



Executive Summary

Alamos Alliance XXVII

Disruption & Discontent in the Global Economy: Addressing the New Challenges

*February 13-16, 2020
Álamos, Sonora, México*

Despite empirical evidence of episodes of sustained growth and human progress, there are many in both the policy front and the popular front who perceive failure and express discontent with current trends among modern political and economic systems. Indeed, this constitutes a time of anger, dissent, and widespread dissatisfaction. The causes and consequences of such perplexing phenomena were at the core of themes and discussions of *Alamos Alliance XVII*. In short, the key questions were: what is going on? And why? And what can be done?

The conference was held in the town of Álamos, Sonora, February 13-16, 2020. The general topic addressed the following subjects:

- *Capital Markets, Interest Rates and Global Finance: Issues and Challenges*
- *The Collapse of the Chilean “Oasis:” Origins and Spillover Effects in the Region*
- *Poverty, Inequality and the Optics of “Millennial Socialism”*

The distinguished economist and expert in international political economy Ricardo Hausmann delivered the keynote address, on *Uncertainty and Complexity in Latin America*. The “early-bird” book presentation breakfast featured a discussion of on Mexico, centered on Luis Rubio’s *Mexico Unmasked*, with additional comments by Carlos Hurtado, the new Chief Economist of the Business Coordinating Council.

The program featured prominent names in academic and policy circles: Phil Gramm, former Senator and Vice Chairman of Lone Star Capital Acquisitions; Douglas A. Irwin, Professor of Economics at Dartmouth University; Kevin Murphy, Distinguished Professor of Economics, University of Chicago; Anne Krueger, former Deputy Director of the IMF; Deirdre McCloskey, Distinguished Professor of Economics, History, English, and Communication at the University of Illinois at Chicago; Ricardo López-Murphy, Former Minister of Finance, Argentina; and, of course, Al “Alito” Harberger.

The first session was entitled *Capital Markets, Interest Rates and Global Finance: Issues and Challenges*. The discussion centered around two key questions: Why are interest rates so low? And why is the supply of risk capital so difficult to acquire? Other topics discussed in this panel included the level of consumer debt and student loans in the United States, the recent and





significant increase in excess reserves (capital reserves held by banks in addition to the regulated or required reserves) since the last recession, in 2008 and the erratic under-performance of the housing market (indeed, where housing “starts” have decreased to historical lows, while demand continues to increase).

What is the influence of the “Fed” and its current monetary policy in these developments? Peter Linneman pointed out two distortions occasioned by monetary policy: quantitative easing and an inadequate monetary policy targeting the housing market. On the former, quantitative easing was characterized as “effectively the largest transfer of wealth in history.” There was no defined expectation from Q.E., whatever followed, and its effects on the market depended solely on the intentions of those who gained from such massive transfers. According to this view, thrift is no longer rewarded, as long-term savers were the main “losers” after the Great Recession of 2009 and the monetary disruption performed by the Fed. A promise of lower interest rates, and of more housing starts, was expected to revitalize the housing market. But what actually followed was an increase in housing prices that caused down-payments to be increasingly difficult to acquire, effectively wiping out homebuyers, plus keeping the amount of new home loans low. So, the high level of down payments is preventing people from acquiring the loans they need to purchase a house. Additionally, the rising cost of public infrastructure typically provided by the government for newly incorporated housing lots (such as roads, electricity grids, and sewage) make it harder for new housing to be developed.

Michael Walker’s answer to chronically low interest rates is simple: the lender-to-borrower ratio. Over 90% of net wealth in the U.S. is owned by households. In turn, the distribution of house ownership is concentrated in the hands of people in the upper end of the age distribution. People over 50 own most of these assets and would be the ones with the capacity to lend. On the other hand, most debt is concentrated in the hands of young(er) adults. Walker characterizes these two demographics as “natural lenders” and “natural debtors.” It is the ratio of lenders and debtors, old and young, what stands out as the principal determinant of interest rates in a country. Today, we have an aging baby-boom generation and decreased birth rates, which dramatically increases the ratio of lender-to-borrower. One consequence is that we have a relatively larger amount of people saving and lending than those willing and able to demand loans. Following simple economics, in a (financial) market with increasing supply and decreasing demand, a lower price (interest rate) follows.

Phil Gramm explained how the huge expansion in monetary base (reserves, coin and currency) was not followed by an increase in inflation. The interest paid on reserves is maintaining inflation stable. It is also the main driver of the low amount of loans being allocated in the financial and





banking sectors. Gramm explained that in the years following World War II, the U.S. was the only large and developed country in the world with capital not destroyed or stolen, and with a relatively high-skilled labor force. Additionally, the United States possesses a stable government with adequate rule of law, making it a very attractive destination of capital. Regarding low interest rates, the issue today is that housing no longer represents a good investment. The 70's policies of subsidies distorted the market, and eventually led to an “over investment” in housing. Buying a home was perceived as a good way to accumulate capital. The recession and housing bubble of 2008-2009 led to a flood of defaults on mortgage payments. There was an overproduction of over-priced housing. The hypothesis, therefore, is that market agents no longer trust housing to be a reliable and worthy investment.

The luncheon address was delivered by Doug Irwin, who addressed the topic of **Clashes over Commerce: is De-Globalization the New Normal?** Recent trade developments under Trump reflect a negative perception of international trade, in accordance with a negative sum mentality that dominates the new conventional wisdom on trade deals. In such agreements, there must be winners and therefore losers. Despite the presidential rhetoric on trade, the popular sentiment throughout the country remains positive, as most constituents perceive trade as an opportunity for greater economic growth.

The second session addressed the (very) surprising collapse of the so-called “Chilean oasis,” and its spillover effects in the Latin American region. Chile’s social unrest in 2019 has baffled many policy analysts, especially in light of the violence that ensued: riots, vandalism, destruction of private and public property, loss of human life, and military intervention in response to a state of emergency called by the Piñera presidency. The paradox, of course, is that such uprisings are occurring in response to the policy framework that transformed Chile into the most successful economic story of the region in the last 40 years, and even a model to emulate in the emerging market world.

Indeed, the overall discussion evoked Vittorio Corbo’s relevant reminder in *Alamos Alliance 2019*, namely, that “people do not know what they have, until they lose it.”

Arnold Harberger pointed out that inequality and job market discrimination are the likely drivers of civil unrest. But these are not the main real problems in Chile; rather, it is the lack of mobility in the country’s labor markets, especially among lower income thresholds. In other words, the ability of young professionals from poor households to get to good paying or managerial jobs, regardless of their education and skill, is limited, due to their social class, and not determined (as it is expected) by investment in human capital. This breeds popular discontent. Rolf Lüders proposed that the main cause of the recent Chilean unrest was “a deep and relatively widespread disappointment with the implicit equal opportunity and meritocratic promise” of Chile’s political





economic model. Lüders pointed to the greater growth in family debt relative to the growth in gross domestic product as a driver of this discontent. He also highlighted the peculiarity of the movement by pointing out the lack of a defined spokesperson, combined with a relatively clear set of demands. These include: a new constitution, pension reform, health care reform, an end to “abusos” and territorial equality. The unequal access to public services is reflected by the fact that neighborhoods of higher income levels typically enjoy a better supply of public transport and other government-provided goods. For now, there is a great deal of uncertainty over the future of the current economic model and how much of it will survive new reforms.

Axel Kaiser offered another angle on the social outburst in Chile (and elsewhere), recognizing that “Chile has been a successful country, independently of how you measure it.” Chile’s income has accumulated sustained growth in all levels, especially the poorest quintile of the population. The middle class has risen substantially since the 1990s, the poverty rate has steadily diminished, and inequality measures show a marked decrease in the same time frame. Despite being a leading country in Latin America, and an example of the success that liberal economic policies have had in modern times, social unrest was not only to be expected but in fact was virtually inevitable. Why? According to Kaiser, the vast majority of the elites failed to counteract the creeping statism that emerged among the country’s media, academic institutions and political branches, such that when the social unrest erupted, they were left with no intellectual resources to counter the deep anti-market sentiment among the *vox populi*. Here, “a problem is that we have focused too much in economics, and not enough on how the free market appeals to people’s dignity.” Indeed, others agreed that the media did “a terrible job” in their handling of the social unrest.

A key lesson, in retrospect, is that market-oriented public policy must be as cognizant of the net results in social mobility and equality of opportunity, as it is on explaining the determinants of long-term sustained economic growth.

The third session continued this discussion in the context of the topics of poverty, the debates on income inequality, and the “optics” of millennial socialism. The thesis of this session centered on the misconception of the concept of socialism and liberal economics, especially among the millennial and young professional-aged population. Some countries (e.g., Sweden) are perceived as successes of modern democratic socialism, when in fact, by definition (due to allocation of means of production) they are not. Deirdre McCloskey urged the need and importance to “**keep explaining, somehow, and getting across, somehow, the importance and relation of free markets and free minds.**” This is an everyday task.

Kevin Murphy added that that “capitalism” is often blamed for the prevalent ills in society, even in cases as seemingly absurd as the phenomena of femicides or the spread of coronavirus. This renders the intellectual debate meaningless, but the popular damage is severe: any alternative to “liberal economics” is seen as superior, whatever it is, and whatever proposals are advanced, independently of facts, conceptual argument or even common sense. This is a failure in rhetoric.





Ricardo Lopez-Murphy raised the importance of the concept of income inequality and a growing discontent among “millennials” on the current state of affairs in open, market economies. But the focus becomes relevant: inequality should be couched in terms of productivity, and mobility. Two solutions to these problems are: modernization and investment in human capital. There are regions within our countries, for instance, within Mexico, where differentiations occur in areas such as educational attainment, or the quality of infrastructure; and it is these inequalities that are responsible for perceived social inequities across states, and even regions (the thesis of the “Two Mexico’s”). If agents are allowed access to fundamental tools, through education; and are also given the ability, through infrastructure, to participate in the labor market; then they will in all likelihood participate in the economy in positive fashion, leading to greater productivity, real wage growth, innovation, and lessor inequality.

Luis de la Calle explained these issues in terms of the topic of *extortionomics* (that is, the economics of extortion). Mexico has a culture of “tips” or extra-legal taxes for services. In many business settings, actors expect to provide “grease” payments to receive preferential treatment, or just to be able to do business. For entrepreneurs and large firms, this represents an added financial cost as well as a transaction cost and proves inefficient in the market. These payments, when demanded extra-legally, can be classified as extortion, yet become part of firms’ interactions with organized crime, government institutions, labor unions, and other enterprises in the value chain.

A possible solution to the optics of “millennial socialism” includes a partnership with the media, to raise awareness of how liberal ideas can appeal to younger generations; greater investment in infrastructure and human capital; and, promotion of technology and open trade.

The culture of corruption stands out as one of the main chronic problems facing the Latin American region.

The closing keynote address was delivered by Ricardo Hausmann, on the topics of ***uncertainty and complexity*** in Latin America. The presentation elaborated a “scrabble theory of economic development.” He compared the word creation game, Scrabble, to the production of goods and services in an extended market. In a scrabble game, the more letters a player has, the more words that the same player can create. This is the recursive feature of languages: an extra letter increases the possible words that can be generated in an exponential fashion. In a market, tools and skills are the equivalent of words: human capital and technology, infrastructure, and education. The main thesis is that countries grow, not by making more of the same, but by changing what they are good at. Hence the importance of promoting complexity; or, in other words, diversity in the means of production, through tools, skills, and technology. A climate of confidence is critical to support the development of tools and skills (words).





This edition of the *Alamos Alliance* focused on a variety of topics: less “intrusive” policies in the monetary and financial systems; education as a medium to improve economic opportunity, productivity, and mobility; and the spread of awareness of the benefits of open markets and open trade. The new popular wisdom does not trust free markets because of policies that have led to baling out inefficiencies, because cronyism tends to be pervasive, and because the idea of a free lunch is far more attractive to sell than spontaneous orders and merit under an extended market. The need for new narratives and communications becomes essential. In 2019, Sebastian Edwards warned that “good economics” was an insufficient driver to address the paradoxes of new millennial generations; namely, the odd mix of yearning for a socialist ideal under the great benefits afforded by technological innovations, especially in communications. To this end, the set of ideas articulated by Hausmann included a call for promoting diversity as a way to improve productivity. While tools, skills and innovation can be characterized as a value chain, there is also a need to promote competitive diversity in ideas, marketing, and narratives

Hence the need to strengthen the basis of future debate and discourse in ideas on trade, markets and rule of law—among many others. These themes, among others, will be addressed in 2021, in *Alamos Alliance XXVIII*, scheduled on February 12-15, 2021.

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