase the Fed swap lines right? For example – and we also discussed that. Absolutely, I mean if the Fed was going to go and say okay here's the swap lines for all these number of countries but we didn't think first that that should be just the Fed responsibility. That there is already in place a number of institutions, multilateral institutions that would actually address exactly what you are asking, what is the burden sharing. We are not assuming that when this new fund, the emerging market funds, buys the assets issued by multilateral funds say a loan from IMF, we're not assuming that this comes without conditionality. So the burden sharing is not that you are trying to give the money for free to the country and then you know, that's it. No, no, no. We're saying that there are private sector difficulties of one nature, there are private sector of another nature and there are public sector of another issue and this whole thing is a burden sharing issue. But there is no way that the first of all, the Fed is going to take the responsibility of assessing which one is riskier than the other. Or that a fund, like the one as proposed will have that kind of responsibilities. We want to use an existing infrastructure in terms of the multilateral organizations, to actually be able to address that particular issue.

Which links to the financial risk analysis that somebody was asking. Again, it's not the role of the committee to go country

by country or risk by risk in each individual case. That's why we were talking about the private sector. We were talking about the IFC for example, right. Because they deal with private sector issues. They will know, not the fund, not the committee, not the U.S. treasury, we have already in place institutions that are precisely doing that. We are not replacing the activities, proposing to replace activities that they are actually are doing. We're enhancing their capabilities in very bad times. We don't want to go back to the solvency issues. Of course firms need to fail. Of course this is not a subsidy to think that things were not working well in the first place. There will be countries that are not eligible to participate.

As Alberto was, I think it was Alberto I can't remember, was addressing. The whole idea is to allow to enhance, to mimic the normal functioning of the market. To mimic the normal functioning of the market. Right now, what is missing is sufficient funds to be channelized to certain government, certain government, certain firms that are facing an external shove that is not due to their bad behavior. We, the committee, are not going to tell you what firms in what countries. I don't think that's the role of the U.S. government in particular or any government in particular. We think that's the role of a multilateral organizations already in place doing that job. We want to enhance them, allow them through a very simple mechanism who very basically recycles what the public wants to hold U.S. Treasury bills.

Okay, the rest.

Next speaker: Let me just a compliment because I think that once, one interesting of the details, they are a large number of issues that arise and a large number of possibilities so it's very easy to actually miss things. Okay? But it's easier to actually look at some general principles, okay.

First, in terms of instruments. Of course, we do not think they should be limited to loans, to rollover funds within guarantees, have a significant role. Guarantees of course can be also designed in a way in which the risks are shared by different

actors, okay. Also we do not, of course, roll out equity. Okay? But if there is a question of whether these resources should always channel through the sovereign, okay? We think that is not a good idea. Okay? So in as long as we can actually deal with the private sector directly, that should be done. Okay? And multilaterals, such as the IFC, have a lot of expertise in actually dealing directly with the private sector.

Of course, there are in many cases in which that is not going to be possible and it is going to be necessary to channel some of the resources or the facilities through governments. But here again, we want to stress the agility and to try to reach the private sector directly as much as possible. Okay? So I think that I mean that is basically…

Next speaker: I think your answers are very comprehensive. There was a question about if there is any precedent for these funds. Mexico, 1995 the U.S. provided funding for $25 billion, you remember in connection with the tequila crisis. And Mexico is about 20% of the region so multiply that by five that gives you $125 billion, we are talking about twice that sum. Mexico's problem was essentially of a different nature than this one. In fact, the fact it's interesting that when you have a credit problem those that will be hit the most are likely to be those that have a more fluid link in the financial market, in the capital market with the rest of the world. I mean countries that are relatively close like Argentina now probably are shielded to a large extent.

But you see, Mexico for example losing about 10% of resource very quickly. You see Brazil, devaluing the real from August to now at the rate of about 60%. So it's quite clear that the problems have not originated in the region, of a different nature those countries that, and also if you look around not just Latin America. I mean who are in big trouble? In some of the countries that you would not expect like Hungary, for example. Like even Russia. Are countries that have, even Russia had loss of international reserves. So those countries that accumulated reserves could be the targets of those that are looking for liquidity. So you can get liquidity where liquidity

is. And therefore what we are trying to do with this is protect the country so that they don't lose the power that they already have through the capital market and allow them to have relatively open capital markets.

So when you go back and think about Mexico's 125 and realize that this problem is of a different nature just talking about 250, as a ballpark figure of course it's something that we should discuss. Not to be used, Mexico used that if you remember and the U.S. made a lot of money out of it because the interest rate that was charged was really very high to relative to the opportunity cost. So that was a very successful operation for the U.S.

Next speaker: Just to add, very briefly, somebody asked about the key actors. We did actually float this idea with some key actors in the multilaterals, in the U.S. treasury and they were extremely receptive in fact to the idea and that doesn't mean if they weren't we wouldn't have been presenting it anyway and because that's our role. But the fact that they were in a sense makes these unprecedented proposals more viable from a political economy perspective.

Swap lines by the Fed, special regimes, what we are seeing today - swap lines are only provided for four countries, Brazil, Mexico, Korea and Singapore. The way things are proceeding, they are being resold through very special sort of regimes. The IMF involvement in Iceland was supported by bilateral money from Russia. The IMF involvement in Pakistan supported by money from China and well, so in a sense many countries are going to be receiving support depending on where they are and what is the geopolitical interest of a certain country that would be ready to support them. So, we think that this proposal, the EMF has the ability of providing a large chunk of liquidity that would be available through transparent rules for the emerging market countries. And since it is a mechanism, as Liliana said, that is intended to enhance the ability of multilaterals, to deal with these problems and essentially has the feature of delegated monitoring that would solve the problems of adverse selection that person there was mentioning burden sharing and eventually

the solvency problem issue that Graciela brought up which I think is very important.

The idea here is that there is, underlying here, there is such a thing as an orderly deleveraging which does not imply that restructuring and bankruptcies are going to happen but we would like to prevent something chaotic actually from happening. And I think that that's the whole thing of the idea. A big chunk of money channeled through transparent general ways that is accessible to emerging countries and destined to enhance the role of multilateralism through delegated monitoring to deal with these problems as they appear. It's not perfect but we think it's better than the alternatives that we are seeing today.

Next speaker: I will address the question of the expectation that we may have for the (inaudible) crack down in imports from Latin America. I believe that we have to distinguish all those problems that are related to the rolling over of the debt and the financing of the budget. But if we believe that there is something that would really hurt the world and would really hurt economic activity and would have a significant impact in aggregate demand across country. That is if every country decided to restrict imports from the rest of the world that is going to be very, very difficult that will imply a deep recession coming from the external accounts to all the economies developed economy or Latin American or emerging economies are going to suffer a lot coming from the trade account.

So what happened is all the things that we are talking about either coming from the restriction in the capital market because we don't have access to borrowing and there is a sort of borrowing constraint affecting demand, that will have an effect on imports too. If we have, in addition to that, a natural reaction of policy makers to try to close the economy, to try to impose farther trade restriction given that they are not able to get the financing to proceed with normal business, that will produce farther multiplying effect on aggregate demand, across country. And I think that when we are looking at the way of taking this sort of exceptional view of stopping the systemic

problem that we have across the world it is that if we don't do nothing with respect to this other problem we will end up with a crack down on the imports and affect the international trade in general.

Next speaker: Okay. One of the questions was about how to cope with companies that let's say got into risk by doing derivatives operations. We didn't discuss this during our meeting in detail, but the basic point I wanted to make is that in a sense we have no a situation in which the market that was in equilibrium, now there will be a you know, excessive supply of funds in parts, in excess demand of funds in other parts and without an interest rate plus the risk factor for just while we have this situation of not enough information about what is happening in the financial markets.

What I wanted to point out is that countries like Brazil and other Latin American we developed financial institutions, capital markets, stock exchange, derivative exchange. We allowed freedom of movement for capital flows and then in a sense if you look at what's happening, say in Brazil, there is a kind of punishment for having developed liquid markets. So that's our major concern is this excess demand, excess supply of funds in a very fast movement inside and outside the region.

Next speaker: Very briefly on the issue of burden sharing, which I think is very important and should be addressed very explicitly. I could not agree more that this is a costly adjustment and that the burden should be shared in proportion to the importance of the individual matter that we are discussing.

Firstly, the overall framework in which we have worked is that we are in very unusual times. This morning we found out that the Bank of England had reduced the interest rate to a level that was the lowest since 1694. So that gives you a very ample window of how unusual the circumstances are. Second, if we look at the treasury bill market and the U.S. Treasury market, we see something that is very interesting and motivates a lot of the way that we have thought through this problem these past couple of days which is the fact that before the summer, say the

10 year treasury bond was about 4% yield and right now it's about 2.5 or 2.6% per year and one can ask why did this happen? Why did this reduction take place? And our view is that there is a very strong increase in the demand for this paper. A very strong increase in the price of the paper.

And in parallel fashion there has been an even sharper drop in proportional terms in other kinds of paper in the international capital market. Many of that paper is issued or a lot is issued in Latin America. The premium that is there under normal circumstances reflects the burden sharing that should take place in the adjustment process. So basically what we are saying is under no circumstances should the flow, the recycling of resources be free. We, what we are saying is it makes no sense to have a 2.5% yield on one kind of bond which was at 4% before the shock and then have another bond increase the yield or reduce the price with respect to what was the case before the shock. It makes a lot more sense and the burden sharing would be included in the way we price the transfer of the resources, the recycling that we call is the basic concept that we have used, the resources and the price should be a price that makes up for the difference in risk taking and so forth.

Let us just put a simple example if Brazil bond is due in March of 2009 and the bondholder who used to hold the Brazilian bond does not want the bond anymore, wants the U.S. Treasury Bond then the interest rate on the U.S. Treasury will probably fall a little bit and the interest rate on the Brazilian bond will probably increase substantially. What we are saying is, use the resources which are in excess of what is needed anyway to channel them back into Brazil and to charge Brazil an interest rate that reflects the burden sharing of the adjustment process. We have space to do it because the U.S. Treasury yield is lower than it is, than what it would be in normal circumstances let's take advantage of that and transfer, recycle that adjustment back into what would be a normal function of the market as close as we can replicate it, of course at a cost to everybody and the spreads that make up for the difference in risk taking and so forth.

So basically what we have discussed these last couple of days is that under no circumstances is this a proposal for a new expenditures or new budget items or anything like that in any country. What we are saying is that the unusual circumstances that we are living that by some measures date back to the 17th century can be intelligently recycled through a facility or through a mechanism such as the one we are presenting today.

Next speaker: Just one question that you asked that we were just (inaudible) that we forgot to answer you. Latin America is about 20% of total trade of the U.S. Latin America is about 20% of total trade to the U.S. So we were just making a back of the envelope calculation and out of this $250 billion approximately $50 billion would be recycled back directly into the U.S. as increased trade. I mean it would protect trade and indirectly perhaps through the multiplier that depends on the numbers it could go up to 100 even a little bit larger than that. So there is a relatively big impact that could come from this operation by preventing a severe contraction in the Latin American economies that would directly benefit the U.S. and therefore the use of these funds in such a way will allow for better balanced adjustment of the global economy.

Liliana Rojas-Suarez: Okay, we have time for one more question (inaudible).

Next speaker: (Inaudible) political experience on this panel not just economic experience but this seems like an intelligent and thoughtful proposal but it needs to be sold to political leaders. And we have in April coming up two important events one is the G20 meeting in the UK where sitting at the table will be Calderon and Lula and Kirchner. And we also have the fifth summit of the Americas coming up in Trinidad, both in April which will be the first Western Hemisphere meeting with a new President of the United States.

So I would like some thinking on the political side. How do you have your own political leadership come to the table and make the case for a procedure mechanism like the one you're proposing?

Next speaker: One other topic that we discuss a lot during our meetings was a problem that we try not to put a lot of emphasis on the action of the IMF. So the IMF is answer to probably is going to be too tough for many countries to accept conditionalities or you know that all over the world the press has blamed the IMF, I don't believe that is true. But that is what happened in different governments and the press. So the idea of this emerging market fund takes precisely the in consideration the possibility that this is going to be more easy for governments to sit at a table and discuss than if we start from the IMF or from the World Bank or from another multilateral organization where the government will have a lot of discussion on who is to be blamed because of what happened in the world. There is a recommendation with respect to banking supervision that was part of the Washington consensus distributed across countries.

I think we have to eliminate the diagnosis from the country. We don't know what happened. Of course everybody have an explanation of what happened. But we don't want to open, I think, that it's not a good idea to open the discussion of who is to be blamed for what happened today. Let's try to focus on the solution. And I think this is what the emerging market fund proposed is just lets try to solve the problem and maybe later on historians will decide who is to be blamed for what happened in the past.

Liliana Rojas-Suarez: Two things regarding your question. First is that as part of our routine as a committee we are in contact with the region too. Like after this meeting we are going to have a press conference with the region via telephone conference. Then we also distribute this statement to Presidents of Central Bank, Ministers of Finance of the entire region. And we keep the dialogue there. But, something that is totally important here and just as Pablo is reminding me that we have been discussing is the essence of the importance of the leadership of the United States here.

This will not happen without the U.S. leadership. We are talking about U.S. Treasuries and the Fed of course. I mean it's

the leadership of the United States that puts all these things together. So we have two parts, being a global problem it has the leadership that you are asking for both from the region and from the United States. Without that, I don't think this could have any hope.

Okay, having said that. I want to, you want to say something else Guillermo?

Guillermo Calvo: A small addition to what you said. That's a reminder that Larry Summers spearheaded the aid to Mexico in 1995. And I think he understands very well what these liquidity packages can do and that was a very successful, once again, a very successful operation as I see it. So having him in the government now I think is a plus. It makes it more likely that we will get a good reception about this idea.

Liliana Rojas-Suarez: Yeah and another member just reminded me that on page two of this short statement we actually cite part of the G20, we said the committee is encouraged by the G20 decision to help emerging markets and developing economies gain access to finance in current difficult financial conditions. So this statement was written in sync with what the G20 has in mind.

Okay, now thank you so much. Please keep in tune we will come back and tell more about that and we really want to thank you for your attendance today.