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91st Year

The Honorable Pedro Sampaio Malan
Minister of Finance, Brazil

The Honorable Angel Gurria
Minister of Finance, Mexico

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Introduction

Chairman William J. McDonough

Welcome to the 356th meeting of the Economic Club of New York in this, our 91st year. We are particularly fortunate this evening in having two distinguished statesmen from two of the very most important countries of our hemisphere. Countries that are similar in many ways – great democracies, important economies, blessed with democratically-elected presidents who are extremely knowledgeable in many matters, but especially including economics, and having – I must say in passing – very good central bank governors and very good ministers of finance.

It is always an interesting diplomatic challenge when you have two such distinguished speakers as to which one should speak first, and we will go by alphabetical order of countries. Pedro Malan, the Minister from Brazil is someone who has had a particularly distinguished career. He was a professor of economics at the Catholic University of Rio and almost all of the very best civil servants in the area of finance in Brazil have been his students. He was the executive director for Brazil at the World Bank. He was at the Inter-American Development Bank, negotiated brilliantly the debt rescheduling of Brazil, then was the Governor of the Central Bank of Brazil, and when President Cardoso won office, he asked Pedro Malan to become his Minister of Finance. We are particularly happy this evening to have with us, and I present to you the Minister of Finance of Brazil, Dr. Pedro Malan. (Applause)

The Honorable Pedro Sampaio Malan

Brazil Minister of Finance

Thank you. It's an honor and a privilege to have the opportunity that the Economic Club of New York offered me to share with you some views about Brazil, the Latin American region, and the international scene. Such an honor and privilege is greatly enhanced by the fact that I'll be dividing the session today with my good, old friend, Miguel Angel Gurria, for whom I have over the years developed an enormous admiration for his professional competence, for his dedication to the public interest at large – domestic and international – for his hard-to-beat eloquence as you are going to see in a moment. In fact, that is one of the reasons why I have asked to speak first because I would be extremely depressed to speak after Angel Gurria.

So what I would like to do is to organize this brief intervention around four themes. First of all, I should like to reiterate what are the three main overall macro objectives of the Cardoso administration which we have been pursuing for the last four years. Secondly, I would like to briefly demonstrate our commitment to these very same objectives by indicating the nature of our response to the Asian crisis after October 1997. Thirdly, I would like to address briefly what has been called in this country, some years ago, the twin deficits – the fiscal situation and the balance of payments disequilibria in the light of the current international situation. And lastly, since 1998 is an election year in Brazil, I would like to make a brief comment on what we expect for 1998, and since we don't look only for the present calendar year, for the other years because we do hope and expect that Cardoso will be reelected for a second term come October 3, 1998. So on the first topic then, the three main fundamental objectives of the current administration in Brazil, to put it briefly, let me start with inflation – 1997 was the fourth consecutive year of declining inflation in Brazil since we launched the Real, the new stabilization program in 1994. Our consumer price index rate of inflation last year was around 4 ½% for the whole year which was the rate of inflation we used to have in three, four days in the months immediately prior to the launching of the new currency. We had a rate of inflation of 2,700% in 1993. We haven't observed and experienced in Brazil rates of inflation of this level since the early 1950s. And I could assure you that 1998 will be the fifth consecutive year of declining inflation in the country. Consumer price indexes will be in the 3% to 4% range which means five years of sustained inflation and a downward trend.

We have been making clear in our public discussions in Brazil that we are not going to give up our commitment to keeping inflation under control which in fact is the responsibility of any serious government anywhere in the world for three or four reasons.

First of all, very briefly because it's widely known, and should be widely known by now at least, that low inflation increases the economic efficiency of a given system by enlarging the time horizon in which investment and saving decisions are taken.

The second reason is of a political nature. We are convinced that this is precisely what the vast majority of the Brazilian society expects from us, and in fact, expects from any government or any administration or any team which succeeds us in the future, which is the preservation of the purchasing power of the national currency which is the preservation of the purchasing power of the wages and the incomes of the majority of the population.

The third reason is of a social nature because inflation is a sort of tax – a compulsory tax which falls disproportionately on the poor. And that's a social reason why to keep inflation under control.

The last one, dear to my heart, is that I'm convinced that when you have a deteriorated national currency, the things that deteriorate are not only the ability of people to relate to the relative prices of goods and services, but there is a deterioration as well in ethical patterns of conduct and the morality in public and private administration. That's one additional reason why inflation should be kept low.

So this being said, inflation of course is not the sole objective. It's just a means to achieve other objectives. Let me turn to the second one which is growth – 1997 was the fifth consecutive growth of GDP in the Brazilian economy – an average of around 4% a year. 1998 will be the sixth consecutive year of sustained growth in Brazilian GDP. Of course, it will be a lower rate of growth than we were anticipating prior to the eruption of the Asian crisis, but it will be a positive rate of growth in real GDP and real GDP per head as well this year.

The question that is a very legitimate question that many Brazilians pose to us is that while country grow at a higher rates, haven't we done this in the past? And our answer is yes, we can, we will, and we are creating the conditions for that. Because we have been insisting that a key thing is having the rates of growth which are sustained over time and which are accompanied by structural change and productivity increases which are the basis for future growth. Now this is precisely what has been happening in the Brazilian economy in the last few years.

It's very easy to generate an increase in economic activity in the very short term. Anyone knows how to do this, and we are not going to do this because we know these are short-lived experiences. We know this from our own experience and looking at the experience of many other countries. We want a rate of growth which is sustained over time.

I will be concerned, to be very frank with you, if we have the current rates of growth in a situation which the country is producing exactly the same things, exactly with the same technology, exactly the same places as we used to produce these goods and services in the past. But this is not what's happening in Brazil. We are producing new goods and services. We are producing new goods and services with more updated technology and liberalization helped enormously this process. And we are producing things in different locations.

There has been a remarkable process of decentralization or de-concentration of economic activity in Brazil at large, in agribusiness, in industry and its services, which is important for the reduction of the very large inequalities in the distribution of regional income and regional economic activity. So Brazil has changed, Brazil is changing, and Brazil will continue to change. And estimates of productivity increases over the last four or five years indicate something, depending on the methodology used, total factor productivity and labor factor productivity increases of 5% to 8% per year in this period. And this is what is the basis of our bet on the ability for the Brazilian economy to grow at higher rates in the future.

McKinsey which is a very highly respected consultancy firm is going to present Monday next in Brazil the study they have made of eight sectors in the Brazilian economy judging them according to the best practices in these sectors elsewhere in the world. And the title they have decided to give to their presentation is that Brazil could double its income per head in the next ten years, or has the potentiality of doing so of course. I haven't seen the study yet but the title was a bit attractive to me for reasons I hope you understand.

So with this being said, growth, even sustained growth, is not an end in itself. They are means to achieve other objectives. The third one, and the most fundamental one to us, is the process of improving living conditions of the majority of the Brazilian population. I'm not going to elaborate this, but the process is taking place. Millions of Brazilians have entered the consumer market, in durable goods especially, for the first time in their lives because we have retired from them the burden of the inflationary tax and stabilization allows these things by allowing the recovery of credit mechanism in the economy.

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There is an increasing access to public goods as well, especially basic education and basic health. And we are consolidating our democratic institutions – the full exercise of citizenship, equality before the law, stable rules, a process which I think is absolutely essential for the consolidation of process of modernization and economic and social development.

So this third objective has been very much in our minds since four and a half years ago when some of us joined Cardoso when he was invited to become Finance Minister in the previous administration. Now our commitment – I'll turn to the second point – our commitment to these objectives, I think, have been expressed recently in our reaction to the Asian crisis. As some of you know, on October 30, 1997 we have to take a very hard decision which was to double, we doubled the level of interest rates in Brazil which were already very high indeed, to a very high– maybe many of you would have problems in dealing with this – but we raised interest rates to an annual level of 43.4% on October 30, 3 or 5% a month.

At the same time, we immediately called the rest of the government, with total and full support of President Cardoso and said, look, the reaction of Brazil to the crisis cannot be restricted to the action of the Central Bank. We must react as government. And within one week we prepared the package of 51 fiscal measures which involved a gain of $18 billion U.S. dollars for 1998, roughly half expenditure cuts and half tax increases.

At the same time, we called Congress and the leadership, relevant leadership in Congress, and said the response of Brazil to the crisis cannot be restricted to the Central Bank and to the Federal government. It has to be a response that will have to involve a cooperation between this active branch of government and Congress. And Congress did respond, they approved our fiscal package in less than one month. We presented it in the first week of November. They approved it by December 10.

In addition to that, the president called a special extraordinary session of Congress which took place in our summer which is January and February where usually there is no Congress in session. And they functioned there from January 6 to February 13. They re-opened last week. And this was a very important session because they have moved to clear the legislative agenda. They approved some very important, in the first round, constitutional reforms. One on public administration which has to go to two votes in the lower house and two votes in the senate. We had already two votes in the lower house. The second vote was on February, I think, 10. And the second final vote was today. We won by 56 against 16. And it will be amended, the Constitution, to allow public administration reform which will be extremely important for the adjustment of finances at the states and municipalities. I don’t want to go into this in depth.

We are going to approve the Social Security reform in the next few weeks as well. It’s only one final round in the lower house that remains. We approved the change in labor legislation during this session allowing temporary labor contracts which is essential to fighting unemployment and creating employment opportunities. We dealt with money laundering law which was very important for us. We have been pushing for this for long. We changed the legislation from secrecy and fiscal and financial legislation and other things which I don't want to bother you with. It was a very extraordinary session.

The point I would like to emphasize in this reaction is that at the same time we said we have to go further. The point I want to emphasize is the following. We made it clear that the Asian crisis, no matter how unpredictable its developments could be and they were very difficult, very high degree of uncertainties prevailing in October, November, and December, which have abated now. We said we are not going to change course in economic policy.

Our proper response, as Mexico has done, in 1995, as Argentina has done in 1995, as we have done in 1995, is to deepen the process, to accelerate the speed of the process of structural change and reform. And this is the proper way to respond instead of tinkering about, well, what was wrong in what we have been doing so far? Let's go further with determination. And I think that that's what we have done. That's what we are doing. And that's what we will continue to do.

Let me address the two, the twin deficits, very briefly. Let me start with the balance of payments. It is true that last year the current account deficits in the balance of payments reached 4.15

percentage points of GDP which is seen as high, although it's a far cry from Mexico's more than 7% in '94 or Thailand's 5% - 8% for five years prior to the crisis last year. But anyway, I understand that the international community thinks that given the changing international circumstances, 4-something is far too high. This year the first digit will be a 3. It will be 3.-something. The consensus of the marketplace is something between 3.5 to 3.8. I don't make official estimate. But it will be lower; the trade deficit will be lower as well.

The point I would like to draw your attention is the following. Last year, more than half of the current account deficit was financed by foreign direct investment. Brazil got $17 billion of foreign direct investment in 1997. And this is important to know the progression here. In the first three years of the decade, '91, '92, and '93, the average was less than $1 billion. It was $2.2 billion in '94, $3.9 billion in '95, $8.9 billion in '96, and $17 billion in 1997. This year will be higher than that on the strength of the privatization programs in telecommunications and electrical energy, both distribution and generation. So we are going to have a lower current account deficit in absolute terms and a higher volume of foreign direct investment. So the share of foreign direct investment or the share of current account deficit being financed by foreign direct investment will be higher than last year which was 51 ½%. And I think this is important because foreign direct investment is not made up of volatile short-term, purely interest arbitrage types of capital inflows. It's more on the nature of bets in Brazil, in the region and its future.

And I do believe that people in these investment decisions – Argentina got almost $7 billion last year as well – when decisions are taken today, they consider the wider market in the region. Mercosur today is a market of $1.2, close to $1.3 trillion, U.S. dollars. It's not irrelevant anymore from the point of view of investment, location, or decisions of international corporations. And I think that we, in the region, from Mexico to down south, we hope at least that we are showing by our actions over the last few years that it's not that we do not have our own share of problems, that these problems are not exactly the same that some other countries in Asia have been facing recently. And therefore, we hope that some degree of ability to differentiate, to discriminate, is gradually emerging. At least this is our hope and we try our best to be convincing about this.

Brazilian exports have grown last year 11%. The first two months of this year, if you consider the average per working day, at 14% compared to the first two months of 1997. And the reason is, again, the one I mentioned before, it's the remarkable process of structural transformation in the Brazilian economy – the productivity of Brazilian exportable production and the productivity of Brazilian domestic production which is potentially efficiently competitive with potential imports has been increasing over time. And privatization and the opening up of the economy helped enormously to that effect. All our railroad systems today are operated by private railroad operators. We are privatizing ports. Brazilian exports are more intensive in infrastructure than Brazilian imports.

The combination of the opening up of the economy, trade liberalization and reduction in import barriers and low inflation is the remarkable force for reducing costs, improving productivity because Brazilian firms cannot, as in the past, shift to consumers any cost increase they have of any intermediate goods increase, including the inefficiencies derived from their own administrative inefficiencies. So they can't do this anymore. The market is not protected anymore, inflation is not there, to allow them to shift to consumers, which today do not accept the old dictum in Brazil that you have to buy today because tomorrow things will be much more expensive or maybe not even available. This argument doesn't play anymore.

So on the fiscal, and I mentioned the fiscal in connection with the other deficit because as we all know there is a relationship between the current account deficit and the fiscal deficit. The current account deficit is an expression of an imbalance between savings and investment. And the proper response, macroeconomic response to a current account deficit which is seen as high or rising is definitely not the return to protectionism which we are not going to return, neither a maximum evaluation or immediate evaluation of the exchange rate which, I, one more opportunity use, we are not going to do. We are going to keep our exchange rate policy commitments which is fairly well known by now. We have moved the wide band five times since 1995. Right now we have the narrow band, the ___ spread, which is the operation of which is fairly well known by markets – domestic and international. And we are not going to respond neither through protectionism nor through changing our exchange rate policy.

But the fiscal thing is the key area. We have to increase private savings to reduce the current account deficit in light of the new international environment. This process is taking place. We have reduced the negative savings, the public sector savings, which is the consolidated public sector deficit. I'm not going to bother you with the details, but I just want to draw your attention to one thing which we have been raising with international organizations. We are all in favor of transparency, on fiscal transparency, and there is a new code of conduct which is under discussion at the Fund which we strongly support. But for us this is related as well to international comparability. And the only thing I'm asking, without going into details, is that in our fiscal accounts, differently from many other countries, we include four dimensions. We include all public sector corporations, at the Federal, state, and municipal level. We include all the net results of actions and omissions of our...we are a Federative Republic as you know, of our 27 states and 5,525 municipalities, or local governments. We include Social Security. We include the national Treasury and the Central Bank. It's this consolidated figure that we publish in our statistics and we think they should be read accordingly.

The situation in this year, 1998, will be an improvement over 1997. I could assure you that in light of the fiscal package that we have approved last year. In the light of the Constitutional reforms, the one approved finally today in the senate and the Social Security reform which will be approved in the next few weeks, in the final, second and final round in the lower house. And we think that the key to the consolidation of the gains we have achieved so far is this process of fiscal consolidation which we consider in a time horizon which is longer than just one single year.

I'm talking too much. Our last point, and I'll be very brief with it, since 1998 is an election year, I think that Cardoso has, in public opinion polls, a degree of support which is the same degree of support that we have for the Real which is the stability of the purchasing power of the national currency. It was over 60%. He's leading the polls by more than twice the second candidate. Sunday last, the second largest party in Brazil held its national convention and decided – part of the party wanted to go with their own candidate for the elections this year – the majority of the party decided to support Cardoso in October elections. And we think that this, barring some major unforeseen events which are always in store and could happen, that it's the most likely outcome and it would allow us a few more years to consolidate the gains we have achieved so far.

Let me conclude this already long intervention by telling you what I have been telling my Brazilian friends, the public sector, the private sector, academics, politicians, when I was sitting at the World Bank as Brazilian Executive Director. And I listen to speeches of some Brazilians to audiences such as this, they used to very proudly raising attention to the fact that Brazil was the fifth largest country in the world in terms of population and territory extension, the eighth largest economy in the world in terms of its GDP.

And I used to call them after the speeches and say, well, that's okay, but this is not the way to go. The rest of the world knows this. This is not in what they are interested. What they're interested in is to know how is it that we are being able, or enabled to handle and to deal with our domestic problems, and there are many, we never deny them – economic, financial, political, institutional, social. This is what they are interested in. And you have to be convincing in your abilities to assure, convince them that you are working with a sense of purpose and direction, that the results are emerging, that there is a track record. But keep in mind one thing, you'll never be able to convince the foreign audience unless you are able to convince your own society that this is the way to go and you're doing things because you believe that these are the proper things to be done and not because someone else from abroad is telling you that this is right thing to do. And this is much more important than statistics about the size of the country and the size of the economy.

So this is what we have been doing in the last four and a half years. We will continue to do, if God gives us strength. And I just, given that the world is a complex environment, I never agree with the simpleminded money key in division between optimistics on one side and pessimistics. The world is far too complex and we always, it's a combination of humbleness and confidence that we have been approaching. And I speak for the economic team, which we have been working together for four and a half years, that we recognize the enormous problems, how much remains to be done.

At the same time, we have some basic confidence, not in ourselves, not in the government, a basic confidence that the Brazilian society will be able to rise to the challenge and will be able to face the challenges ahead with the proper time perspective which extends far beyond one calendar year. So we're looking at some years ahead and we invite you to consider Brazil, looking years ahead, look in the region as well because I think, I'm sure that knowing Angel, that many things I've said, he share with me, because we are on the same wavelength for many years on many decisions.

So with this, I would like to conclude, just apologizing for speaking much more than I should have done. The only excuse that I have is that my speech is close to seven hours shorter than the speech that Fidel Castro delivered to the last meeting of the Communist Party in Cuba a few weeks ago. Thank you very much for your attention. (Applause)

Chairman William J. McDonough: Well, thank you Pedro. I think if there's a small need for a few extra votes, you could reform the Constitution and give absentee ballots to the Economic Club of New York and you would do very well – 100% I would suspect.

Mexico has long had a great asset which is its very high quality senior public servants. And it would be very hard to find one with a greater record of public service than Angel Gurria. In the very difficult period of the 1980s, he was a senior officer of the Ministry of Finance. It was he who did almost all of the negotiating for the stretching out of Mexico's debt, for its restructuring, and led many bankers, some of whom are present, to understand that making a bet on Mexico was a good bet indeed.

When President Zedillo came to office, he decided that he would like to have an outstanding Foreign Secretary. And so Angel Gurria, who had always been well known for his diplomatic skills – including making people do what they really didn't want to before he instructed them what they really wanted to do – was made Foreign Minister and filled that post with great distinction. However, a couple of months ago, the then Secretary of Hacienda, Secretary of Finance, became the Governor of the Central Bank of Mexico. And once again the president picked the best possible person to return to his home ministry, the Ministry of Finance, and I can assure you that all of us who follow Mexico very closely thought that that was the perfect choice. Ladies and gentlemen, the Minister of Finance of Mexico, Angel Gurria. (Applause)

The Honorable Angel Gurria

Mexico Minister of Finance

What do you think about the mute, Minister of Finance of Brazil? (Applause) Thank you very much to both of you. To Bill, for his introduction, and to Pedro, for his comments. We are indeed very, very old friends. The friendship is old, not us. (Laughter) And thank you to both Bill and Ray Price for the kind invitation. It's a great opportunity.

As you remember, President Zedillo shared with you in the fall of '95 some thoughts on what we thought was going to happen in Mexico, and the idea is that I follow up today and tell you a little bit of what did happen, and mostly some of the challenges that lie ahead. As you know, in '95 when he spoke to you, it was a tough year. We had negative growth. It was a big year for the adjustment to sort of absorb the impact of the big devaluation at the end of ‘94. Then ‘96 was a good growth year, upwards of 5%. And, of course, ‘97 was an outstanding year in terms of growth, 7%, which was the highest in 16 years.

So that’s the basis, the foundation. It was 7%, and also different from what we’ve had whenever we had very high growth, inflation actually came down, interest rates came down. We created about close to 700,000 new jobs in the formal sector which is a critical element of the economic strategy. And both the fiscal and the current account deficits also showed progress.

And more importantly, and you’ll find out why, the question of domestic savings, if there is one single reason why we had a crisis in ‘94, if you had to choose one reason, you’d say it’s because the domestic savings rate dropped to an all-time low, maybe around 15% of GNP. And you need about 25% to grow at 5% which is the minimum speed which you need to grow at in order to create a million jobs every year, which is what our population demands. And if you only saved 15%, you were bringing in 8% or 9% from abroad, if it came in the form of mostly short-term, very volatile flows, they turned around and went home very fast after a spate of bad news in ‘94. That was basically the origin of one of the most important economic crises that we’ve had in our modern history. So increasing domestic savings in ‘97 was a very, very critical element. Actually they went up to, higher than 21% of GNP.

Now, there was also something which is different, in that in ‘96 growth was led by mostly exports. Mexico is now a very larger exporter, the tenth largest exporter in the world. Our exports are probably, in this year, around the $10 billion mark per month. So we’ll export upwards of $120 billion of which 80 to 85% are manufactured goods. Oil will probably be about 10% or less. And then the rest will be some mining and some agriculture products. But mostly, Mexico is now a large exporter of manufactured goods which it wasn’t in the past; and led ‘96 in terms of the growth.

The reasons why we grew in ‘97 are mostly because consumption grew and because investment grew. So it was demand-led. And that is a very important change in terms of how this recovery is spreading throughout the economy. And if anybody would have asked how do you see ‘98 in October of ‘97, and I think this applies for the world as a whole, I think you would have probably gotten a euphoric answer. I’d say how do we look at ‘98 today is a sober objective confidence with an external environment which is much less conducive than it looked like towards the last quarter of ‘97.

And let me just elaborate a bit on that, obviously the international environment changed, mostly Asia, and for Mexico, price of oil. In terms of the international prices of oil, the direct impact on Mexico stems from the fact that we are no longer an oil country meaning we no longer depend fundamentally on the exports of oil. But we are a country with oil which is okay, but we are a country which, although it no longer depends on oil for its exports or for its GDP growth, still depends very highly on oil for its tax revenue. About a third of our total tax revenue comes from oil directly or indirectly. And therefore, the price of oil affects us because as it drops internationally, we get lower revenues.

And what we did was that in the face of lower revenues, and this was just like eight days after I had taken office, we cut the budget by exactly the amount that we calculated that we were going to lose in revenues. The budget's at $15.50 per barrel, average for the year, for a typical Mexican barrel of oil, meaning a mix of X percent of heavy and light and extra light, whatever, $15.50. When I got to the Ministry of Finance on the 5th of January, by that time it was very difficult to justify that it would be $15.50. So we said it looks more like it's going to be around $13.50 for the year. So we cut the $2.00 which basically translates into roughly $2 billion of revenue lost. And we cut $2 billion of expenses. The reason is we wanted to have the budget exactly as it had been approved by the Congress. Not to add to the deficit, not to add to the debt, not to raise revenues by tariffs or by taxes, but basically by sort of tightening our belt in the face of a drop in revenue.

And we did that and basically I think it worked well because we still did not have a gap, a black hole that was developing. We actually moved before the hole was created. And I think it worked well, we sort of plugged it, and the market reaction was quite positive – the idea being of course you act early before all the spending units and the government which are so fast and so good at putting their biddings and their expenditure starts in an organized fashion. And January is a good time of the year, as early as you can get, to announce that you're cutting the budget. And we started off with a new perspective on the oil.

Asia is looking like it may affect us in several ways. One is, of course, trade, meaning it's difficult to sell to them these days. Second, they're trying to sell a lot more to us. And third, and probably more importantly because we, in Mexico, deal, you know, very little with the Asians in terms of our total trade. They're going to make or try to make big inroads in the U.S. market which is a very important market for us.

So, you know, we've got to make a big effort to increase productivity, competitiveness. We have a few elements that help us. We've increased investment in exports or export-related projects. There is NAFTA which is an important cumulative access at lower and lower tariff levels to the largest market in the world. And there is also the fact that in the case of Asia, many of your imports, U.S. imports from Asian countries, are controlled by quotas rather than by simply prices. That together with the fact that many of the Asian exports are also capital-intensive probably will attenuate the effect. But I don't want to make, you know, any bones about this, basically I think the Asians are going to come out of their problems very strongly, swinging in terms of competitiveness, and we've just got to be ready for them. And I think we got fair warning and we must all prepare for that.

In terms of the other side of the impact, and that is we now hear, now that I've been making the rounds in New York, there's about $7 billion, $9 billion for, you know, Korean mandates and this mandate and the other mandate. And that means raising money in the markets, in terms of emerging markets, is going to be more competitive, maybe somewhat more expensive. Now at some point in time we thought there wasn't even going to be a market. But, as you know, we floated a billion dollar global bond, the dollar bond, last week which was picked up by the market very nicely in a day. Actual total demand for the bond was about double the nominal size, but we kept it at a billion rather than take more in, to keep the price tight to sort of whet the appetite and the market for better things to come.

But basically we found out that the market was actually there. And I think it galvanized the markets a little bit. It said, there is a market out there, there's a good product, there's good pricing, there's a good country attached to it. I think, you know, the market will buy it. And we tested the market and it did. It swallowed it very nicely. It did not cause any indigestion. It was widely spread. In fact, geographically it was very interesting, Latin America contributed with about, I don't know...12 or 13% of the issue which was also quite interesting.

The very important element now is with this new scenario, with a changed international scenario, with a more sober, more cautious scenario, what will happen to Mexico's outlook for '98 and onwards? Well, first of all, we will not grow at 5.2%. We probably will grow somewhere around or close to 5% because you can't cut the budget by 0.4% of GNP and not have any consequences. Also you cannot have a less conducive international environment and not have any consequences. But we'll probably still grow at about double the U.S. rate, and you know, we'll grow in real terms, per capita terms, whatever. It'll be a year in which, you know, as we like to say we're on the right road. We know where the road leads. We're in a good car. We have a good driver. And suddenly it starts raining a bit. All you've got to do is slow down a bit and you know you're going to get there, but you've got to be cautious. And you know, if you slow down some, then it's going to be all right. That is what we're doing.

We will continue to create jobs, again maybe around the 600,000 to 700,000 in the formal sector. Interest rates and inflation will continue to come down. And I think we will continue to have a very important dynamism in terms of the exports which is very relevant in terms of Mexico now having become an important player in world markets.

Now the question after '98 is how do you keep up the growth and how do you provide for a smooth transition at the end of the century when a new administration comes in? This is very critical. We have had a history of problems towards the end of successive administrations and then people start to get a little nervous about transitions.

First of all, and this is where the single most important economic policy issue comes in, the savings rate is directly related to our capacity to sustain growth rates over time. If we can save most of the investment that we need in order to grow, then of course, it's like the baseball field, you know, you build it, they will come. If we have 21% growth or 23...sorry, savings, next year, or maybe 25% savings by the end of the century, then the rest of the savings that we need will come naturally at a reasonable price meaning we will not have to pay a huge interest rate or huge return on investment. It'll come naturally. It'll come almost, you know, sort of organically. And it is because we will not need it so badly that it'll come.

And that is happening. Last year we had upwards of $12 billion in direct foreign investment plus your financial flows and your debt flows. This year it's looking good. A group of businessmen just visited the president and said $10 billion only among them, just for the year of '98. So again it looks like the current account which may be a little wider than last year, maybe around the $12 billion level because of the oil impact, may be substantially, as the lawyer's would say, substantially financed by direct foreign investment. And that means you don't need debt, you don't need short-term flows in order to cover it. If any come, they're welcome, but you don't need them to finance the current account.

The question of the savings, and maybe I should elaborate briefly on this. Pedro mentioned the question of the new Social Security legislation in Brazil. We passed our legislation in '95 and we actually now have it operating in the field starting July of '97. There are 17 pension fund managers fighting for people's individual accounts. And hopefully, by the end of the century we'll have about 3 ½ % of GDP accumulated in those mandatory retirement accounts which will provide for a stable, long-term source of financing for housing, for infrastructure, the types of projects that do need long-term savings.

Now this is the future. In the financial system, in the economic life of our country, those savings, those pension funds, the insurance, or the development of the insurance industry attached to the application of the pension funds, is going to be the single most important variable going forward. And it will change, not only the way in which we do business, it'll change the way we relate to the rest of the world financially. So I don't want to, you know, stress the point too much, but basically having launched that, having passed the legislation and now being in operation and accumulating these pension fund balances, is basically a critical, probably the single most important economic or financial decision in Mexico's recent economic history.

Let me also mention that there is another side to this, and that is I mentioned that we have become a very big trading country. We have continued to promote free trade because we are convinced that free trade works. We've signed five new free trade agreements and we're now negotiating with Europe for a free trade agreement. We now have with Chile, Venezuela, Colombia, Bolivia, Central America, and we're negotiating with countries like Israel, who have been very interested in the concept of non-hemispheric.

And, of course, NAFTA, with the United States, we now trade about a billion dollars every two days, both ways, and growing, growing rather briskly. And the U.S. is selling more to Mexico than ever before. We are actually now your second largest buyer of goods after Japan...after Canada, sorry, before Japan, in terms of the volume of, the amount of the dollar value of the goods we buy. We are, you know, we are now a country which is, with 300 million crossings between the United States and Mexico every year. And as I was saying to my colleagues at the table, the very strange peculiarity, and that is that 75% of that huge trade rolls through because of the border. So that is leveraging itself and the potential for business is growing very fast.

In fact, one of our problems is how to diversify our trade and that is one of the reasons why we're negotiating with Europe because it is basically so easy. You know, once you get into a competitive mode here, you have a lot of demand. And basically, the sucking sound that some people were talking about before NAFTA was signed is the sound of goods going both ways with jobs being created in the U.S., in Canada, and in Mexico at a level of trade which was doubled over the last five years. So it is a very great success. But it works also with Chile, and it works with Central America, and now Venezuela and Colombia together are our largest Latin American trading partner in the so-called G-3. So free trade works, whether you're the small country or whether you're the large country. And that is why we are promoting the concept.

And now let me say two things to end. First of all, we have tested a number of trade regimes, in particular of exchange rate regimes. In the particular case of Mexico, we took some time to test the free float and it is working. It is working well. When you face vagaries of markets whose impact you don't know, you have, of course, your stock markets, you have your interest rate markets, but you also have your exchange rate which picks up some of the pressures and rolls with the punches and reacts accordingly and adjusts. And that is not only appropriate, but convenient in the case of Mexico. There are other situations in other geo-economic situations which have their own logic. In our case, this particular solution is working well and I think we are fairly satisfied that it is working well.

One last comment, and that is that as Pedro reminded us all, the question of good economic policy is absolutely indispensable for the success of a country, but it has to be accompanied by some other elements of the life and society of that particular country. As you know, President Zedillo found a tough economic challenge which he has addressed. But at the same time, addressed a true political, and conducted a true political revolution in the sense of deepening our democracy, of changing our election rules, of creating a totally independent electoral authority, of having campaign financing rules which say 90% of campaigns will be financed by the budget. And as you know that is a difficult point in many countries in the world. In many modern democracies, it is a source of controversy. And that has produced a dramatic impact in the quality of our own democracy. And I think together with that deepening of our political and democratic life, as you moved into a multi-party system that today has no simple, or single majority in the lower house, no single party has an absolute majority for the first time in our modern history. Where the give and take and the checks and balances of any modern democracy are present in our daily life, not only the legislative life, but the debates about any national issue, that I think is not only commendable, I think it is critical to understand the Mexico of today – an important economic recovery, sound foundations in terms of the future on the economic side and also a very important change, a very important re-vamping, a very important improvement of the political infrastructure and our life and society. Thank you very much. (Applause)

QUESTION AND ANSWER PERIOD

CHAIRMAN WILLIAM J. MCDONOUGH: I suspect that 20 years ago the notion that an American central banker could chair a meeting at which the speakers were the finance ministers of Brazil and Mexico and sit through both speeches and think, I absolutely agree with everything that's been said, that would have been a very rare thing 20 years ago. But it's a very welcome change as these two great democracies of our hemisphere show that sound policies are also sound politics. Our questioners this evening are Paul Ford, a senior partner of Simpson Thacher & Bartlett, and Henry Kaufman, the chairman and president, etc. of Henry Kaufman & Company. We will have a slightly different version of our normal practice in which both questioners question both speakers. Rather, we're going to shift it so that Paul Ford will be asking his questions to Pedro Malan and Henry Kaufman to Angel Gurria. But if both gentlemen will rise, which will give me the opportunity to sit back down, and we will start with the first question being from Paul Ford to Pedro Malan.

PAUL FORD: Thank you very much, Bill. I guess like Pedro I appreciate going first so that my question will be heard and probably forgotten before Henry gets up with his second question. Minister Malan, I think tonight's presentation by both yourself and Minister Gurria indicate the importance of foreign investment in the economic stability of both nations. One of the questions, I think, that's in the minds of the audience here tonight, many of whom are either in the process of or contemplating investments in the telecommunications industry and the electric distribution and generation industry, and the ports and all the other great infrastructure projects that your country has undertaken is the foreign exchange policy of the government. You've mentioned very strongly your commitment to maintaining the exchange rate. We are also aware of the budget deficit, of the concern of the government to maintain some controls over public expenditures. We know that the initiatives with respect to civil service and pension are good ones, and frankly ones that we admire because we're not sure they could be achieved here in the United States with the alacrity with which you've achieved them there. But nonetheless, the deficit does exist. It did deteriorate at the end of 1997. And I'm sure we would all be interested to hear what your thoughts are about additional initiatives to maintain control of, or indeed reduce the budget deficit during 1998.

THE HONORABLE PEDRO MALAN: Thank you. Could I pass this to Angel Gurria or I have to answer myself? (Laughter) Very brief comments. First of all, you started your questioning period with privatization program in Brazil. Let me say something which I think is important. It has created roots in Brazil. It will go forward, now especially in these areas of telecommunications and electrical energy. As we have been saying for a long time, there are three basic reasons for that. First of all, there's an increasing economic efficiency. We are convinced that the private sector does better these things than public sector who are always affected by the election calendar, by changes in administration, by laws which affect procurement and puts at a disadvantage a public corporation vis-a-vis the private sector. The second reason is the fiscal one by selling public corporations; we're reducing contribution of public sector enterprises to the overall consolidated public sector deficit. At the same time, the private sector in many cases assumes part of the debt of the public sector enterprise. And thirdly, no less important, is because the continuation and the deepening of privatization allows the government to concentrate on what it really should be doing, especially on account of very vexing levels of social inequality such as Brazil, which is to invest in basic education, basic health, instead of doing things which are better left to the private sector. Now this is what I want to say about privatization, we affirm our commitment to the continuation of the process. Now talking about commitment, you used a word which I would like to mention here, a commitment to the exchange rate. What I said is a commitment to our current exchange rate policy. We don't have a fixed exchange rate. I was very much surprised talking to a former minister of finance of an industrial country which I'm not going to name, when the gentleman in conversations with me a few months ago indicated to me that he thought that we Brazilians have a currency board arrangement in terms of our foreign exchange rate policy. I say, look, Mr. Foreign Minister X, I'm not going to name him, this is not the case. You were badly informed about this issue. We don't have, when we talk about commitment, we are not talking commitment to the current level of the exchange rate because Angel mentioned that, that we need to have some flexibility in this arrangement, that this is now in our view, as we do. We have, as I said before, we have moved the wider band many times. We move continuously the narrow band. And we think the system suits our convenience for the time being and we're keeping the system this year. And President

Cardoso has already announced that, if reelected, he is going to keep the same system in his second administration. So we are not talking about changes in the current period, I could assure you that. Social Security, you're right, we are moving ahead. We are moving ahead in this vote which is the second and final which will take place shortly. But we are working on the second round of Social Security reform. The president invited Andre Lara Resende, who is one of the brightest economists in Brazil, as his personal assistant to work in the second round. In the wider mandate of increasing, Resende rightly pointed out private savings as a share of GDP. Lastly, on the fiscal deficit, we are presenting our statistics in a very transparent way. All of you could look in the internet at our figures in a very desegregated fashion, the contribution of the central, Federal government, the Treasury, the states and municipalities, public sector corporations, to the deficit. Last year what we have, especially in the last month of 1997, a number which surprised us – he's right – a figure which was worse than we thought. We identified the reason. The reason is in the aggregate of states and municipalities. We are probing this thing deeper. And the reason is it's a very high significant privatization revenues which accrued to states and the way they are captured in the statistics of the Central Bank is that they appeared as deficits and as expenditures, while this is not an exact characterization of the picture. Many of the states have used privatization revenues to address either contingent liabilities such as pension fund ____ disequilibrium to pay debts but not debts against, to financial institutions. Therefore, when it's debt that you pay against a financial institution, it is recorded below the line in Central Bank statistics. When you pay other types of debts which are not to financial institutions, they are not recorded. In other words, our total nominal deficit in 1997 was, if you exclude altogether privatization revenues, very high, 5.89% of GDP, which is not comparable with Maastricht, which is not comparable with other statistics for central governments because we include all the dimensions that I mentioned before. If you include privatization revenues, it's less than 4% of GDP. It's a significant primary surplus if you include privatization revenue. We think we shouldn't, although we published both statistics. We think privatization should not be considered as current revenues, although many countries which I'm not going to name have used this in the past and this was accepted by international organizations. That's the reason why when we discuss transparency, we want to discuss transparency together with international comparability. I could assure you when it comes to the fiscal situation, that 1998 will be a significant improvement over 1997, partly because the fiscal package we have approved last year would involve a gain of close to $18 billion, U.S. dollars. Thank you very much.

HENRY KAUFMAN: Minister Gurria, I'd like to draw on your broad experience in my first question. Having gone through the debt problems yourself in the 1980s, and more recently, what lessons did you learn from that experience that you think are either being neglected or ignored by the present debt problem Asian countries? Or to put it differently, what do you think has been done better in the Asian crisis than during the past debt problems?

THE HONORABLE ANGEL GURRIA: I can tell you some of the things they have done better and, I think, are things that are going to help pull them out of the crisis a lot faster than we think. And that is they have been saving at more than 30% of GNP, sometimes for ten years, for fifteen years, and that is going to be a very, very big difference. The second thing they did better is that they have had reasonably strong fiscal positions, meaning for example, Korea did not have a penny in public debt. The case of Mexico, because our problem in '94 and '95, basically we had public debt which was maturing over the next 12 months, which was very big and we had to refinance that. In the case of Asia, what you basically have is a crisis of the super-structure, meaning the financial system and in some cases, like in Indonesia, the association of the industrial productive system with the financial system and its relationship to foreign creditors mostly foreign banks. Whereas I think in the case of Latin America, if anything, our crisis was somewhat deeper in structural terms because we had greater problems, more structural problems to address, like the savings rate, like the deficit situation, like the question of privatizations, etc. So we never give advice to anybody. The only thing is that we sometimes share our experiences. On the financial system crisis, the only thing that we would venture to say, as President Zedillo just shared with this colleagues in the APEC meeting in Vancouver a few weeks ago, is if you have a problem in your financial system, face it, address it, attack it, and solve it as soon as you can. Because every day that you save will be a lot of money that you save, and in terms of confidence, which is even more important, a lot of confidence that you will rescue which is what we did with our own financial system. And that is why we are sort of at the end of the solution of that problem of individual financial institutions which got in trouble during the crisis. It becomes exponentially more expensive if you don't address it face on.

PAUL FORD: Minister Malan, I'd like to follow up on that question. Interestingly enough, it actually does coalesce with what Henry just asked. One of the interesting facts about Brazil that may not be that well known because it happened a couple of years ago was that the Brazilian government recognized the weakness of its financial structure and set about very strong measures to strengthen the financial sector in 1995 and 1996. There were some 40 institutions that were either closed, restructured, merged, or put under supervision of the government. That happened well before the Asian crisis came. And as a result, when the Asian crisis did come, the fact that they had taken that medicine early on really, in my view, was one of the principle reasons why the international community had the confidence to see this through and not to prompt the kind of speculative attacks that would otherwise have been so devastating. It would be interesting for you to talk a little bit about that because I think that's a real triumph of the Brazilian system and one which, in fact, is an indication of the type of farsightedness that the government has had. But tell us a little bit about the strength of the banking system, of the financial system right now, particularly the exposure to foreign exchange obligations. And also I think interestingly, the asset quality of the financial institutions today in Brazil and how that has improved over the past two or three years notwithstanding the seeming threats from Asia.

THE HONORABLE PEDRO MALAN: I could speak for hours on this issue. I'll try to be very brief. We make a distinction, maybe it would help if I make a distinction between three different types of animals. One is the Brazilian private banking industry, the other one is the state, meaning provincial governments, banks which were almost 30 when we started, and the official Federal banks. If I may start very briefly with the private, it's important to remember that the

Real Plan was not the first attempt that we made at stabilization. There was one back in 1986 which was the Cruzado Plan, in which inflation was held very low for almost ten months, but enough for the best banks in Brazil to clearly get the message that they lost inflationary revenues which account in 1993 for, on average, for nearly 30% of the total revenues of the Brazilian banking system. And so the best banks in Brazil, large, medium, and small, started a process of adjustment, guessing rightly that Brazilians were not destined to live under chronic high and rising inflation forever, that someday the Brazilian economy would be stabilized. So the process of adjustment that the majority of the private banks in Brazil started was after the Cruzado Plan back in 1987. So the ones that have not, especially among the big ones, are precisely the ones who have disappeared. I'm referring to Banco Economico – we have a huge fight to have it closed in August 1995 – Banco Nacional, and Bamerindus. All the others have been in the process of adjustment for long. In 1993, when I was at the Central Bank moving to the other, the state provincial banks, we made it a law which makes it a crime for an administrator, for an official state bank, to extend loans to its controlling shareholder. That means the governor of the state or to state companies. This is a crime since 1993. It has not been done. Unfortunately, it had been done before and this was reflected in the books of some of the banks. We have passed legislation ever since which clearly sends a very clear message that we have, we are in the process of reducing, with a view to eliminating, the presence of state banks in the Brazilian domestic financial system. We have privatized Rio and Minas Gerais. We are going to privatize Banespa by this year. Others being liquidated, privatized, many transformed in development agencies, not working with the public. That is to say not having liabilities redeemable with ____.

And this is a clear defined strategy which we'll be pursuing. The Federal banks, we have Banco de Brasil, which we have a huge capital infusion as you know, 8 billion Reals last year. The bank is undergoing a major process of restructuring which is going well. We have National Savings Bank which is in a major process of restructuring as well. It's going well. And two regional development banks, in the northeast and the Amazon. ____ the fifth we have privatized already in the last few months. So the author of the question mentioned 43 banks which have been closed, liquidated, merged. This was under our action. There were another 40-something which have been merged, changed ownership, by purely market-driven concerns about this restructuring process which is actually taking place. And I think he's right. That's one of the reasons why we could, in confidence, double interest rates as we did in October. We think that it is a temporary measure, but I think this was not being a destruction of the national, the domestic financial system because this process of adjustment has been going on for many, many years and we are more prepared now. The level of the bad assets have declined. Of course, we know that we can't have these high interest rates for long but they have been reduced by more than 15 percentage points since we raised them on October 30. And we have much more confidence now in the Brazilian domestic financial system and I am sure that many of you know the quality of the banking practices in Brazil and the quality of Brazilian private banks.

HENRY KAUFMAN: Minister Gurria, I'd like to follow up on your comments concerning your fiscal situation. You indicated in your remarks that there is a potential slowing in the revenues from oil. You indicated that there was increasing competition coming from the Asian countries, both directly and through the United States. What does that do to the pressure for the expansion of social programs on the expenditure side of your fiscal package?

THE HONORABLE ANGEL GURRIA: As I announced the cut of about $2 billion in the budget, I said it’s going to be about 60% investment cuts and about 40% current expenditure. And in the current expenditure side, all the priority social programs, especially those that are addressed to the most vulnerable part of the population were left untouched in terms of their main goals. The programs that have to do with health, education, infrastructure, some nutrition subsidies, some food subsidies to the poorest sectors of our society, the poorest of the poor let’ say, were left untouched. And also some of the basic programs which allow these members of society to actually go up one notch to then be able to take advantage of the market opportunities, also were left untouched. Now this is a tricky balance because you can’t cut investment so much that you are neglecting future growth. But basically you can’t touch those fundamental programs for the poorest because the private sector will take over telecommunications, they’ll take over electric generation, they’ll take over, you know, hotels, and they’ll take over steelmaking. Nobody will take over the protection of the poorest. That is the ultimate mandate of any government.

CHAIRMAN WILLIAM J. MCDONOUGH: We have one last question to each of our speakers.

PAUL FORD: All right, I think to round out the discussion from Brazil’s side, I think the

Minister from Mexico talked about the access to the international capital markets. And I think it would probably be a good idea to hear from Minister Malan about Brazil's access to the capital markets and what its program for financing is going forward in the near term.

THE HONORABLE PEDRO MALAN: Well, we usually don't reveal in public our borrowing program for the balance of the year. But I could assure you that we have, even as we speak today, many offers being presented to us and the Central Bank for several Brazilian issues in the immediate and near future. As Angel said, we reserve the right to decide on the basis of our assessment of current market conditions and exchanging views with the people making proposals to us what's the best way to proceed. But the fact is that we have since the perceptions about abated fears about meltdowns in Asia and that the situation is relative to what it is in November, December last year has improved, we have been increasing significantly our international reserves which are now very close to $60 billion, U.S. dollars – again the levels prevailing prior to the crisis and this is related to inflows of capital, part foreign direct investment, $2.2 billion U.S. dollars January and February of this year without privatization so far. Very significant inflows in March so far. And, of course, other types of capital inflows. So much so that we have decided to increase the minimum time that we have reduced from three to one at the height of the crisis, we have increased now on March 1 to two years. And the period for rescheduling operations that we have reduced to six months, we have increased back to one year. So we are considering the several options that we have, but we think that as long as we keep showing that we are moving domestically in all the fronts that we have to move to consolidate the gains we have achieved so far, we think that, not exactly the same conditions prevailing as Angel said, before the Asian crisis, that we will be able to borrow at reasonable terms in international capital markets.

HENRY KAUFMAN: I want to draw again on your broad experience here, besides the area of finance, which I really shouldn't do, but there are probably in this audience, we all read from time to time about the Chiapas problem. And secondly, those of us who travel particularly to Mexico City are very much concerned about personal security. And those are issues that are near and dear to our heart. So I'd like to hear your views on both of these.

THE HONORABLE ANGEL GURRIA: Well, I think the question of security; in Mexico City in particular, is something which is of great concern both to the Federal administration as well as to Governor Cardenas who is now running Mexico City as you know. And it's something, we look towards what happened in New York, by the way, where over time you had an increase in the problems with public security in the city, and then with the allocation of resources as well as some technology introduced together with more public security budget you basically turned it around. And now you have, not only in the city of New York, but in many of the urban areas in the United States, a very much improved situation in terms of public safety. And I think that is the kind of blueprint, that's the kind of course we'd like to take and we're indeed taking. And I left Chiapas for the end basically because I think it is important, first of all, to put the Chiapas situation in perspective. It is a conflict in a relatively small area of one of the smallest states in a fairly large country with almost 100 million people. It is also important to acknowledge that its impact throughout the world has been much more important because there has been a lot of notice taken about the problem. I think in the end what happened in Chiapas, the root of the problem in Chiapas is, of course, poverty, in some cases extreme poverty of some of the Indian populations in the area. And I think that is why if we are going to address the root of the problem, we should address the problem of poverty. There are negotiations going on on some of the specifics and some of the demands on both sides, etc. But basically we should address the question of poverty. And we should address it in a way which has a regional development aspect to it rather than by addressing the question of trying to solve it by handouts. I think what you have to do is to resolve the reasons of poverty, and that is infrastructure, the reasons why industry has not located there, why the comparative advantages of the region, which are many, have not been able to express themselves in terms of attracting investments. And why we still have there, in a region which is the most, the richest in Mexico in terms of energy production, in terms of oil production, water, electricity, perfect for plantation-type agriculture, etc., and why that has not developed. And basically you look at the road situation, the railway situation, the connections to the ports, etc., and you find the reasons. And I think we should address those and at the same time of course continue with the social programs. I'd just like to mention in ending, Henry, to complement your earlier question, the budget in Mexico today is 58% devoted to social endeavors. To the extent that you are, as I said, moving, creating the spaces in the budget by moving areas of investment and expenditure which were before taken up by the government, now taken up by the private sector, both foreign and domestic, you've created the space to attend to the neediest and that is almost now pretty close to 60% of the total budget of Mexico.

(Applause)

CHAIRMAN WILLIAM J. MCDONOUGH: Well, ladies and gentlemen, your applause shows our collective appreciation for the very interesting remarks of these two statesmen. And I think it's especially important, the eloquence of their comments about the importance of resolving social issues, something of which we have great familiarity in the United States, and a similar need to continue to solve. Thank you for coming. Good evening.