

Research Abstracts

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CENTER FOR LATIN AMERICAN ECONOMICS

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Preface

The Center for Latin American Economics is pleased to present the ninth issue of *Latin American Research Abstracts*. The issue includes 87 abstracts written by 117 authors and co-authors. The abstracts appear in alphabetical order by the lead author surname. The authors' mailing addresses appear in these *Abstracts* so that readers interested in receiving copies of the papers can request them directly from the authors.

In preparation for our next publication, we urge you to send abstracts of your recent research, along with copies of the papers. We ask that the authors write the abstracts in English, limit the abstract to 250 words, and confine submissions to research related to Latin American monetary and economic issues. If you are interested in becoming an associate, we urge you to contact us at the following address:

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The Center serves as a catalyst to facilitate communication among scholars. We thank you for your support in this effort.

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**Procurement and Privatization of the
Electrical and Telecommunication Services
in Brazil**

Successful privatization of public telecommunications and electrical services depends on careful re-regulation of the concessionaires. An important objective should be to remove the well-recognized managerial inefficiencies common in government ownership. It is important, at the same time, to create a regulatory framework that guarantees effective competition so that privatization does not result simply in the transference of rent-extracting ability from the public sector to the private. While the current operators of public services are inefficient in part as a result of a lack of competition, a less appreciated source of inefficiency is the limitations on their ability to choose and purchase equipment on the world market. This paper addresses the effect that Brazilian protectionism has had on the efficiency of the telecommunications and electrical service industries. The paper also examines alternative regulatory scenarios and their probable outcomes.

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**The Association of the Caribbean States
(ACS) and the European Union (EU):
Mutual Challenges of an Asymmetrical
Relationship**

In October 1994, the Council of the European Union (EU) adopted a basic document on the relations of the European Union with Latin America and the Caribbean (LAC). *Europe and Latin America: A Partnership for Action*, stated that a key purpose of EU policy in LAC has been developing the EU's trade and economic relations with regional groupings such as the Association of Caribbean States (ACS). Stable and mutually advantageous links with the EU are even more important for the ACS. The establishment of ACS in 1994 reflected not only the strong integrating resolve of Caribbean political leaders but also the trend towards a new regionalism that prevails in the Third World – one in search of alternatives to economic globalization and interdependence. Historically, the EU has substantial interests in the Caribbean, but it is facing three serious challenges generated by the three parallel processes it is now engaged in: (1) Economic and Monetary Union (EMU), (2) enlargement to the East and (3) democratization and reform of its institutional system. The consolidation of a genuine Common Foreign and Security Policy, an end already delineated in the Treaty of Maastricht, also poses a challenge for the EU, particularly in the Caribbean, where the hegemonic presence of the United States deters it from deploying a more autonomous, dynamic and comprehensive policy. Despite existing asymmetries, there is an interest on both sides to foster a dialogue to enhance economic relations.

The Social Challenge of Globalization and Regional Integration in Latin America and the Caribbean

In a world context influenced by sudden and turbulent changes, two dialectically linked themes, globalization and regional integration, have become common subjects of most international conferences. Both phenomena have profound social impact. Globalization is an objective but contradictory process that escapes the direct action of governments. It has the capacity to include and exclude as well as to civilize and marginalize. Before globalization, the only viable alternative was to adapt actively in order to maximize benefits and minimize costs. Regional integration, on the other hand, is an important instrument of public policy that can become, together with other policies, the ideal vehicle to promote equitable and sustainable development. But regional integration is not the panacea which can cure all social evils, especially if it is approached only from a technical and economic standpoint as is happening with the process towards a Free Trade Area of the Americas (FTAA). As the construction of the European Union demonstrates, regional integration is a process by which countries make substantial concessions of sovereignty, a dear value for Latin American and Caribbean societies. Therefore, in order to succeed, it must be accompanied by measures that enhance democratic participation in the process and practical solutions for the two main social problems facing the region: inequality and poverty. Without abandoning the present negotiations towards a FTAA, Latin American and Caribbean countries would do well in advancing their own subregional integration processes by prioritizing social objectives.

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Macroeconomic Policy and Poverty in Brazil

This paper discusses the structural and macroeconomic determinants of poverty in the recent Brazilian experience. The paper looks at the evolution of the main structural determinants of poverty in Brazil during the last two decades. It decomposes changes of various poverty indexes across different groups assigned by characteristics of the heads of households (i.e. gender, years, schooling, race, working class, sectors of activity, region, population density). Next this decomposition is taken one step further by disentangling changes in these different poverty cells in terms of their respective changes in mean and in degree of inequality of per capita income. The main lesson is that inequality reduction is a fundamental component of poverty alleviation policies. Another part of the paper describes the evolution of poverty, inequality, and macroeconomic development in Brazil during the last decade and develops an aggregate monthly time series analysis of the determinants of poverty in the 1980-96 period. This analysis shows that higher inflation and higher unemployment imply lower per capita earnings for all deciles. The direct effects of inflation on per capita family earnings are somewhat milder and decrease as we move to the upper tail of the distribution. In other words, poverty tends to be more adversely affected by higher inflation rates than mean incomes. Similarly, the unemployment elasticity of per capita earnings decreases as we move towards the upper tail of the distribution.

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Forecast Errors and Financial Developments

As central banks have moved towards a forward-looking implementation of monetary policy, the role of forecasts in the policy process has greatly increased. Against this background, this paper looks at the accuracy of forecasts and, more specifically, addresses the question whether forecasts of growth and inflation can be improved by including information from financial markets. The empirical work presented suggests that average forecast errors are not large enough to seriously undermine the basis for forward-looking monetary policies, except in periods of common shocks and at cyclical turning points. It also appears that unexpected changes in non-financial variables are the primary source of forecast errors. Nonetheless, for several countries, forecasts could also be improved by using the information contents of changes in the yield curve and of the movements in exchange rates and other asset prices.

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Poverty and Macroeconomics Policies

Poverty has declined substantially since 1987 in Chile. Has this reduction on poverty benefited all groups and regions? Are there specific sectors of the economy that have been left out of this reduction? These and other questions are discussed in this paper. We characterize the poor in terms of education, employment, demographics and economic activity, as well as the economic policy framework prevailing during the last decade. The paper also discusses issues such as informality and minimum wages. The work shows that there are no significant biases in poverty changes across gender or rural-urban distinction. In addition, education has increased at all levels of income, and demographics have not shown significant changes. Overall, one can conclude that the reduction of poverty has been equitable with just one exception, which is that poverty is much more concentrated in the non-mining primary sectors, mainly agriculture.

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Evolutionary Market-Making: Economics vs. Finance

Markets are the basic institutions that lie at the heart of most economic and financial analyses. It is surprising, then, how very little work has been done on the existence of markets themselves. Using a model of non-sequential search, we investigate the implications of two paradigms for the existence of markets. The first is economic, involving Nash equilibrium and evolutionary game theory. The second is financial and is rooted in the no-arbitrage criterion. It has an evolutionary interpretation as well. The contrast in the conditions that are required for equilibrium under these two paradigms illuminates some fundamentally different implications between economics and finance for the existence of markets and price dispersion.

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Public External Debt: Sustainability and the Macroeconomic Impact

Two seldom-addressed issues in the Ecuadorian economy are analyzed in this paper: the sustainability of the Ecuadorian public external debt and the macroeconomic

impact of the public domestic debt. This work provides empirical evidence that public debt crowds out private investment not only because of the initial impact of the deficit on interest rates but also because the public sector competes for loans in the market. The financial cost in the emission of bonds would be higher, augmenting the public sector's current expenditures, and further deteriorating the fiscal balance. Assuming Ricardian equivalence, an exercise is presented regarding the impact of public sector deficits observed in the past. Had deficits not been incurred, the Ecuadorian economy would have reached the correct level of growth one year and three months earlier.

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Solving Dynamic Macroeconomic Models Using Linear Quadratic Approximation Method

This paper presents the linear-quadratic approximation used by Kydland and Prescott (1982) to solve real business cycle models. In contrast to the models used by traditional macroeconomics, real business cycle models are characterized by their microeconomic foundations and for being dynamic, stochastic and nonlinear. Because of these characteristics, it is not always possible to obtain analytical solutions for these models so that the use of numerical algorithms as the linear-quadratic approximation is needed. This work presents an application of this methodology for the Ecuadorian case that describes with some success the empirical regularities of the economy.

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Do Funded Pensions Contribute to Higher Aggregate Savings? A Cross-Country Analysis

This paper provides statistically significant international evidence on the interaction between funded pensions and aggregate savings, after controlling for country-specific effects and for other saving determinants that have typically been identified in earlier cross-country studies. Using panel data for eleven countries (both OECD and non-OECD), this study goes beyond earlier work which has been based on individual country studies only (which have suffered from a small number of degrees of freedom). Building several proxies of pension wealth based on internationally comparable pension fund and life insurance data, the paper estimates the relationship between aggregate saving rates and pension wealth using ordinary least squares and two-stage least squares over the 1982-1993 period.

The empirical analysis supports the predictions of a simple two-period life-cycle saving model that incorporates tax treatment of pension returns, population heterogeneity, capital market imperfection and various features of pension design. It is found crucial to stimulate a positive saving impact of funded pensions from the low-saver group and to limit the negative income effect on savings by the high-saver group that emanates from the higher implicit rates of return on tax-exempt funded pensions. This requires that funded pension schemes are mandatory rather than voluntary, that tax exemptions on pension returns are limited to low savers, and that it is discouraged to borrow against the accumulated

mandatory pension assets; otherwise, funded pension schemes will fail to stimulate savings.

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Empirical Regularities of the Chilean Business Cycle

The paper documents the properties of business cycles in a wide range of economic activities for the Chilean economy, using the standard atheoretical methodology of Kydland and Prescott (1990). Building up an annual database going back to 1960, we first examine the evidence on the historical features of business cycles in Chile over 37 years of the data. In order to analyze the changes in the features of the cycle, we subsequently divided the period into sub-samples, consistent with successive stages in the level and stability of growth in the country. Finally, the paper concentrates on the 1986-1997 decade – a period of stability for the Chilean economy and over which quarterly data is consistently available – to extract stylized facts of Chilean business cycles that we can compare with international evidence. While the country holds many of the typical features of business fluctuations in OECD countries, Chilean cycles present some striking peculiarities. Trade plays an important part in economic activity as exports move contemporaneously with output and the terms of trade lead the cycle long in advance. The market for inputs – labor as well as capital – adjusts with a significant lag to the cycle, pointing to some form of real or financial rigidities. Finally, public policies play a significant role in short-run economic

fluctuations: government expenditures and monetary policy variables lead the cycle 2 to 3 quarters ahead. Kydland and Prescott's monetary myth is alive in Chile.

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Entry and Exit of Banks in Latin America and the Caribbean: Public Policy Concerns and a Proposed Solution

Banking authorities face the problem of how to resolve or otherwise deal with existing banks that are weak or insolvent without imposing costs on consumers or taxpayers. Two aspects of this concern should be delineated. One is the basic question - how can bank regulations be structured so that the future exit of weak and insolvent banks would be relatively without costs? The second question is - how can the authorities resolve existing weak and insolvent banks without imposing costs on depositors or taxpayers? The regulatory system suggested in this paper - a substantial capital requirement and structured early intervention and resolution - would require weak banks either to become strong by increasing their capital or to exit the field before they impose costs on depositors or taxpayers.

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Public and Private Provision of Infrastructure and Economic Development

This paper examines the role of infrastructure in long-run economic growth. The paper consists of two sections. The first concentrates on the theoretical role of government spending in growth models, and the second details examples of private participation in infrastructure development. Using a simple endogenous growth model, we find that while the hypothesized benefits of infrastructure expenditures may be large, they require care in matching appropriate financing. As the development and maintenance of infrastructure will continue to be pivotal to the long-term success of growing economies, we emphasize the lessons on financing and the caveats of private participation to those who are exploring innovative mechanisms for infrastructure design.

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Macroeconomic Coordination and Commercial Integration in Mercosur

Commercial integration in the Mercosur area has increased substantially in the last few years, and it is expected to

continue to grow rapidly in the near future. However, given the historical record of policy management in the region, especially in Brazil and Argentina, the main partners of this integration initiative, it is not clear whether macroeconomic policies will provide the required conditions of sustainability for such a rapid trade expansion. This paper discusses the relationship between macroeconomic coordination and commercial integration in the context of Mercosur. After examining the impact of policy instability on trade flows within the region in recent years, it evaluates the prospects for closer coordination of macroeconomic policies in the future.

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**Fiscal Impulse in the Brazilian Economy,
1989-1996**

This paper develops an alternative indicator of fiscal policy, which allows a more accurate picture of the underlying fiscal trend in the recent Brazilian economy. This indicator corrects conventional fiscal-stance measures for the effects of the economic cycle and yields a measure of the discretionary change in the budgetary position of the public-sector known as the fiscal impulse. Section 2 of the paper briefly examines the evolution of traditional fiscal policy indicators over the recent period. The details of the estimation of the fiscal impulse measure for the Brazilian economy are presented in Section 3. Section 4

concludes the paper with a reassessment of recent fiscal policy episodes, using the data generated in the previous section. The resulting fiscal-impulse measure indicates that, on average, the fiscal stance during 1989-96 was more expansionistic than suggested by traditional fiscal policy indicators.

Public-sector Debt Dynamics in Brazil

The understanding of the determinants of public-sector debt dynamics is a key step towards a fuller assessment of fiscal sustainability in the Brazilian economy. After brief analysis of the current macroeconomic policy mix, this paper calls attention to specifics of the Brazilian debt dynamics process and utilizes a simulation model to envisage the implications of different fiscal policy scenarios.

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**Direct Foreign Investment in Latin
America: Determinants and Tendencies**

This paper analyzes both the FDI flows to ALADI countries and the macroeconomic and political factors that determine these flows. The econometric model includes variables that represent theoretical components such as: the degree of economic development; market size and its dynamics; the exporting affiliates' operations; macroeconomic stability; and policy towards the TNCs. The results suggest that a transition in the form of transnational expansion in the region is on course.

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Militarizing Mexico: Where is the Officer Corps Going?

This paper examines in detail the internal document, *Mexican Army and Air Force Development Program*. It identifies those features which indicate changing attitudes toward and frustration with the military's current mission and structure.

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The Scope of Monetary Policy: Theoretical Framework and Empirical Regularities in the Mexican Experience

An important topic in the debate over economic policy in Mexico is the role a monetary authority should play in affecting output, employment, and international competition while maintaining price stability. We present a simple model to suggest that, within certain limits, it is desirable to focus monetary policy on preserving liquidity and on facilitating the intertemporal transfer of savers' resources. Beyond certain limits, however, monetary expansion has neutral effects whose principal repercussions are expressed in the price level. The document concludes by examining the relations between monetary aggregates and the principal real sector indicators for the Mexican economy.

The examination tends to confirm both the aforementioned hypothesis of money neutrality and the concomitant recommendation that the Bank of Mexico persist in its focus on supplying liquidity simultaneously with price stability.

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A Bargaining Model with Uncertainty and Varying Outside Opportunities

The purpose of this paper is to propose an alternative way of explaining –within the framework of theory of bargaining – the observed phenomenon of wage rigidity with all shock adjustments reflected in employment fluctuations. Under the assumptions of a constant elasticity production function and a reservation wage independent of shocks, standard models predict this behavior. Once the latter is removed, however, the result is not maintained. The proposed two-stage model, in which the second stage involves negotiations over employment after the shock is observed, would recover the stylized fact of interest as a consequence of the uncertainty that the agents have over the situation at the time of negotiating salaries. The model draws various formulations and allows for Pareto efficient and inefficient outcomes depending on union power and the observed situation.

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**Pension Reform in Colombia:
 Macroeconomic and Fiscal Effects**

The purpose of this study is to analyze some of the macroeconomic, fiscal, and financial effects of the pension reform adopted in Colombia in 1993, which established competition between the PAYG system and the new privately run fully funded system. Although the reform succeeds in immediately increasing the contribution rate and effectively reducing the benefits, the fiscal cost of the transition is still high, reaching an estimated 1.5 to 2.3 percent of GDP annually in the next three decades. Thus, a new generation of pension reforms needs to be adopted in order to address the fiscal burden as a result of: (1) concessions granted to special groups of public servants; (2) the delay in making effective the new retirement conditions; (3) the level and conditions under which public guarantees are provided; (4) the retirement age conditions; and (5) the high rate of payroll taxes (which hampers coverage).

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Financial Integration in Latin America

The main purpose of this work is to examine financial internationalization. The paper looks at the actions that a country ought to take in order to maximize the net benefits of integration. It also evaluates the actions that governments should take in order to facilitate an ordered and gradual integration of the financial sectors.

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**Inflation Stabilization and the Consumption
 of Durable Goods**

Exchange-rate-based stabilizations in chronic-inflation countries have often been characterized by an initial consumption boom (which is most evident in the behavior of durable goods) followed by a later contraction. This paper provides an explanation for such a boom-recession cycle based on the timing of purchases of durable goods. The initial fall in inflation results in a wealth effect which induces many consumers to bring forward their purchases of durable goods, thus generating an aggregate consumption boom. Since most consumers replenish their stock of durable goods at the beginning of the program, a later slowdown follows.

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Banking Crises: An International Experience

This paper analyses the experience of 24 banking crises in 22 countries. For each crisis, we identify the origins, the measures initially adopted, and the policies that effectively dealt with their resolution. We draw several lessons. First, asset-price bubbles are a destabilizing factor, and the authorities should learn more about their effects on the financial system. Second, deregulation must be accompanied by the strengthening of the supervisory body. And third, to increase the market's role in monitoring and disciplining banks, it is necessary to foster the transparency of bank actions and increase the disclosure of information.

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Towards an Evaluation of Regional Integration in Latin America in the 1990s

The decade of the 1990s has witnessed a wave of regional integration

initiatives in Latin America. The renaissance of regional integration has not been uncontroversial. Some interpret regional integration as a costly policy option, which is harmful to the countries involved and to the multilateral system more generally. Here we argue that regional integration is a potentially valuable tool for modernization and development in a second best world, arising from imperfect and incomplete markets at home and abroad. This article reviews the strategic dimensions and rationale of regional integration, analyses potential costs and benefits, and outlines directions for future research and economic policy. We conclude with policy suggestions contributing to amplifying the benefits and minimizing the costs of regional integration agreements.

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Direct Investment in Uruguay in the 1990s: Business Strategies

The flows of FDI to Latin America have increased in the 1990s. Although Uruguay has not received a great amount of foreign capital, the participation of FDI in some economic activities is important. This paper analyzes the business strategy of some transnational corporations in Uruguay in light of regional integration and liberalization processes, both of which have impacted positively those foreign enterprises seeking more efficiency and better export performance. The transformation has involved more business concentration and specialization but not business diversification. Finally, uncertainty associated with regional integration and the changes in the rules of play of some industries, such as telecommunications

and energy, will determine the amount of future investments.

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Financial Liberalization and Policy Challenges

We are confident that there is a growing discontent with the conventional wisdom concerning economic policy. The unhappy fact seems to be that a stable macroeconomic environment may be necessary but not sufficient to coax the desired outcomes from liberalized financial systems. In this paper, we review several promising extensions of the conventional model and discuss their policy implications.

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The Social Security System: Analysis of Its Composition, the Impact of Inflation and the Bases for an Alternative Intermediate Reform

The reform of the Social Security system is perhaps the most important item of the agenda of constitutional reforms in Brazil. Without it, the increase in the ratio of the number of retired people to the number of contributors will create dramatic fiscal problems in the long term. This article analyzes the evolution of the Social Security expenditures in Brazil during the last 15 years.

The focus of the paper is on the composition of the expenditures and the trajectory of its real value, with special emphasis on the impact of inflation. In the wake of the Real Plan, the possibility that the prices might accommodate the structural pressures for increasing expenditures has practically disappeared. As a consequence, the need to reform the retirement system has become more evident. The paper defines the taxonomy of the different proposals of reform, comments on the most relevant issues being discussed within the debate about Social Security and includes a proposal for reform. Although this proposal makes only a few changes in legislation and preserves the legal existence of the job time retirement, it would have a considerable economic impact compared with the preservation of the status quo. This reform proposal is a more ambitious and more feasible alternative than the one currently being discussed by Congress.

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Consumer Protection in Chile: Why So Little and So Late?

This paper deals with the policies regarding consumer protection and evaluates the degree of protection existing in Chile before and after the enactment of the Consumer Rights Law of 1997. Two studies of consumer rights cases are presented: (1) the case of process/cured meats in 1991 and (2) the role that CONAR (National Advisory Council on Advertising Self-Regulation) plays in regards to false advertising. The paper argues that consumer rights in Chile are not satisfactorily protected due to the lack of support by interested politicians. The work concludes with a possible explanation of the problem.

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Infrastructure Franchising and Government Guarantees

Government guarantees for private infrastructure projects reduce the incentives of firms to perform efficiently, weaken the incentives to screen projects for white elephants, and shift government obligations to future periods. Thus, the use of guarantees needs to be limited, and they need to be carefully designed.

Franchising schemes should in principle assign risks to the parties best able to

manage and control them. The mechanisms by which contracts are awarded should be simple so that possibilities for evaluator subjectivity are reduced, the award process remains as transparent as possible, and the likelihood of having to renegotiate is minimized.

Infrastructure franchises have usually been awarded on a fixed-term basis. Such contracts expose franchise holders to considerable demand risk, which investors are often unwilling to assume without government guarantees. These contracts are also inflexible, since it is difficult to determine a fair level of compensation to the franchise holder if the contract is terminated early or modified.

Under an alternative mechanism, the franchise is awarded to the firm that asks for the least present value of user fee revenue for a given tariff structure, and the franchise ends when the present value of user fee revenues is equal to the franchise holder's bid. Such contracts reduce the demand risk borne by the franchise holder (and the concomitant demand for government guarantees). Since the level of fair compensation is equal to the revenue remaining to be collected, the contracts make straightforward the fair compensation of franchise holders in the event of early termination.

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The Morning After: The Mexican Peso in the Aftermath of the 1994 Currency Crisis

The Mexican peso crisis of December 1994 shocked politicians, analysts and pundits. Shock was followed by panic, as investors fled the country. It took a massive bailout package put together by the IMF and the US Treasury to generate some tranquility in the markets in mid to late 1995. From early on the Mexican authorities stated that stabilizing the value of the peso, within the context of a freely floating exchange-rate regime, was one of their most important objectives. During most of 1995, this objective seemed to be highly elusive. Starting in 1996, however, the peso began to exhibit an impressive degree of stability so much so that a number of analysts began to wonder whether this stability was consistent with a freely floating regime. Some even argued that it was *deja vu* all over again and that the Bank of Mexico was manipulating monetary policy in order to artificially maintain a strong peso. In this paper, we try to explain the relative stability exhibited by the peso/dollar nominal exchange rate since late 1995. Specifically, we approach this issue from two main angles: First, we ask whether the behavior of the peso/dollar rate since 1995 is broadly comparable or consistent with the behavior of a typical floating exchange rate. And our answer to this question is a qualified yes. Second, we explore whether the Bank of Mexico followed some sort of feedback rule from the exchange rate to monetary policy

during 1996-97. Our answer to this question is another qualified yes, but perhaps more strongly qualified than the first one.

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Returns to Regionalism: An Evaluation of Non-Traditional Gains from RTAs

The last decade has witnessed a renewed interest in regional trade agreements (RTAs). There seems to be a general ill-defined belief on the part of many policy-makers, and among a number of academics as well, that there is more to a RTA than the traditional gains from trade. This paper examines several possible benefits that RTAs may confer to their partners, including credibility, signaling, bargaining power, insurance, and coordination. It assesses the necessary conditions for each of these candidates to work; gives stylized examples of specific types of policy where it might be applicable; examines real cases where the explanation might be relevant; and discusses their overall plausibility. It concludes by examining NAFTA and the Europe Agreements viewed in this light.

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Private External Overborrowing in Undistorted Economies: Market Failure and Optimal Policy

We show that an undistorted free market economy endowed with perfectly rational and informed agents overborrows, i.e., borrows beyond the efficient level, because of the agents failure to internalize credit rationing resulting from sovereign risk. It follows that the elimination of the market imperfections previously identified in the literature as causes of market overborrowing, such as misinformation or moral hazard, will not cure private overborrowing. We then explore the possibilities of economic policy as a remedy and find optimal consumption and capital inflow taxes.

Traditional capital control taxes are suboptimal and probably counter-productive, while a dual exchange rate and foreign debt quotas would be optimal.

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Threshold Models (TAR)

The author introduces the threshold models which appear to be useful in fitting processes composed of several regimes. In

contrast to the Markov-Switching models, where the change from one regime to another is determined by latent variables, in the threshold models, the change is determined by observable variables. The case of a two-regime process is analyzed. The methodology used by Hansen (1996) in calculating the threshold and testing the threshold hypothesis against linearity is reviewed. In addition, the paper presents an exercise for the Ecuadorian nominal exchange rate from which it seems to be that a threshold autoregressive model (TAR) would better fit the series for the 1995-1997 period than an autoregressive model.

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The Welfare Gain from Trade in Factors

This paper provides a simple but powerful graphical analysis of the gains from factor movements. The analysis can be extended to general settings, which include differentiated products and nontraded goods.

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Alternative Means of Financing the Private Health System for the Elderly

The object of this study is twofold: (1) to determine if funding health care for the elderly under the ISAPRE (Institute of Precautionary Healthcare) system is possible without creating problems and (2) to provide recommendations for financing the care if it is indeed necessary. The study examines medical expenses of the participants in the ISAPRE system and compares these expenses with an estimation of their lifetime income. Health care expenditures are estimated, concluding that a problem of financing under certain conditions could possibly exist. The study describes possible options in dealing with such a problem. The analysis concludes that the health care financing for the elderly at this point does not require fundamental changes in the healthcare system.

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Dynamics of the Welfare State

The goal of this paper is twofold: to shed light on the endogenous dynamics of the welfare state and to provide a procedure for selecting among various equilibria. To this end, a dynamic model is presented in which

agents are assumed to be locked into current decisions for a while. If frictions are large enough, the economy might exhibit more than one stable Pareto-rankable stationary state. Equilibrium paths would then be determined by history. The economy might become stuck at an inferior stationary state with too much insurance and too little effort.

Are Stabilization Programs Expansionary?

The empirical evidence presented in this paper casts doubts on the by now widely accepted fact that exchange-rate-based-stabilization programs are expansionary. Even though these programs were associated with output booms, no evidence of booms caused by the stabilization programs is found. Rather, positive external shocks seem to have caused both the output booms and the stabilization programs.

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Inflationary Pressure Determinants in Mexico

Consumer prices in Mexico are modeled using a quantity theory of money framework augmented by a cost function dual based on imported input prices and labor costs. To proxy for the implicit cost of holding idle cash balances, both an interest rate series and a change in the rate of inflation variable are utilized. Empirical estimates indicate that the model performs better for the post-1975 variable exchange-rate period than for the entire sample (1969 - 1996). Movements in

the M1 money supply, exchange rate, and implicit cost-of-holding-cash-balance variables are found to significantly affect consumer prices. Parameter estimates for the wage coefficients have algebraically correct signs, but are statistically insignificant at the 5-percent level.

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Latin American Progress under Structural Adjustment

Following the Bolivian and Chilean macroeconomic reforms of the mid-1980s, many governments in Latin America began implementing market-oriented structural adjustment packages. A basic question remains: how have these economies performed subsequent to the adoption of their respective policy reform efforts? Partial assessment of the trends observed in nine Latin American economies is provided with respect to real per capita gross domestic product, consumer prices, interest payments as a percent of merchandise exports, and nominal dollar per capita imports. Countries covered include Argentina, Brazil, Chile, Colombia, Ecuador, Mexico, Peru, Uruguay, and Venezuela

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The Inflationary Effect of Administered Prices

For sometime, the Mexican public sector (PS) has directly participated in the determination of the prices of a large number of goods. The way the PS has adjusted administered prices (AP) has affected the level of inflation. Three strategies have been followed to adjust AP. Until 1987, the PS controlled the increase in the price of 163 goods, which accounted for 36% of total expenditures. To complement the stabilization program of 1987, AP were temporarily fixed so as to serve as a nominal anchor. The constant adjustment lags in AP, that prevailed until 1991, created a strong variation in relative prices and contributed to increases in the price level. Since 1992, the policy changed, leaving price determination to the market in those goods produced by the private sector. As a result of that policy, the proportion of total expenditure on goods with AP dropped to 16%. On the other hand, the price of the goods produced by the PS, starting in 1992, has increased according to an announced monthly rate that reflects the target of inflation of the authorities. Liberalization and monthly price adjustment policies on AP reduced price variability but increased the impact of those increases on inflation. Today the announcement of an increase in AP has a stronger effect on the inflation of market determined prices than in the past, since AP affect inflationary expectations. The effect that AP has on inflationary expectations suggests that it would be feasible for Banco de Mexico to use inflation targets to anchor expectations.

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Measuring Unfairness in the Distribution of a Good: An Analytical Framework and an Application for Education and Health in Argentina

It has long been argued that societies have a concern about the distribution of certain goods. Chief among them are basic education and health. This paper discusses a theoretical framework to measure unfairness in the distribution of a good. The variables that determine the consumption of a good are divided into socially acceptable and unacceptable sources of differences in individual consumption levels. For each value of the acceptable variables, the expectation of the good consumption, conditional on the unacceptable variables, is computed. Unfairness in the distribution of a good is related to the dispersion in the values of those conditional expectations across individuals. The paper proceeds to examine difficulties in the empirical implementation and some possible ways to deal with them. Empirical results are obtained using data for Argentina. In particular, unfairness indexes pertaining to health services and education levels are calculated using conventional non-parametric and parametric techniques.

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Determinants of Foreign Direct Investment Inflows in Developing Countries: Real Exchange Rates or Host Country Reforms?

This study examines the effects of movements in the real effective exchange rate

on Foreign Direct Investment (FDI) flows from the perspective of the eclectic theory of international investment and, hence, the advantages of foreign ownership, host country location, and internalization.

We use pooled cross-section and time series data from developing countries to examine the effects on FDI of real exchange-rate movements, controlling for other country-specific (and time varying) factors, including corporate tax rates, tariff rates, the degree of openness to international capital flows, contract enforcement, nationalization risk, and corruption.

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Regional Integration in an Asymmetric Context

Taking into account the possibility of a bloc in South America as well as a South and North America bloc, this paper analyzes the advantages and disadvantages of integration within the Americas. We adopt a stylized general equilibrium model based on Frankel and Stein (1994), but we introduce several changes in order to make it useful to analyze the asymmetry between North and South. We develop a two-sector model, with one sector producing homogeneous goods in perfect competition and the other producing differentiated goods in monopolistic competition. This specification allows us to include in our analysis factors such as transportation costs and different market sizes among the integrating regions as well as other factors like comparative advantages.

There are no simple answers to the issue of regional integration between North and South America. However, it seems clear that taking into account the big differences between those regions, not only in their market

size but also in their comparative advantages, the North-South bloc is a better option than merely a South bloc and it may also be a step towards free trade.

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Institutional Arrangements and Fiscal Performance: The Latin American Experience

This paper explores the links between institutional arrangements and fiscal performance in Latin America. In the first section, we consider four measures of performance: the size of the public sector, fiscal deficits, the size of the public debt and the degree of procyclicality of fiscal policy in response to business fluctuations. Two institutional dimensions are considered, namely, electoral systems and budgetary procedures. The second section presents a stylized description of fiscal performance in Latin America. The third section describes the main characteristics of electoral systems in Latin America and evaluates the impact of electoral institutions on political outcomes. The fourth section describes the main characteristics of budgetary procedures in Latin America and presents an index of budgetary institutions, based on Alesina, Hausmann, Hommes and Stein (1996), which is subsequently used in the empirical analysis. The fifth section evaluates the impact of institutional arrangements on fiscal performance. We explore the interactions between electoral systems and budgetary institutions. The final section makes conclusions.

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Financial Reforms and Monetary Systems in Latin America: The Cases of Argentina and Mexico

This paper presents evidence of the linkages between market discipline, government guarantees, bank performance and exchange-rate stability in Argentina and Mexico – the two largest Spanish speaking countries in Latin America. As will be detailed, Mexico's encompassing deposit guarantee program was associated with risky lending behavior beginning during the 1991-2 bank privatizations. The resulting bank crisis offered unresolvable tensions in the goals of monetary policy – preserving the banks versus preserving the exchange rate – and motivated a policy trajectory that had much to do with the subsequent exchange-rate crisis.

In contrast to the Mexican experience, Argentina's limitations on deposit guarantees and its restrictions against bank bailouts were followed by a wave of bank privatizations in which the typical bank did not engage in behavior that would be measurable ex-ante as risky. When the Asian financial crises of fall 1997 stampeded investors even out of non-Asian emerging markets, including Argentina's, a governmental conflict between supporting the banks and supporting the currency did not materialize.

While no single empirical model yields all of the foregoing narrative, the results of various researchers' econometric models of the Argentine and Mexican financial systems offer varieties of evidence that have not until now found their way into the literature. The consideration of these several models together allows them to yield conclusions collectively that their constructors could not and did not draw piecewise.

The Road to Oblivion? The Impact of the North American Free Trade Agreement on Mexico's Maquiladoras

This paper presents the results of a simple econometric examination of the effects of the North American Free Trade Agreement on the growth of Mexico's maquiladoras. Despite the rapid growth in maquiladora employment in the wake of the inception of the North American Free Trade Agreement, the null hypothesis that NAFTA had no effect on maquiladora employment cannot be rejected at any typical level of significance. Moreover, even though this null hypothesis cannot be rejected, the actual value of the relevant coefficient is negative. That is, NAFTA has either had no effect on maquiladora employment or has discouraged it.

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The Macroeconomic Relevance of Real Estate in Mexico

Empirical evidence shows that the real estate market behaves cyclically. Changes in the prices of these assets have repercussions on the economy as a whole, the financial system being one of major importance. The literature that analyzes the mortgage market has found that the main factor behind a default decision is the net value of the house to the outstanding loan amount, or the net housing equity. The purpose of this paper is to test this hypothesis analyzing the relationship between the loan to value ratio and the default rate using aggregate data. Evidence is found that a major part of the mortgage credit expansion in Mexico took place when the probability of default was relatively high and that the

mortgage crisis was initiated prior to the 1994 exchange-rate crisis.

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Leading Indicators of Currency Crises

This paper examines the empirical evidence on currency crises and proposes a specific early warning system. This system involves monitoring the evolution of several indicators that tend to exhibit an unusual behavior in the periods preceding a crisis. When an indicator exceeds a certain threshold value, this is interpreted as a warning signal that a currency crisis may take place in the following 24 months.

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Debt Management: Some Reflections Based on Argentina

A good liability management strategy is one that helps to minimize the cost of borrowing over the medium and long term. The objective is not to save the last basis point in each transaction, but rather to bring down the overall borrowing cost. In this paper, we will use Argentina's experience to illustrate some important elements in the design of a liability management strategy. Of course, the paper will take into account the specific characteristics of the Argentine capital market and of the debt instruments that are available.

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Volatility, External Debt, and Fiscal Risk: Simulations of the Impact of Shocks on Fiscal Adjustment for Thirteen Latin American Countries

This paper examines how the combination of indebtedness and exogenous shocks induce volatility for the countries of Latin America. A technique for simulating the impact of shocks on the costs of external indebtedness and the response of fiscal policies in adjustment to such shocks is presented and applied to thirteen indebted Latin American countries.

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Electoral Budget Cycles in Latin America and the Caribbean: Incidence, Causes and Political Futility

The paper examines the effect of elections on fiscal policies in 21 countries in Latin America and the Caribbean from 1983 to 1996. The budget surplus proves to be lower than normal in the pre-electoral and higher in the post-electoral year. Both the expenditure and revenue sides contribute to this cyclicity.

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Welfare Costs of Business Cycles for Ecuador: A First Approximation to the Ecuadorian Case

This paper presents the welfare costs of business cycles for Ecuador based on Lucas (1988). Assuming that individuals have CRRA type utility functions, Lucas concludes that welfare costs of fluctuations of business cycles are determined by - precisely - the relative - risk - aversion coefficient and the volatility of economic activity in relation to its trend. Preliminary evidence for the period 1990-1997 reveal that the social cost of business cycles in Ecuador could amount to 1% of the GDP per year.

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Heterogeneity and Efficiency of the Ecuadorian Private Banking System

The objective of this investigation is to determine the heterogeneity of Ecuadorian private banks with respect to size, performance, profits and the main factors that influence the rentability of these banks, particularly, to test the importance of market structure and the efficiency over the banks' profits. Using factorial analysis, it was found that the factors that explain the existing differences between private banks are size, administrative efficiency, capitalization, liquidity, financial efficiency and the quality of the assets.

According to these factors, banks with homogeneous characteristics were grouped together to analyze the behavior in relation to their size. From this analysis, it was found that the bigger and medium size banks have greater operative and financial efficiency; the smaller banks, on the other side, are better capitalized and have greater liquidity. As for the quality of assets, the smaller banks have a better ratio of productive assets to total assets, but their overdue loans are very high in relation to their loan portfolio. Finally, the econometric estimation of the profit function through panel data, did not support the traditional Structural-Conduct-Performance hypotheses. In other words, the structure and concentration of the market would not be fundamental factors in determining the bank profits. However, the alternative Efficiency hypothesis was proved, but by using proxy

variables for efficiency different from the market share variable, which is most frequently used in empirical research.

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Regional Inequality and Recovery in Growth in the Framework of Economic Integration

In order to correct spatial and economic inequalities, regional planning has taken place in Brazil for some forty years, as a result of the creation of Sudene. Strategies were developed for the regional dispersion of production. Large public investments were made in the poorest and slowest growing areas of the country. The Brazilian government led this initiative through the implementation of policies intended to integrate economic activity in marginal regions – the north, the northeast, and the west central – with the intense growth of the south central region.

The result was satisfactory in a number of ways. The state of Sao Paulo's share of GDP declined persistently. The economic role of the marginal states increased. Increasingly, income in the various Brazilian states converged from 1970 through 1985, as a result of the diversification of productive activity to every region. However, this was not sufficient to erase socio-economic disparities between regions. More troubling is that in the 1990s income disparities between regions were aggravated, coincident with (1) the opening of the Brazilian economy, (2) the reduction in the role of the state not only in the area of investment but also in regulating the economy, (3) the deep and far-reaching current restructuring of production, and (4) the increase in competition among states and

among regions in the struggle to attract private investment.

Our intention in this work is to construct a panorama of the recent evolution of the trajectory of regional inequalities in the country based on social and economic indicators of the decade 1985-1995, which form part of the Regional Atlas of Inequality.

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Napoleon, Bourses, and Growth in Latin America

The value of equity market transactions in emerging economies soared from about 2% of the world total in 1986 to 12% in 1996. This boom was accompanied by an explosion of international capital flows, especially flows into developing country stock markets. Moreover, while equity flows were a negligible part of capital flows to emerging markets a decade ago, equity flows now represent about 20% of private capital flows to developing nations. These developments raise critical questions for policymakers. Are stock markets of developing countries simply casinos where an increasing number of foreigners are coming to place bets? Or, are the developing countries themselves reaping large benefits? If better stock markets are important catalysts of economic development, what can policymakers do to improve the functioning of their bourses? In addressing these policy issues, this paper makes three points: (1) Better functioning financial markets cause faster economic growth; (2) Countries where legal codes stress the rights of shareholders and where the regulatory system rigorously encourages corporate information disclosure tend to have better developed financial markets; and (3) Once one views the strong empirical connection among the legal and regulatory environment, the financial system and growth, Latin America's legal and regulatory systems stand out as deserving

particularly careful scrutiny as the region looks to accelerate economic development.

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The Employment Problem in Latin America: Perceptions and Stylized Facts

Most Latin Americans are concerned about lack of jobs, low wages and the possibility of being unemployed. Macroeconomic policies have taken a radical turn in the past decade, which has boosted economic growth in the region by more than 2%, reduced the inflation rate to below 30% in nearly every country, and opened up new opportunities for private investment in the most diverse economic activities. But during the 1990s, employment has grown at a slower pace than in the second half of the 1980s, unemployment rates have not declined, and informal sector activity has increased. Although real wages have performed much better, enormous wage gaps have opened up between skilled and unskilled workers. And while workers lament the lack of jobs, employers consistently complain about the scarcity of properly qualified staff and the deficiencies of the educational system. The employment problem in Latin America is undoubtedly one of the greatest challenges faced by the governments in the region. This article, which serves as an introduction to the group of studies prepared by the Office of the Chief Economist of the IDB, presents the perceptions of Latin American citizens and employers concerning the employment problem and compares them to the conditions in the labor markets of the region.

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Ties that Bind: Employment Protection and Labor Market Outcomes in Latin America

This paper reviews the regulations governing hiring, firing, overtime work, social security contributions, minimum wages and collective bargaining in Latin America and examines their impact on labor market outcomes. Data are used from Latin America, the Caribbean and OECD countries.

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Labor Supply and Unemployment Insurance: Estimations for Chilean Economy

The objective of this paper is to estimate Chile's labor supply and then to utilize the estimation to examine institutions' various unemployment insurance programs as to the impact they might have on an individual's decision to work. Utilizing information from the 1992 socio/economic survey (CASEN), the first part of the study considers two models of labor supply, differentiated by gender. The second part analyses the impact of alternative protection programs for unemployed workers regarding their decisions to work. The paper analyses the effect of unemployment insurance decreasing over time as well as a mixed program that

includes unemployment insurance and severance pay for each year of service (IAS).

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Comparing the Mexican and Thai Crisis: A First Analysis

In December 1994, the Mexican central bank was forced to devalue the peso. The devaluation sent powerful shock waves through out Latin America. Three years later, Thailand also faced a currency crisis that spread through out East Asia. The two crises shared many similarities, but they were also very different. The currency crises in Mexico and Thailand underscore the dangers facing developing countries. Both countries were once paradigms of development and economic reforms; yet, they all showed the fragility of their economic and political systems. The two crises had many similarities, but also key differences. The similarities lie in the fragility of the political systems. High levels of corruption and lack of transparency reduced investor credibility. Other problems included the politicization of the financial system, the lack of independent institutions, the mismatch of assets and liabilities, and the inability of the government to respond properly to external and internal shocks. There were also important differences. First, the public sector was the root of the Mexican crisis, while it was the private sector that drove the Thai crisis. The latter also involved a much larger financial sector. Therefore, the damage will be more widespread.

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Measuring Core Inflation in a Small, Open and Dollarized Economy: The Peruvian Case

The inflation targeting literature has been mostly concerned with closed economies that have had very little inflationary experience (New Zealand, Canada, UK, Sweden, Finland, Australia and Spain). Only recently, Svensson (1997b 1998) has started the debate for open economy inflation targeting; and Masson, Savastano and Sharma (1997) explored the conditions to implement this policy in developing countries. The aim of this paper is to test the viability of the inflation targeting approach to monetary policy design in a very different setting. Economies like Argentina, Bolivia or Peru are characterized by the significant use of a different currency in transactions. The issue of currency substitution has been absent in this literature. Using different measures of core inflation we analyze how different monetary aggregates relate to these measures of inflation. Finally, we discuss the issue of forecasting ability of different sets of indicators to predict core inflation

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Mercosur: A Means to the Opening or the Consolidation of a Closed Bloc?

Mercosur is an imperfect customs union whose Common External Tariff (CET) is lower than the one that each member was utilizing before 1991. From 1990 to 1994 regional trade grew, and the patterns of trade changed. The aim of this paper is to examine whether the Mercosur countries' welfare and productive efficiency improve as a result of the custom union or if the productive inefficiency of each member is protected because of the union. In order to analyze this issue, we performed three different experiments using the GTAP, a multi-country Applied General Equilibrium Model. The first experiment simulates a unilateral tariff reduction resembling the trade liberalization results of the CET. The second experiment supposes that the Mercosur countries remove all tariffs on regional trade without changing the external tariffs. Finally, in the third experiment, both policies are implemented. In the three experiments, regional trade increases as a consequence of trade liberalization inside a natural block such as Mercosur. Welfare in Mercosur countries also increases in the three experiments. The results indicate that the best policy for Argentina is unilateral trade liberalization, represented by the first experiment. However, the best one for Brazil is the unilateral liberalization plus regional liberalization (represented by the third experiment).

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Macro Policy and Employment Problems in Latin America

Despite macroeconomic stabilization and structural reforms, employment problems have persisted in Latin America. The 1990s have seen a slowdown in the rate of job creation; unemployment rates have stagnated at about 10%; informal sector employment has expanded; and increases in real wages have been particularly favorable to skilled workers. The purpose of this article is to explain this apparent labor paradox. The main conclusion is that economic cycles explain the fluctuations of employment and unemployment rate (around their structural levels), while price stabilizations and structural reforms have affected the composition of labor demand and relative wages.

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Environmental Protection of Urban Transportation: the Case of Santiago de Chile

The urban transportation system generates a diversity of environmental impacts: the quality of air at the local level, global environmental issues, noise, use of resources and others. The way in which the cities face growing transportation demand determines environmental stability. This paper analyzes the relationship between the

transportation system and the urban environment, identifying the principal environmental impacts of this system. The paper identifies those transportation factors that affect the environment, comparing what happens in developed and developing countries. By applying the Plan of Transportation and Decontamination proposed for the city, the paper evaluates Santiago’s need to address environmental quality issues for the target date of 2005. It addresses the urgent need to design and apply new ways to discourage the growth of automobile use and to maintain and increase the use of public transportation in order to provide a sustainable transportation system.

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Risk Analysis — The Cost of Regulation of Toxic Substances Emitted in the Atmosphere as a Result of Development: the Arsenic Case in Chile

The developing countries are generally in the beginning stages of dealing with environmental regulations. Chile is no exception, as currently indicated by its serious arsenic problem due to the melting of copper. To regulate these emissions, a proposal has been submitted to have a standard of applicable concentration throughout the country. However, little information is known about exposure, health effects and cost to reduce this emission – information, which is necessary to propose a realistic and efficient policy.

This paper represents the results of a three-year project that combines engineering, economics, and health studies. It presents requirements for a risk/cost evaluation of

different quality standards. The results show that there are win/win options that make significant improvements in health at a very low cost. However, the costs rapidly increase when the standard for quality is made more restrictive while the additional benefits in health are very low. The results suggest the need to regulate case by case instead of utilizing one single instrument, which could be extremely expensive and could leave important areas without enough protection.

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Terms of Trade Shocks and Minimum Wages for a Dual Labor Market: A CDE Analysis

The aim of this work is to analyze the general equilibrium effects of terms-of-trade shocks in exportable sectors under particular assumptions about the labor market. The model used is based on the Blake, et al. (1995) model of the Mauritian economy, which consists of three productive sectors: traditional exportable, non-traditional exportable, and non-traded goods. Two new features are introduced: First, dual labor markets: female and male workers are perfectly mobile across sectors, participating in different proportions in each activity. Second, minimum wages: they are applied to the whole economy, for each type of labor.

A series of experiments are performed to evaluate the general equilibrium effects from favorable and unfavorable shocks in terms of trade in the exportable sector, paying particular attention to the effects for each type of worker. An important result is that the intensity of usage of each type of labor in a sector is a key to explaining differences in the effects on the two types of worker when a shock occurs. This work also discusses the

alterations in the output-price response in the economy as a whole when a minimum wage is imposed.

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Macroeconomic Consistency Model for Ecuador

This paper presents a large set of economic and accounting relationships that form the macroeconomic consistency model for Ecuador. The consistency framework contains a set of output tables for the flow of funds in the financial sector and the savings and investments equilibrium for the base year and projected years. The Excel based model is presented with simulation scenarios to demonstrate the capability of the model.

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Cost Index of Labor, 1982-1995

The objective of this paper is to review labor costs for the overall economy. The period being considered, 1982-1995, involves several changes in salary policies. The variables utilized in this work are:

- Salaries & Liquid Compensations (SYC)
- Employee Contributions (APERS)
- Employer Contributions (APATR)
- Tax on Personal Retributions (IRP)

In the private sector, the variables are utilized according to geographical areas and economic activities. The public sector is classified into three areas: central government, public enterprise and government agencies. The results are presented as monthly indexes and simple annual averages for the 12 months of each year.

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Provincial Budgets, Intergovernmental Transferences and Equity

This paper explores the distributional impact of provincial budgets and national transfers to provinces in Argentina (1991). Due to the scarcity and quality of the data,

conclusions are tentative and debatable. Equity has been a goal of revenue sharing since its birth in the 30s. The Constitution of 1994 grants constitutional status to the system by establishing that the distribution among the provinces should be equal and fair and should foster equal development, an equal standard of living and equal opportunities nationwide. Results suggest that: provincial budgets improve the distribution of personal income; all provinces' expenditures and financing are progressive; there exist significant differences among provinces with regard to determinants (size of budget and progressivity); at a national level, provincial budgets and their financing are progressive and improve the aggregate distribution of personal income; and finally, the effects on personal and territorial distribution are complementary.

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Earnings and Welfare after Retrenchment: Central Bank Employees in Ecuador

This paper measures the earnings and welfare losses experienced by displaced employees of the Ecuadorian Central Bank (BCE) and links these losses to individual characteristics such as age, gender, education, seniority, and wage in the public sector. Data are from a survey of BCE employees taken fifteen to eighteen months after separation, including subjective evaluations of well-being in addition to information on activity and earnings. The paper shows that welfare losses are not highly correlated with earnings losses, partly because some displaced employees (especially women) withdrew from the labor force after separation. Consequently, the individual determinants of earnings and welfare losses are different. They also differ according to the nature of the separation

(voluntary for roughly half of the employees and involuntary for the rest). We estimate that on average the welfare loss of involuntarily displaced employees was 10% higher than the compensation they receive, while the welfare loss of those who voluntarily left was 20% lower.

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Temporary Capital Controls

In the 1990s a new breed of capital controls emerged with two distinguishing features: they were asymmetric, in that they were designed to discourage capital inflows, and they were most often temporary. This paper develops an analytical framework that allows us to examine the macroeconomic consequences of these policies, calibrate their potential effectiveness, and assess their welfare implications.

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Social Services Viewed Through New Lenses: Agency Problems in Education and Health in Latin America

Latin America spends large amounts of resources on social services; yet, its life

expectancy and education levels are low compared to other regions with similar levels of income. A key reason is the inherent difficulty of making social services produce efficiently in response to demands and needs. This article shows how improving the organization of these service systems can make a significant difference in health conditions and student learning. A general framework, which applies the lessons of theories of the firm to the particularities of social services, is developed followed by a summary of case studies which assess the impact of organization on performance in education (in Brazil, Venezuela and Chile) and in health (in Uruguay, Chile and the Dominican Republic). The paper shows that the relationships and rules followed by governments, service providers, and consumers can mean the difference between success and failure. It also describes a wealth of approaches, some of them with long histories that point toward better ways of organizing social services and ultimately improving health and education.

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Credit Union Policies and Performances in Latin America

This paper presents a conceptual framework for explaining credit union (CU) loan delinquency and profitability in developing countries, together with empirical estimation for a unique sample of Latin American CUs. Delinquency and profitability were found to be responsive to the incentives

that CUs create for their borrowers to repay loans. These incentives include loan and deposit rates; the use of loan collateral to the extent in which the CU maintains a serious culture of loan repayment; and in the case of delinquency, the financial health of the CU. Certain other CU policy variables that operate only partially through borrower incentives were also found to have important effects on delinquency and profitability, including especially the credit union wage rate. Profitability was examined using a translog profit function, extended to reflect two types of inefficiency. One type of departure from profit maximization involved the CU's decision to alter prices (loan or deposit rates) to favor borrowers or depositors. More general departures from efficiency were modeled using a slack variable concept capable of parameterizing inefficient combinations of any inputs and outputs. Within both frameworks, CU price and delinquency control policies were found to be important determinants of profitability. So important was delinquency control to maintaining profitability that higher wage rates and often higher deposit rates were found to increase profitability in part because of their beneficial impact on loan repayment, despite the fact that raising these rates directly increases costs.

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Wage Determination in Brazil: Duality or Non-linearity in the Return to Education?

The objective of this paper is to examine empirically the existence of duality in the Brazilian labor market. The method of analysis consists of evaluating the variations in wages among workers - wages that are not the result of differences in productivity. Data from 1988 are analyzed using the methodology proposed by Dickens & Lang (1985 and 1992), which determines endogenously the two sectors beginning with the model of switching-regressions. The results suggest that there is no duality in the Brazilian labor market. Although the dual model explains wage differences better than the competitive linear model does, its performance is inferior in a competitive model with non-linearity with regards to a return to education. The evidence suggests that education is the basic determinant in higher wages and access to more advanced positions in the Brazilian labor market.

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Income Distribution, Factor Endowments, and Trade Openness

This paper studies the empirical links among factor endowments, trade, and personal income distribution. The motivation is that many developing countries have implemented radical trade reforms in recent years. These reforms have changed relative prices, have induced a reallocation of resources, and may have led to the introduction of new production techniques. These changes are quite complex and their final effect on income distribution is theoretically unclear. The authors' aim is to present the stylized empirical facts on the relations among income distribution, factor endowments, and trade.

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Regional Financial Market Integration: Learning from the European Experience

What may be called the European model of market integration has evolved over many decades. In particular, the original plan to integrate Europe economically via a progressive program of harmonizing national legislation has, particularly in the area of financial markets, given way to a radical alternative based upon Member State mutual recognition of existing national legislation and regulation. Whereas this shift had been initiated largely on pragmatic grounds, the mutual recognition approach has since taken on an ideological and strategic dimension in political negotiations which makes the study of

its effects all the more important. This is particularly so when seeking to evaluate whether aspects of the European model could be successfully applied within other regional settings, such as Latin America.

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Fiscal Decentralization and Government in Latin America

Although Latin America remains highly centralized, the tendency toward decentralization is quite strong. A larger portion of the general government budget is spent at the sub-national government levels. The autonomy that these governments have in deciding how much to spend and what to spend it on is increasing as well. In this context, a very important issue is the possible effects on fiscal performance of the move toward decentralization. In particular, this paper concentrates on the effects on government size.

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Labor Markets in Latin America: A Supply-Side Story

This work shows that the factors affecting labor supply have been key determinants of the changes in employment, unemployment and income differentials taking place in Latin America in the 1990s. The two main forces driving labor supply in the region have been demographics and education. One

of the main causes of the reduction in employment growth has been that the annual growth of the working age population declined from around 3% in the 1980s to 2.5% in the 1990s. This deceleration was caused by declines in fertility in previous decades. Employment growth in the 1990s was also lower because of changes in female labor participation rates. This deceleration was the net result of changes in female education, declines in fertility, and a shift in the age profile of women out of the 30-39 age group (which registers the highest participation rates) toward the 40-49 group (which typically has lower participation rates). Demographics and education tended to reduce the natural rate of unemployment in the region. The share of the youngest groups declined and this tended to reduce unemployment because young workers typically have unemployment rates that are four times greater than those of their elders. Since Latin American countries are ageing, the natural rate of unemployment will decline in the future.

Education and demographics have surprising effects on inequality. As individuals age, the wage differences among them widen, thereby increasing income inequality. One of the main reasons behind the increases in wage inequality is a worsening of the distribution of education. The income differences between poorly and highly educated workers in the region are a consequence of slow education progress.

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Poverty and Excess Inequality: Latin America, 1970-1995

The objective of this work is to assess the changes in poverty and inequality that have taken place in Latin America and the Caribbean from 1970 to 1995, with special emphasis on the 1990s. The main distinctive

characteristic of the study is that rather than focusing on individual country experiences, as most of the literature on this subject has done, we produce aggregate indicators for the whole region.

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Macroeconomics Stabilization of North American Monetary Union for Mexico

This research examines the macroeconomic stabilization costs and benefits of fixed and flexible exchange-rate systems and monetary union for Mexico. Considering that the North American Free Trade Agreement (NAFTA) also removes restriction to intra-regional investment and gradually opens the financial services market to competition among the North American countries, the free-trade accord allows each country to independently choose a monetary policy rule for pursuing and maintaining macroeconomic stability. By developing a two-country model characterizing the interdependence between the United States and Mexico, the costs and benefits of these monetary arrangements are examined with regard to their ability to cushion the Mexican economy from various shocks, particularly supply shocks. The empirical literature has found evidence of asymmetric supply shocks among the three North American countries that would otherwise threaten the liability of a fixed exchange-rate system, including a North American Monetary Union for Mexico. As a result of these findings, the empirical literature supports a flexible exchange-rate system. Yet, the basis for this support appears tenuous. In particular, as production integration and trade integration in intermediate goods increase under NAFTA, Mexico will become more vulnerable to supply shocks arising in the

United States. Supply shocks thus would become synchronized in both economies, thereby raising the benefit of monetary union over fixed and flexible exchange-rate systems. Furthermore, monetary union will reduce the vulnerability to idiosyncratic financial shocks of the kind that have buffeted the Mexican economy on several past occasions with lasting consequences for economic stability and growth.

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Changes in the Regulatory Framework of the Electrical Sector in Uruguay

This paper focuses on the Uruguayan electrical sector and regulatory issues. Five topics are covered: 1) regulatory framework, 2) the electrical sector and Mercosur, 3) regulatory models, 4) production and capacity of generation, and 5) costs and tariffs.

1994 GATT and the World Trade Organization: A New Agenda for Uruguay

This paper deals with the World Trade Organization's new agenda of January 1995. It is organized in three sections. The first section deals with strategies of trade liberalization. The second presents the results of the Uruguayan Round as it relates to access to markets, new rules of international trade, and institutional change. The third section discusses the agenda for Uruguay.

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Privatization in the Electrical Sector: Specifics of the Brazilian Case

The objective of this paper is to analyze specifics of the Brazilian electrical sector as it relates to privatization. Brazil has some peculiarities that have not been addressed in other countries, that are also involved in the transference of state owned electrical enterprises to the private sector. This work addresses one of these peculiarities, a strong dependence on hydraulic energy, and analyses this peculiarity in a separate section. Difficulties of government intervention in the electrical sector are analyzed. The work also examines an important aspect that distinguishes the Brazilian electrical sector from the electrical sectors present in more developed economies: the rapid growth of demand for electricity. Some peculiar characteristics of the possibilities of expansion of electrical energy supply in Brazil are addressed. The final section of the paper presents conclusions.

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The Effect on Exchange Rates and Interest Rates as a Result of Intervention in the Exchange-Rate Market and Sterilization

This work studies the impact on the exchange rate and interest rates of the Banco de Mexico's intervention in the exchange-rate

market through the mechanism of options as well as the sterilization policy that the Central Bank has followed. This work concludes that up until now there has been no important effect on exchange rates or interest rates from interventions in the exchange-rate market or from its subsequent sterilizations. However, the results of the work indicate that during the last months of 1997, the effect of the sterilization on interest rates was statistically significant, but very small. Finally, during periods when interventions might have occurred, interest rates are slightly higher than in periods in which this possibility is not present. This result reflects certain temporary distortions that emerge in the money market upon the carrying out of sterilization operations.

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**Accumulation of International Reserves
Through Put Options: The Case of Mexico**

This work describes how international reserves are accumulated through dollar put options implemented by the Bank of Mexico. Models for valuing the put option and determining the optimal moment for the Bank of Mexico to exercise such an option are presented. This work demonstrates that the probability of exercising such an option is not affected in any significant way by changes in the volatility of the exchange rate. The work compares actual market behavior to the

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**Do Exchange-Rate-Based-Stabilization
Programs Cause Economic Booms? Some
Unfavorable Evidence from Labor Market
Variables**

It is commonly held that most exchange-rate-based-stabilization (ERBS) programs implemented in Latin America over the past years have initiated expansions. Most existing ERBS models, however, are built in the monetarist tradition in which nominal rigidities are the dominant driving force of the dynamics of output in the short term. The paper shows that this nominal rigidity feature delivers grossly counterfactual predictions: prices and real wages behave countercyclically in the theoretical ERBS models, when they appear to be procyclical in the data. The only ERBS model that is successful in this dimension is a variant examined by Rebelo and Vegh (1995). However, we show that this success is achieved only when fiscal neutrality is abandoned – i.e., when a fiscal policy shock in the tradition of the RBC literature is introduced. Our findings suggest that more successful models of ERBS programs require policy makers to incorporate real factors in the analysis and abandon the extreme assumption in the current literature that nominal variables (such as the exchange rate) are the only relevant source of output fluctuations during those programs.
