

Research Abstracts

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CENTER FOR LATIN AMERICAN ECONOMICS Research Department

Preface

The Center for Latin American Economics is pleased to present the thirteenth issue of *Latin American Research Abstracts*. The issue includes 100 abstracts written by 142 authors and co-authors. The abstracts appear in alphabetical order by the lead author's 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 not yet a member, we urge you to join by filling out the application form at the back of this publication. Please send communication to the following address:

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The Brazilian Economy, 1945–1964

The paper discusses three distinct periods in Brazil's economic history: (1) the quest for re-equipment: 1946–55, (2) the golden years: 1956–62 and (3) the crisis in the early 1960s. It begins with economic policies of Eurico Gaspar Dutra, who served as president from 1946–51. It addresses several problems during Dutra's administration, including an overvalued exchange rate, inflationary pressures, and the administration's inability to improve infrastructure and expand capacity. The paper continues with Getúlio Vargas's administration (1951–54). It addresses the decision to liberalize import controls and the resultant exchange rate crisis. It also examines the loopholes in the relationship between the Bank of Brazil and the monetary authorities. Discussion of the golden years includes President Juscelino Kubitschek's economic plan that resulted in 5 years of economic expansion from 1956–61. The last section of the paper examines the administration of Joao Goulart (1961–64) and his lack of a credible economic program. The result was rampant inflation and political polarization between left and right. The paper addresses this schism, which led to the 1964 military takeover.

Latin American and the Caribbean Interests in the WTO

The first section of this paper analyzes trade flows and the size of domestic markets in Latin America and the Caribbean in terms of market access. The paper accounts for differences among the Latin American countries in terms of multilateral negotiations and regional integration. The work considers themes not traditionally dealt with in the WTO/GATT such as: environment, labor rights and competition. The paper also addresses the issue of coping with special and differential treatment. It does this by giving particular consideration to the Uruguay Round provisions while taking into account the varying developmental levels in the Latin American economies. The progress of trade liberalization agreed upon in the Uruguay Round is covered. The paper address those issues that are essential for the next round of multilateral trade negotiations, in particular, the issue of improving international discipline in the application of anti dumping duties and the issue of restraining the adoption of unilateral measures by specific countries. The conclusion establishes taxonomies based on specific interests of particular Latin American and Caribbean countries.

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Existence of General Equilibrium: Are the Cases of Non Existence a Cause of Serious Worry?

In this work, we attempt to characterize the main theoretical difficulties in proving the existence of competitive equilibrium in infinite dimensional models. We show cases in which it is not possible to prove the existence of equilibrium and some others in which, even though the existence of equilibrium can be proved, the equilibrium prices appear not to have natural economic interpretation. Nevertheless, we find that in pure exchange economies, most of these difficulties may be avoided by mild restrictions of the model. In productive economies, new specific problems appear, for instance non convexity of the production sets or non boundedness of the feasible allocation sets. To prove the existence and the efficiency of the equilibrium in productive economies, we need some strong hypothesis about the technological possibilities of each firm.

Existence and Uniqueness of the Competitive Equilibrium for Infinite Dimensional Economies

In this paper, from the excess utility function, we obtain a binary relation in the social weights space. For an infinite dimensional economy, we then prove the existence of equilibrium. In our approach, we don't suppose the existence of a demand function. Finally, we obtain a condition for the uniqueness of equilibrium, and we give some examples of economies that satisfy this condition.

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Investment under Uncertainty

The aim of this paper is to relate the General Equilibrium Theory and modern Finance Theory. We work with an infinite dimensional economy with a market for goods and actives, and with a finite number of agents. Each agent has an intertemporal utility function with uncertainty on the states of the world. We characterize the equilibrium with actives and spot goods and analyze sufficient conditions for the existence of equilibrium in this case. We show that it is possible to extend to infinite dimensional models the Chichilnisky theorem on uniqueness of equilibrium. Finally, we analyze payoffs and prices of actives that follow Ito processes in a CCAPM frame.

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Segmented Labor Markets and Segmented Incomes: Contingent-Work and Income Inequality in Chile

The decade of the 1990s has spurred saving, investment, employment, and economic growth in Chile in the midst of increasing political stability. Nonetheless, the improved economic performance did not reduce income inequality. Chile has the worst income distribution of all Latin America, following Brazil (Leiva and Agacino, 1995). The wealth inflow of the richer 20 percent of the population exceeded by a factor of 13 that of the poorer 20 percent of the population during the 1990-98 period (MIDEPLAN, Social Indicators, web page). The persistence of income inequality despite the experienced employment and GNP per capita growth could be partially attributed to the duality between "good" and "bad" jobs resulting from the *at-the-margin* deregulation and subsequent expansion of contingent work arrangements. High unemployment rates following the increased international competitiveness and greater demand for skilled labor, motivated the deregulation of contingent work contracts with the purpose of creating employment. However, the 1970s and 1980s' deregulation and subsequent expansion of contingent employment led to a segmented labor market in which the wage and benefits' gap between precarious jobs in the secondary or contingent market and secured jobs in the primary labor market grew wider.

This paper examines the evolution of contingent work arrangements through the past decade: their incidence, distribution, and implications for income inequality according to the employment regulation in place. The study uses micro-level data from the 1994 and 1998 *Encuestas de Caracterización Socio-Económica* to ascertain existing fluctuations in the observed contingent work trend and its consequences for wage inequality. Through revealing the evolution of the Chilean labor market, the findings identify groups with more vulnerable living conditions and factors contributing to the persistence of wage inequality. The results also provide useful

information for designing effective policies, which target poverty and the persistence of income inequality.

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Methodological Proposal to Estimate the Requesting Size of Central Bank Notes for the Costa Rican Economy

This paper presents a methodological proposal to estimate the requesting size of Central Bank notes (¢10000 bills, ¢5000 bills, etc.) for the Costa Rican economy. The estimates consider growth in the bills demand (caused by consumption changes), continual replacement of old or damaged bills and bank vault inventories. Using OLS, we develop a demand model for value of bills in circulation as a function of lagged GDP, expected inflation rate and labor force. The results obtained were robust, and forecast performance was evaluated through applying standard methods to a real case. Also, the calculation of replacement rates by denomination and bill inventories was improved. Finally, we made a qualitative analysis of other factors that may affect the volume of bills requested.

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Will Pension Reform Contribute to Economic Growth in Latin America?

The paper discusses the likely contribution of recent pension reform to economic growth in Latin America. Following the 1981 pension reform in Chile, a number of countries in the region have introduced individual retirement plans in the 1990s. These are expected to replace, partially or totally, existing pay-as-you-go social insurance pension schemes with funded individual pension plans run by private pension fund managers. Proponents of the reform, the World Bank among them, claim the reforms will contribute significantly to economic growth in the region by raising household savings and by improving the efficiency of both capital and labor markets. The paper reviews the theoretical and empirical support for these claims and concludes that the contribution of pension reform to economic growth is likely to be modest.

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Devaluation Expectations and the Stock Market: The Case of Mexico in 1994/95

Using company-level data, this paper examines the relative stock-market performance of firms with different foreign-exchange exposures around the time of the 1994/95 Mexican crisis. Contrary to what one might have expected given the alleged peso overvaluation, exporting firms outperformed the market beginning in late 1993. Although interest rates fail to show a clear confidence loss in the exchange rate regime, the relative performance of net exporters suggests that expectations of devaluation increased continuously. The methodology presented is relevant beyond the Mexican case: sectoral differences in stock market performance may constitute valuable leading indicators of exchange rate changes in emerging markets.

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The Pros and Cons of Full Dollarization

We analyze the costs and benefits of full dollarization compared to its closest alternative, a currency board, quantifying for Argentina where possible. Potential advantages include lower borrowing costs and deeper integration into world markets. One cost is the transfer of seigniorage to the United States. The country may also lose the *exit option* to devalue in the face of major shocks. Similarly, even a country with a currency board may lose some ability to act as lender of last resort to the banking system. We review how various country characteristics influence the balance of arguments.

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Financial Market Imperfections, Real Exchange Rates, and Capital Flows

We explore the role of domestic financial market frictions in explaining sharp movements in real and nominal exchange rates, capital flows, and output for a small open economy. Financial intermediaries arise endogenously to insulate depositors from the consequences of liquidity shocks and stochastic investment project returns, and to provide intermediation for efficient

capital accumulation in the presence of a costly state verification problem. An increase in the world interest rate may provoke an increase in the fraction of credit-rationed entrepreneurs, a decrease in the steady state capital stock, and - when the elasticity of substitution between labor and capital is low - a depreciation of the real exchange rate and an outflow of capital. Hence, we can account qualitatively for the recent experience of several emerging market economies in a model where all prices, including exchange rates, are perfectly flexible.

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State–Government Bailouts in Brazil

As a result of the consolidation of the democracy after the end of the military regime in the mid 1980s, Brazil has gone through a period of remarkable decentralization both in fiscal and political terms. The move towards decentralized management and control of public finances has been followed by a series of bailouts of state governments by the federal government. The lack of effective control on borrowing, coupled with reputational effects originating from these repeated bailout operations, reduced fiscal discipline and created an explosive accumulation of debts in Brazilian states during the last decade. The main purpose of this paper is to assess the determinants of state debt bailouts in Brazil and their relationship with states' fiscal discipline during the 1990s. After providing a brief overview of intergovernmental fiscal relationships in the Brazilian economy, the paper describes the development of state debt bailouts from the mid-1980s, with special emphasis on the 1989, 1993 and 1997 bailouts. It then discusses the determinants of state debt bailouts in Brazil with special consideration given to the issue of moral hazard. The paper also presents empirical evidence that the occurrence of bailouts during the 1990s is associated with lower fiscal discipline in Brazilian states.

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Banks, Domestic Debt Intermediation and Confidence Crises: The Recent Brazilian Experience

This paper examines the recent evolution of the Brazilian public domestic debt and interprets it in light of the confidence crisis literature. The analysis of the recent developments in the Brazilian public domestic debt market shows that the likelihood of a default must not be assessed only using simple summary aggregate measures of public domestic debt size and maturity, but must also take into consideration other structural aspects. Our analysis emphasizes the two main pillars of the Brazilian public domestic debt market: home bias and the role of the banking sector in intermediating the debt. Evidence from yields of a "perfectly" indexed bond shows that the rollover premium was very small when the devaluation occurred, and was still fairly small on October 1999, indicating that the rollover of the public domestic debt has not, so far, constituted a serious problem. Positive prospects for the public domestic debt market will depend, however, on the Brazilian government maintaining the current fiscal austerity program.

Debt Management in Brazil: Evaluation of the Real Plan and Challenges Ahead

The Brazilian domestic debt has posed two challenges to policy-makers: it has grown very fast and its maturity is extremely short. This has prompted fears that a default or a compulsory lengthening scheme would be imposed. Here, we analyze the domestic public debt management experience in Brazil, searching for policy prescriptions for the next few years. After briefly reviewing the recent domestic public debt history, we decompose the large rise in federal bonded debt during 1995–98, searching for its macroeconomic causes. The main culprits are the extremely high interest payments, which were caused by the weak fiscal stance and the quasi-fixed exchange-rate regime, and the accumulation of assets of doubtful value, much of which may have to be written off in the future. Simulation exercises of the net debt path for the near future underscore the importance of a tighter fiscal stance to prevent the debt-GDP ratio from growing further. Given the need to quickly lengthen the debt maturity, our main policy advice is to foster and rely more on, inflation-linked bonds.

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Review of Recent Studies on Brazilian Trade Relations

This work has two main objectives: (1) to survey a sample of recent economic studies on the present conditions of Brazilian foreign trade relations, including works in progress, so as to support the activities of the Brazilian Chamber of Foreign Trade (Camex) and (2) to select a sub-sample of representative research and, based on that selection, propose seminars on relevant themes related to the design, implementation and evaluation of trade policies. The survey's emphasis is on the motivation, results and policy implications of Brazilian foreign trade relations. Overall, the survey reviewed 78 studies covering a broad sample of subjects under the general heading of external trade relations. Among these, 21 were selected for the proposed seminars. These 21 studies were the subject of a separate evaluation and were grouped under five headings: (1) trade barriers including sections on identification, measurement and impacts of their elimination; (2) bilateral agreements; (3) economic integration and liberalization; (4)

competitiveness, which includes sections on diagnosis and public policy proposals; and (5) international negotiations.

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School Attendance and Participation in the Youth Job Market in Uruguay

This paper discusses truancy and school attendance by youths between 14 and 17 years old in Uruguay. School attendance has been above 70% for the last ten years, while labor force participation has been stable, less than 30%. In turn, 10% of youths of this age range declare both attending school and being active in the labor market while another 10% declare doing neither. In this context, the determinants of the decisions on investment in schooling are analyzed, and a probit model is estimated to assess the impact of a set of explanatory variables on the probability of school attendance, based on data from the Uruguayan Household Survey for 1997. Additionally, a model is estimated for the joint decision on school attendance and labor market participation. The evidence suggests that both decisions can be seen as alternative ones, and that a set of variables representing individual characteristics and family background of the youths exert a significant influence on each of them.

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Capital Markets and the Exchange Rate with Special Reference to the Dollarization Debate in Latin America

The central focus of this paper is the optimal choice of a foreign exchange system for emerging market economies, EMs, taking into account the conditions under which these countries operate, and that have been revealed to us as a byproduct of recent financial crises. I believe this discussion is necessary because there is a yawning gap between available theories and the concepts and issues that surfaced in the current policy debate. The risk of not subjecting this issue to professional analysis is that exceedingly bad and incomplete policy advice can pass for

serious opinion. A shocking example is the emerging consensus that most EMs should adopt flexible exchange rates. You sense a spontaneous nod of approval as the issue is raised in policy circles, even though most of the time flexibility remains largely undefined. Thus, I am afraid that flexibility is becoming a code word for what we used to call *discretion*.

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Fear of Floating

In recent years, many countries have suffered severe financial crises, producing a staggering toll on their economies, particularly in emerging markets. One view blames fixed exchange rates—*soft pegs*—for these meltdowns. Adherents to that view advise countries to allow their currency to float. We analyze the behavior of exchange rates, reserves, the monetary aggregates, interest rates, and commodity prices across 154 exchange rate arrangements to assess whether *official labels* provide an adequate representation of actual country practice. We find that, countries that say they allow their exchange rate to float mostly do not—there seems to be an epidemic case of *fear of floating*. Since countries that are classified as having a free or a managed float mostly resemble noncredible pegs—the so-called *demise of fixed exchange rates* is a myth—the fear of floating is pervasive, even among some of the developed countries. We present an analytical framework that helps to understand why there is fear of floating.

Fixing for Your Life

The Asian crisis took place against a background of exchange rate regimes that were characterized as soft pegs. This has led many analysts to conclude that "the peg did it." Most analysts have drawn the common policy lesson from this experience that emerging markets (EMs) would do well to allow their exchange rates to float. We present evidence that EMs are very different from developed economies in key dimensions that play an important role when it comes to the choice of exchange rate regime. In EMs devaluations are contractionary, the adjustments in the current account are far more acute. Credibility and market access, as captured in the behavior of credit ratings and interest rates, is adversely affected by devaluations. Exchange rate volatility is more damaging to trade and the passthrough from exchange rate swings to inflation is far higher in EMs. These differences between emerging and developed economies may explain EMs reluctance to "just float." In the context of a simple framework, we highlight why lack of credibility may lead to fear of floating and procyclical policies.

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Employment and Productivity in Brazil in the '90s

During the '90s, the Brazilian economy went through important changes. The economy was opened to both international commerce and capital flows, the inflation rate dropped steeply, and the state presence was reduced. These structural changes had important effects on the economic growth and on the labor market. First, the industrial employment fall was compensated by the increase in the commercial and services employment. However, after 1997 this phenomenon almost ended, leading to an increase in the unemployment rate.

This paper is concerned with analysis of labor market performance in the 90's, showing the evolution of the employment level and structure, the real labor profitability and work productivity on the economic sectors, and the unemployment rate. The conclusion of this analysis is that the real profitability and the labor costs increased in all sectors. In addition, the marginal labor productivity increase exceedingly compensated the relative price changes that occurred during the economy stabilization. It was also concluded that there was a great increase of the structural unemployment, suggesting that labor legislation modifications are needed.

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The Poverty Reduction Strategy of the Government of Brazil: A Rapid Appraisal

This paper provides an overview of both the current structure of poverty in Brazil-through a detailed poverty profile-and of the aggregate dynamics of poverty in the last two decades. We then assess a number of government policies and programs which are either specifically designed to reduce poverty or have a direct bearing on current or future social welfare. A brief discussion of the *Comunidade Solidária* Programme is followed by an analysis of the coverage and targeting performance of mainstream programs in the areas of education, health, social security and other transfers. Our main findings are that a fifth of the Brazilian population live in indigence, and that this does not represent a substantial improvement over the situation two decades ago. A share of the blame for this must be borne by the highly regressive pattern of incidence of *social expenditures*, which are, on the whole, disproportionately appropriated by the middle-classes and the rich.

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Economic Growth and Instability in Brazil

From the 1960s, the trade-off between stability and economic growth has been the focus of economic policy in Latin American debates. This old controversy still divides economists and politicians in many countries when analyzing losses in economic development caused by stabilization efforts. As a result, instability has been acknowledged as a growth inhibitor in Latin America, and it has only been since the 90s that stability has merited political prestige. This has not been the case in Asia, where this transition of principles has been in existence for at least twenty years.

This paper analyzes inflation as a symptom of instability and evaluates its effects upon economic development. It also reviews Brazilian economic growth history, identifying domestic factors of instability and the international financial markets effects on the relation between instability and Brazilian economic growth in recent years. Finally, the paper provides a brief examination of the conditions to Brazilian economic retaking, without the resumption of uncertainty that frustrates the perspective of a sustainable economic growth.

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Exchange Rate Policy in Chile since 1960: Political Economy and the Choice of Regime

This paper analyzes exchange rate policies in Chile since the 1960s. A brief overview on main policies is presented. Particular attention is put into the two episodes of fixed-exchange rate as well as the reasons why policy makers may have arrived to those decisions. The paper also examines the long tradition in Chile of the use of a crawling peg to preserve competitiveness and as a quick exit during times of crisis. More specifically, this paper attempts to uncover political economy factors that may have influenced the decisions on exchange rate policy. Empirical evidence on the economic environment during different episodes of exchange rate management as well as the influence of political economy factors is presented.

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The Wage Elasticity of Labor Demand in the Uruguayan Manufacturing Sector after Reunionization: New Evidence

This paper provides new evidence on the magnitude of the elasticity of substitution between labor and capital for the Uruguayan manufacturing sector. Labor demand is derived using a right-to-manage model estimated for the period 1985–97 using data from six industries. The evidence found suggests that the elasticity is generally less than 1. Differences by industry and in time are also found. The latter result may be linked both to the integration process undergone by Uruguay in the nineties and to the changes in the bargaining framework that took place in that same period. As a nested CES production function is used to derive the labor demand, the partial elasticity of substitution between production and non-production workers is also calculated, its magnitude being quite low. Finally, the model was estimated using data from industrial surveys (gathered from firms) and from household surveys. The comparison of results shows that when using industrial survey data, the estimated elasticities are higher than when using household survey data. The result is probably related to the different coverage of both sources, as well as to the different accuracy reached in measuring wages.

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Unique Equilibria in a Diamond-Dybvig Model

Standard models of bank runs are notorious not only for featuring Nash Equilibria (i.e. For a given set of fundamentals, a bank can close or stay open depending upon strategic interactions among depositors.) but also for lacking a satisfactory way of choosing among equilibrium outcomes or assigning a probability distribution to those outcomes. As a consequence, it is not possible to study the relationship between fundamentals and bank failure nor the effect prudential policies have on the latter.

We develop a Diamond-Dybvig style model with stochastic bank fundamentals (bank asset returns), which depositors observe imperfectly. Using iterated dominance arguments a la Carlsson and van Damme (1993), we find a unique equilibrium over the space of fundamentals. In particular, we are able to partition the set of fundamentals into two connected subsets: for fundamentals in the first set the bank always closes and for fundamentals in the second set it always stays open. This model unifies two strands of the bank run literature. Here both liquidity demand and asset returns play explicit roles in determining whether a bank has a run or not. Thus, we can show, as historical experience has suggested, that banks are more likely to close in periods of higher perfectly anticipated demands for liquidity. We also find that reserve requirements have ambiguous results that depend on the underlying probability distribution of portfolio returns. A version of capital requirements can reduce the probability of bank closings even though, in this model, banks fail primarily for liquidity reasons.

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Distributive Effects of Brazilian Structural Reforms

This paper aims at measuring the evolution of income distribution and its determinants during the period of economic reforms. The paper is divided in two parts: the first and main part of the paper explores long-run relations between reforms and income distribution using standard decomposition techniques. The second part explores these relations at a higher frequency.

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Economic Growth in Latin America: Sources and Prospects

This paper examines the growth experience of Latin America and discusses future prospects. For this purpose, we use alternative approaches. We first perform growth decompositions to look at the behavior of total factor productivity and examine differences across regions of the world and within Latin America. Then, we use cross-country growth regressions to compare the relative performance of Latin American countries vi-à-vis the rest of the world. This approach allows us to go beyond the traditional, and perhaps misleading, straightjacket of attributing growth to productivity or investment. It highlights the role of human resources, and institutional and policy factors. With this framework, we show that high inflation and inward looking development strategy are the main reasons for the low growth of Latin America. But, as reforms have advanced within the region, growth prospects have improved.

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Convergence, Human Capital and Economic Growth

Recently, much attention has been paid in the literature on economic growth to the phenomenon of conditional convergence, the tendency of regional economies with lower level incomes to grow faster, conditional on their rate of factor accumulation. This study uses the standard neoclassical growth theory, to obtain the first approximation of the convergence hypothesis in human capital between the 31 states and the Federal District in Mexico, using educational indices. The study estimates the annual rate of convergence of human capital and the convergence of income per capita conditional on human capital variables.

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The Political Economy of Exchange Rate Policies in Argentina, 1950–1998

In this paper, we examine the currency experience of Argentina over the last four decades. Our main focus is on the economic, coalitional, and institutional factors that have affected exchange rate policies. We distinguish three main periods regarding the behavior of the nominal exchange rate: periodic adjustments in the peg until the mid-1970s, accelerated devaluations through the 1980s, and stability since the beginning of the 1990s. These periods coincide with different strategies of development, which have subjected exchange rate management to different macroeconomic constraints. On this basis, we analyze each of these periods with some historical detail and develop different tests of the hypotheses suggested previously in the paper.

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Anatomy of an Electrical Crisis

This work presents a formal study of the Chilean electrical law. It examines whether the law provides sufficient pricing in order to deal with drastic falls in the quantity of energy provided without power cuts. It examines whether the law includes effective incentives to provide adequate capacity of reserves and also analyzes in detail the consequences of limiting compensation to

regulated users. The paper concludes that the pricing system in force in Chile is intrinsically rigid in order to accommodate large supply and demand shocks because the cost of failure is not a contingent price. It is not reasonable to suppose that the regulator is able to replicate ex-ante the prices that a contingent market would yield because the information requirements to be able to do so are formidable.

The paper obtains the following results: (a) In dry years, the energy price ought to be greater than the operational costs and the capital from the reserves of the power stations. (b) Legal incentives that moderated the consequences of supply restrictions were cancelled when compensation to the regulated users was limited in Article 99. (c) The errors of calculating the price, which were committed by ignoring extreme droughts, do not affect the hydraulic generators but rather affect those who sell at a fixed price independent of their hydraulic-thermal mix. (d) Limiting the compensations to regulated users in extreme droughts was unnecessary and ineffective for financial equilibrium of businesses. (e) The limitation of compensations disarmed the system of prices without benefits of economic efficiency. (f) If compensations are limited to regulated users, it is efficient that the transactions between generators are valued at cost of failure, measured at the average value of the regulated users who are rationed.

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Proposal of Macroeconomic and Financial Indicators for Early Warning Signals for Detection of Banking Crises

The main objective of this paper is to report the project results for the design of an early warning indicator system for banking crisis detection. This paper presents a proposal of indicators and some methodologies to monitor the macroeconomic and financial areas. In the first case, the recommendation is to monitor a whole of macroeconomic indicators and a vulnerability index. In the second case, the proposal is to analyze a system of 19 financial ratios for commercial banks classified by similar groups. Furthermore, it includes a horizontal and vertical study of the financial statements according to the groups.

The work finds that the external sector gave the major concentration of signals for the last quarter of 1998 and is the sector that produces the higher vulnerability for the financial system.

Concerning the vulnerability macroeconomic index, in the period studied (1997–98), the paper found that the behavior of the indicators did not show alert signals, except for January 1997, when the private sector credit followed an unusual trend. However, the behavior of this whole index was stable.

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Analysis of Commercial Banks Sensibility in Presence of Macroeconomic Shocks

This document analyses the sensibility of response toward two major risks that banking institutions confront when there are changes in the macroeconomic environment - liquidity and credit. The work also develops a clustering of bank entities taking as classification criteria the banks' capability of response.

One of the main results is that the average elasticity of reaction level is relatively low. However, there are significant extreme values found in the most vulnerable banks in the presence of changes of certain macroeconomic variables. These banks should be followed more stringently due to the possibility of contagion effects caused by shocks that weaken financial development. Also, we found that monetary variables produce less effects on liquidity and credit risks than real variables on prices and the Economic Activity Monthly Index (IMAE). In general terms, the banks are clustered from moderate to low reactions. This result can be either, convenient or inconvenient, depending on the Central Bank's point of view. If the criteria are to determine how volatile the behavior of banks can be against changes in the macroeconomic environment, this result is favorable in obtaining financial system stability. However, if the criterion has to do with the capacity of central bank policy to affect banks in their financial development, the results are not quiet as promising.

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Stopping Hot Money

While high interest rates and foreign exchange sales are the most common way of dealing with a speculative attack in the foreign exchange market, several countries resorted to capital controls during recent periods of currency market turbulence. The purpose of this study is to use daily financial data to examine four of these capital controls episodes—Brazil, 1999, Malaysia 1998, Spain 1992, and Thailand 1997. We aim to assess the extent to which the capital controls were effective in delivering the outcomes that motivated their inception in the first place. We conclude that in two of the three cases (Brazil and Thailand), the controls did not deliver much of what was intended—although, one does not observe the counterfactual. By contrast, in the case of Malaysia the controls did align closely with the prior of what controls are intended to achieve: greater interest rate and exchange rate stability and more policy autonomy.

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Inequality and Economic Growth

In the first part of the paper, we survey the recent theoretical and empirical development to understand the relationship between inequality and economic growth. We incorporate the contributions of social evaluation of investment project (basic needs) and the so-called Mincer's curve. Then we study the inequality phenomena in Latin America (especially Argentina) not only looking to the indicator of income concentration but also paying attention to the behavior of the relative wages between skilled and unskilled labor, and also to social mobility behavior. We then relate inequality behavior to economic growth, an income level estimating Kuznets curve and equation, using cross-state, across country, and time series data. After *controlling* the education influence on inequality, a more clear Kuznets curve is observed (supporting recent results of Barro.)

Output and Capital Input Per Capita Convergence in Latin America: A 1960–1995 Preliminary Analysis

This paper studies the convergence in output per capita in 7 Latin American economies during the period 1960–95, breaking it down on into two main determinants: total input and total factor productivity. Total input is in turn broken down in two inputs (labor and capital) and each one of these inputs is separated in its quantity and quality components. The paper presents the convergence of the capital input per capita only. Hence, it presents a partial picture of convergence. However, it gives some useful insights about the economic growth pattern of Latin American economies.

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The Argentine Credit Risk Indicator in a General Framework for Regulatory Credit Risk Capital Requirement

Argentina has Basle-style credit risk minimum capital requirements for banks but also a *credit risk indicator* (CRI) that increases the risk weight of a loan according to its interest rate. This paper delves into the microeconomic foundations for such a mechanism using portfolio theory. Perfectly competitive banks maximize von-Neumann-Morgenstern utility subject to capital requirements in a single period under multivariately normally distributed loan losses due to defaults. Basically following Rochet (1992), it is shown that to limit the bank's failure probability, the optimal risk weights should be proportional to the spread between the loan rate net of expected default and administrative costs and the risk-less rate. This is precisely what the *credit risk indicator* can approximate, if adequately constructed.

Credit market equilibrium interest rates are determined in a banking CAPM framework, and the spread is shown to be proportional to the betas of the individual loans. Thus, the optimum risk weights should be proportional to the betas of the individual loans because they reflect the covariance (undiversifiable) risk of the loans. This works well under the assumption of unlimited liability for banks. However, when limited liability prevails, moral hazard problems arise, especially if capital levels are low. The analytics of the limited liability case is not pursued in this paper. However, Argentine minimum absolute levels of bank capital required by regulation are quite high, so this problem should in practice not be serious. Thus, the CRI has the potential to further the regulatory objective beyond Basle style risk weights.

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The New Wave of Capital Inflows: Sea Change or Tide?

Will capital inflows boom again in Latin America as countries recover from the 1998-99 recession? And will they bust again shortly thereafter repeating the cycle of the past? Is there something fundamentally different about the new wave of capital inflows to alter this historical pattern, a sea change in the way the region is financially linked to international capital markets? Or is nothing really new under the sun, and will the new wave of capital inflows be just another tide, bringing in its wake a capital withdrawal and a financial market drought? This paper addresses these important issues, over which there is much controversy.

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The Determinants of Income Inequality in Brazil: Class Conflict of Educational Heterogeneity

This work considers the question: What are the principal determinants of income inequality in Brazil? It suggests a generic framework to categorize the determinants of income distribution based on five factors: individual characteristics; acquired characteristics; the role of the labor market, the role of capital markets; and the role of housing. Based on the empirical evidence presented in the literature, the paper concludes that the common approach to the inequality debate is spurious. The work suggests that the correct approach would be to investigate the nature of the class conflict through the framework and distribution of opportunities in education. A formal model suggests that Brazil is in Pareto-inferior equilibrium, in which there is a significant educational inequality that generates an income inequality followed by an inequality in political power and opportunity. The paper concludes that this equilibrium is fixed and inefficient.

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A New Poverty Profile for Brazil Using PPV, PNAD and Census Data

This paper presents a poverty profile for Brazil, based on 1996 data – an exceptional year, for which three different sources of distributional information were made available. We use PPV consumption data to estimate poverty and indigence lines. PPV-based poverty measures are compared to those based on more traditional sources, and the implications are discussed. Quasi-census data (contagem) is used to help disaggregate the PNAD into finer geographical units, allowing for an unprecedented refinement of the country's poverty map. Poverty measures and shares are also presented for a wide range of population subgroups, based on household-level data from the PNAD 1996, adjusted for imputed rents and spatial differences in cost of living.

Robustness of the profile is verified with respect to different poverty lines, different spatial price deflators, and different equivalence scales. Overall poverty incidence ranges from 23% with respect to an indigence line (15% for urban areas) to 45% with respect to a more generous poverty line (37% for urban areas). More importantly however, poverty is found to vary significantly across regions and city sizes, with rural areas, small and medium towns and the metropolitan peripheries of the North and Northeast regions being poorest. The marginal impact of each of these attributes, controlling for all others, is investigated through probit regressions run on PPV data. These confirm the importance of spatial variables, but suggest that education remains the central personal attribute determining the likelihood that a household experiences poverty. Some tentative recommendations to improve the quality of the available data sets are also made.

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Three Policy Varieties to Face Capital Surges in Chile

Chile's recent history includes three interesting episodes that shed light on the policies designed to face surges of capital inflows and their effect on the national economy. These occurred during the years previous to the debt, tequila and Asian crises, respectively. During all of these, Chile appeared as a successful country, but not always on the basis of sound macroeconomic fundamentals. Our analysis reveals the great policy inconsistencies of the first episode, related to inefficient absorption of capital inflows and high vulnerability to external shocks (with a drop in GDP of 14% in 1982). The second one shows quite a different policy approach, based on lessons from the past experience, which allowed vigorous growth in combination with external strength (GDP grew 10% in 1995). Finally, in the third period, we point out that, despite a generalized good economic performance, lack of timely prudential actions led to risky imbalances in the external front (GDP decreased 1% in 1999). We pay special attention to the reserve requirement (encaje) on short-term capital inflows, as a tool used in every pre-crisis period; furthermore, we take into account the role of concomitant positive or negative shocks such as terms of trade. Our study concludes that the differences in performance depended mainly on whether or not an active and comprehensive set of policies focussed on achieving sustainable equilibria.

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Income Distribution and Trade Liberalization

The paper presents a general framework for the analysis of the evolution of personal income distribution following trade liberalization. The model allows many factors of production and the possibility of capital gains. In this framework, the short run evolution of inequality depends on the wage to wealth ratio, while changes in the interest rate determine the changes in long run inequality. The general framework is applied to the dynamic specific factors model of Eaton (1987). In this model the land-labor ratio determines whether a country exports the land-using or the capital-using good in the long run. The type of the export good determines the effects of liberalization on inequality. In land (labor) abundant countries, inequalities increase (decrease) along the dynamic path. The model provides an explanation for the differences between Latin American and Asian countries in their response to trade liberalization. Econometric analysis provides mixed results for these predictions, with the correct signs but non-significant coefficients for the coefficient on the interaction between openness and the land-labor ratio.

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Latin American Trade Regime Reforms and Perceptions

We examine the effects of recent trade reforms in Latin American countries. In general, these countries have changed from the inward oriented economic attitude sponsored by the United Nations Economic Commission for Latin America (ECLAC), towards an outward looking perspective that is part of the *Washington consensus*. The paper details the changes in the level of tariffs and in quantitative restrictions, showing that there is a clear divide between the 80s and the 90s, with recent tariff structures that are flatter and lower. There has been an explosion in Free Trade Agreements (FTAs) within Latin America. Even if these agreements are not always effective and are riddled with excluded goods and services, they represent a change in perception and a willingness to trade with neighbors that did not exist previously. The effect has been a doubling in the rate of growth of exports in the last decade, coupled with an especially high growth rate in intra-LA trade. Cross-border investments have also become common. Nevertheless, the amounts exported by these countries are small. Even a country with low, uniform tariffs and few other forms of protection, such as Chile, did not get to export one thousand dollars of exports per capita, a quarter of the corresponding value for OECD countries.

A worrying trend for the area is the growth in the new forms of protection as traditional trade barriers are lowered. A survey of the major Latin American countries and their trade partners shows an increase in the use of sophisticated methods such as the use of standards, certification procedures and antidumping and anti-subsidy measures against other countries in Latin America. Moreover, there is a willingness to fall back on administrative protection with measures that are cumbersome and protectionist. Even countries that are members of a customs union, such as MERCOSUR, can indulge in costly trade wars using these instruments. Developed countries have also stepped up their use of these measures, and they appear less enthusiastic in their support of free trade. It would be ironic if, when LA countries finally start to believe in the benefits of free trade, the developed countries were to close the door on their imports.

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Endogenous Protection in Mercosur: An Empirical Analysis

Political economy views of trade policies are important in order to understand the structure of trade protection that bears not only on a particular country but also lies behind most international agreements. This research tries to understand the equilibrium structure of protection in Mercosur, developing empirical analyses based on the literature ensuing from the model set forth by Grossman and Helpman (1994, *Am. Econ. Review*). Indeed, Mercosur's common external tariff (CET) may be explained under a political economy perspective. And the existence of deviations at the level of both external and internal tariffs makes it interesting to contrast both structures under this approach. Different general equilibrium frameworks, in which governments are concerned both with campaign contributions and with the welfare of the average voter along with a set of organized special-interest groups that are concerned only with the welfare of their members, are used as the theoretical basis of the empirical tests. The interaction between the government and the interest groups-which make contributions to the government in exchange for protection-gives as outcome the structure of protection. This work builds four-equation systems (one equation for each member) for explaining the CET and the internal tariffs. The results, up to now (at the two-digit level), have shed an interesting light on the sectoral dynamics of protection in each country; notably in the case of Brazil and Uruguay.

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Price Level Determination and the Inflationary Dynamics in Mexico

This work presents an econometric model to explain the behavior of inflation in Mexico during the period 1985–98. It uses a co-integration analysis and appropriate statistical methods to formalize, clarify, and quantify ideas related to inflation. In order to put the results in perspective, a comparison is made with a low inflation country. The work describes the data utilized, discusses the order of integration of the variables, and analyzes the long-term relationship (cointegration) among the variables. The work analyzes the dynamic properties of the correction of error models and offers several conclusions in the final section.

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The Risk Premium of the Exchange Rate in Brazil during the Real Plan

We apply principal theoretical models and econometric techniques in order to identify and measure the country risk premium by using Brazilian data of the future exchange market after the Real Plan. We identify a country risk premium that varies long term and which correlates with the macroeconomic fundamentals of the economy. Beginning with 1999, corresponding to the introduction of the floating exchange rate, we observe a decrease in the importance of the risk premium relative to the forecasting errors of the forward discount. The techniques utilized permitted us to analyze important questions of economic policy, particularly those related to real interest rates.

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The Swings in Capital Flows and the Brazilian Crisis

The paper analyzes the Brazilian crisis with emphasis on the role of capital flows and the players involved. It concludes that while foreign investors (both banks and institutional investors) were long in Brazil, the speculation against the currency was not overwhelming. Once their position changed, the crisis erupted. But the change in position cannot be attributed to either a compensatory liquidation of assets story by foreign investors caused by the Russian crisis or to the effect of international interest rates. Brazil's better than expected macroeconomic performance in the aftermath of the crisis was partly due to the fact that the private sector was largely hedged at the moment of the crisis and was insulated from the immediate effects of the devaluation. In addition, the reasons for a low passthrough of the exchange rate depreciation to inflation are related to a depressed level of demand after the crisis that discouraged the passthrough and a previous overvaluation of the exchange rate that was corrected by the nominal devaluation.

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Is Adopting Full Dollarization the Solution? Looking at the Evidence

The paper discusses the advantages and disadvantages of the full dollarization option and offers a few stylized facts and conclusions regarding the effects of full dollarization. On one hand, a full-dollarized economy delivers an impressive inflation performance and may even reduce the impact of external confidence shocks, although not external real shocks. On the other hand, full dollarization does not guarantee fiscal discipline. Neither does the elimination of currency risk preclude default risk or the high volatility of sovereign spreads. In addition, it is not clear whether the reduction in domestic interest rates is the consequence of full dollarization or the competitive internationalized banking system.

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Political Decentralization, Fiscal Federalism and Creation of the Municipalities: From an Economic and Social Point of View

This work demonstrates that two important aspects of political decentralization – the creation of municipalities and the increase in current revenues to the municipalities – have had undesirable consequences, both from an economic and a social point of view. The reasons are many. First, the decentralization has increased the absolute and relative amount of tax revenue transfers from the big municipalities to the smaller ones and from the Southeast to other regions. This has more than likely inhibited productive activity in the larger cities, particularly in the Southeast, without stimulating productive activity in the less populated cities or in other regions. Secondly, this decentralization has benefited those living in small municipalities. This group is a small part of the total population and not necessarily the poorest. The political decentralization has harmed those living in medium and big cities since their resources have become scarcer. This group represents the largest part of the population. Thirdly, there has been an increase in the resources used for establishing legislative bodies while at the same time there has been a reduction, in relative terms, in resources available for social programs and investment.

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Research and Development and the Importation of Technology: A Comparative Analysis between the Manufacturing Industry in Uruguay and Spain

The objective of this work is two-fold. On one hand, it is to carry out a comparative study of the

innovation in the manufacturing businesses in Uruguay and Spain with the purpose of identifying similarities and differences between both countries, keeping in mind the different levels of industrial development. The second objective is to evaluate the impact of technological importation on the decision of businesses to carry out their own research and development. The paper adopts a microeconomic focus that differentiates between the total effect on the probability of carrying out research and development as well as the intensity in which it is carried out. The results show the existence of a complementary relationship in both countries between the importation activities and the generation of technology. For the two years analyzed, the effect on the smaller size companies in Uruguay was more intense.

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Transparency and Accountability in Bolivia: Does Voice Matter?

In this study we analyze the institutional factors that affect public accountability and corruption by focusing on the incentive structure faced by providers and users of health services in Bolivia. The Bolivian Popular Participation and Administrative Decentralization reforms, implemented since 1994, provide a unique scenario by which to study the comparative effects of institutional incentives over policy performance. We analyze the effectiveness of hierarchical controls and voice/exit factors in deterring public corruption at the municipal level. Three questions are analyzed through a survey of thirty municipal hospitals.

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Current Account and Deviations of Terms of Exchange and Volumes of Exports: Chile 1985–1999

To limit the risks of a sudden stop in external financing that would jeopardize intertemporal consumption smoothing, the current account deficit should be limited to sustainable levels. However, the volatility of the terms of trade and some export volumes cause difficulties in assessing a sustainable current account level. This paper provides a *trend indicator* for the current account based on *normalized* external prices and export volumes. Thus the exercise allows evaluating, in a simple and timely fashion, whether the deficit level is sustainable and, if not, what demand adjustment measures are needed to correct it.

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Foreign Direct Investment: Good Cholesterol?

This paper studies the proposition that capital inflows tend to take the form of foreign direct investment- i.e. the share of FDI in total liabilities tends to be higher in countries that are safer, more promising and with better institutions and policies. It finds that this view is patently wrong since it stands the historical record on its head. The work then uses alternative theories to make sense of the facts. It begins by studying the determinants of the size and composition of the flows of private capital across countries. It finds that while capital flows tend to go to countries that are safer and have better institutions and financial markets, the share of FDI in total flows is not an indication of good health. On the contrary, countries that are riskier, less financially developed, and have weaker institutions tend to attract less capital but more of it in the form of FDI. Hence, interpreting the rising share of FDI, as a sign of good health is unwarranted. This is even more so, given that FDI's recent rise has taken place while total private capital inflows have fallen.

Is FDI a Safer Form of Financing?

It has been common to attribute financial crises to short-term capital inflows, while foreign direct investment (FDI) is seen as a safer form of finance. The relationship between crises and the composition of capital flows is particularly relevant at present because the flow of capital to Latin America is becoming increasingly dominated by FDI. This paper asks whether the composition of capital inflows and of the stock of foreign liabilities is relevant for financial crises, be it their frequency, depth, or length. It explores the possible role of FDI as a benign form of external liability relative to other classes of liabilities, reviewing both analytical and empirical arguments.

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Why Do Countries Float the Way They Float?

Countries that are classified as having floating exchange rate systems (or very wide bands) show strikingly different patterns of behavior. They hold very different levels of international reserves and allow very different volatilities in the movements of the exchange rate relative to the volatility that they tolerate either on the level of reserves or in interest rates. We document these differences and present a model that explains them as the optimal response of a Central Bank that attempts to minimize a standard loss function, in an environment in which firms are credit-constrained and incomplete markets limit their ability to avoid currency mismatches. This model suggests that the difference in the way countries float could be related to their differing levels of exchange rate pass-through and differences in their ability to avoid currency mismatches. We test these implications and find a very strong and robust relationship between the pattern of floating and the ability of a country to borrow internationally in its own currency. We find weaker and less robust evidence on the importance of pass-through to account for differences across countries with respect to their exchange rate/monetary management.

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Educational Choices and Educational Constraints: Evidence from Bolivia

Recent efforts at poverty alleviation emphasize increasing government spending on education. However, even if spending were perfectly targeted, it is not evident that spending itself will lead to higher educational attainment. Bolivian household data is used in this paper to ascertain the probability of an individual quitting school due to financial or other reasons. Simulations show that government cash transfers can help to improve educational attainment somewhat. However, nonmonetary limitations must also be addressed if educational attainment is to improve significantly, in particular, for indigenous women who have the lowest levels of education in the country.

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Estimation of Tax Evasion in Chilean Businesses

This work estimates tax evasion in Chilean businesses from 1985 to 1997. The discrepancy of the actual taxes collected and the potential taxes are calculated by utilizing the *Operating Surplus* of the System of National Accounts (SCN), which makes diverse adjustments. The estimated evasion for 1997 is around \$604.223 million (some US\$ 1,400 million), a number that represents 41.7% of the theoretical collection. At the same time, the results show a declining trajectory in tax evasion beginning with 1989, the year in which tax evasion reached 58%. More than 75% of that evasion was derived from businesses evading the value added tax (IVA).

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The Center and the Periphery: Tales of Financial Turmoil

The literature on the international transmission of shocks has not discriminated where the shocks originate. One might expect that the global or regional consequences of a disturbance depend importantly whether the shock originates in the periphery—to borrow a term from Arthur Lewis—or in the center. We provide some preliminary answers to this question. Our approach is in the event study tradition, as we analyze the daily behavior of financial indicators for thirty-five countries in and around a collection of events. The analysis of the Russian-LTCM crisis revealed that there were a variety of withdrawals from risk-taking, which drastically reduced the liquidity of markets and increased their volatility. Most explanations of these events have emphasized the

behavior of investors, but an equally plausible explanation can be found in the role of market making. A simple model that stresses this mechanism is presented.

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Structural Shifts and Changes in the Distribution of Poverty: The Case of Mexico

The Mexican economy underwent a dramatic shift in development strategy in the 1980s. The economic reforms and the exogenous shocks that plagued the economy had different effects on workers in different sectors of the economy and changed the structure of poverty. Surprisingly, there was very little correlation across sectors between poverty alleviation and growth in either output or earnings. In the tradable goods sector, the explanation for the poor performance in terms of poverty alleviation despite relatively rapid growth appears to lie with the relatively skill intensive pattern of growth which occurred during the recovery from the crisis.

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Fiscal Responsibility at the Provincial or State Level: Argentina and Brazil

The evolution of public finances in Argentina and Brazil in the last few decades has been characterized by two important tendencies. First, both countries have suffered recurrent fiscal deficits in a context of macroeconomic disequilibrium. Secondly, they have both experienced pressures toward fiscal decentralization. With these considerations in mind, the present work examines alternative plans that will enable the state and provincial governments to conduct prudent fiscal policies. In an attempt to resolve the problems arising from decentralization and fiscal deficits, the work attempts to find solutions that are capable of responding to the institutional reality of each country. The first section of the paper is a brief summary of the international experience of fiscal responsibility under federal systems. The sections that follow examine the fiscal role and the process of public debt in the Argentine provinces and the Brazilian states during the last few years. The paper closes by evaluating the present plans that have emerged in these countries as well as addressing future prospects of consolidating fiscal discipline at the state or provincial level.

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Output Costs, BOP Crises, and Optimal Interest Rate Policy

Central banks typically raise short-term interest rates to defend currency pegs. Higher interest rates, however, often lead to a credit crunch and an output contraction. We model this trade-off in an optimizing, Krugman-type model in which the crisis may be delayed but is ultimately inevitable. We show that higher interest rates may delay the crisis, but raising interest rates beyond a certain point may actually bring forward the crisis due to the large negative output effect. Welfare may also be a non-monotonic function of the increase in interest rates. There is in fact a whole range of interest rate increases for which it is feasible to delay the crisis but not optimal to do so. The optimal interest rate policy involves high interest rates before the crisis and a further hike when the crisis takes place. The larger are the output effects, the looser is the optimal

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The Reserve Requirement, Capital Flows and Domestic Expenditure: An Empirical Evaluation

The rapid expansion of private-sector expenditure in the 1990s was accompanied by a massive and increasing foreign capital inflow. A tight economic policy, characterized by high interest rates, was implemented in order to contain the private expenditure growth. As a way of reconciling high interest rates with increasing international financial integration, a reserve requirement on capital inflows was applied. The paper shows that private spending responds to the volume of capital inflows, and that these, in turn, respond significantly to the reserve requirement. We show that the effect of monetary policy on domestic spending is weakened by capital inflows when the exchange rate is not free to fluctuate in response to changes in interest rates. The reserve requirement can be used to avoid this weakening, by compensating the effects on capital inflows produced by interest rate spreads. The results also show that if the reserve requirement had been eliminated, capital inflows would have grown significantly and the excess domestic demand situation of 1997 would have been aggravated. A more effective strategy for controlling private expenditure would have needed a higher reserve requirement and an even tighter monetary policy, or else a counter-cyclical fiscal policy that would have increased public saving in periods of private expenditure expansion.

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Anticipated Economic Indicators

There is no doubt about the usefulness of obtaining anticipated signals concerning a country's economic behavior. This is particularly true for policy makers, businessmen, investors and workers. Bolivia has a few set of short-run economic indicators. The most important one is the Monthly Economic Activity Index (IMAE), provided quarterly by the National Statistics Institute. Since this index is available with approximately a three-month lag, it would be useful to forecast its behavior over time, getting these results before the IMAE is officially published.

The paper proposes anticipated indicators to show future IMAE's behavior through simple functional form econometric models. Monetary aggregates M1 and M2, cement production, and energy consumption became useful variables to explain output behavior. Most of the forecasts have shown a similar growth pattern when compared with those of the IMAE. Despite some differences in the projected and observed growth rates, the goal of showing in advance the economy's evolution has been reached.

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Estimations of the Degree of Openness in Brazil's Capital Account—1988 to 1998

This paper estimates the degree of financial integration in the Brazilian economy by using a model of interest rate determination developed by Edwards and Khan, in an extension suggested by Haque and Montiel. Using time-varying parameter estimation based on the Kalman filter technique, it shows a high and increasing degree of financial openness after 1992. This indicates a small autonomy of domestic monetary policy over domestic interest rate. It also indicates that its behavior is mainly explained by the covered U.S. interest rate. The increasing value of the coefficient after 1992 shows that the imposition of restrictions over short run inflows after 1993 was inefficient in giving the Central Bank a bigger control over interest rates.

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Labor Markets and Income Support: What Did We Learn from the Crises

The adoption of emergency employment and short term training programs to provide income support to the population affected by the episodes of economic volatility since 1995 reveals the failure of the traditional, labor law-based income support mechanisms in Latin America. These emergency programs are not additional and transitory, but rather have become a permanent component of social policies. As such, they present policymakers with the opportunity to build a more encompassing and better designed mechanism to protect workers against the effects of macroeconomic volatility. The paper argues for an income support system centered on unemployment insurance, complemented with additional mechanisms to provide effective income support to workers during normal times; the paper also discusses what changes are necessary in emergency programs to make them work as part of that system.

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Policy Reversals: Electoral Competition with Privately Informed Parties

We develop a unidimensional spatial model of two party competition in which parties are better informed than voters about the bliss point of voters. The two parties base their positions on private information they have received concerning the voters. Surprisingly, in certain circumstances, the policies implemented by the left-wing party, upon obtaining power, are to the right of the policies implemented by the right-wing party upon its obtaining power. The driving force behind this result is that, in the event of a shock, right-wing policies often become more attractive, and thus the incentives pushing the left party to the right become very strong. By winning the election the left party can avoid the right party implementing extreme policies, while the right-wing party can see what it considers as relatively attractive policies implemented by the rival party.

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Unemployment Insurance: Case Studies and Lessons for Latin America and the Caribbean

This study examines unemployment insurance (UI) for its potential application and implications for Latin American and Caribbean economies. It surveys current experience with unemployment insurance programs through case studies and draws lessons learned in particular for the Latin American and Caribbean region. Seven case studies are examined: three within the region (Argentina, Barbados, and Brazil) and four outside (Japan, Germany, Poland, and the United States). The study also examines a specific sub-issue regarding the financing of training through unemployment insurance revenues.

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Economic Model and the Social Question

This paper reviews the interrelationship between market and inequality. Does the capitalistic system inevitably generate an inequitable distribution? Meritocracy would be the central argument that justifies the present situation. But, does a meritocratic society exist in Chile? Until what point do initial conditions impact the individual trajectory of each person?

What is the relationship between inequality and economic growth? The paper reviews the positive and negative aspects of the relationship. It also examines the following questions: Is income inequality an ethical problem? How much inequality can a society tolerate? The paper ends by reviewing the role the welfare state has played and suggests that it be substituted with an integrated state, whose principal direction is towards equality of opportunity.

Poverty and Income Distribution in Chile (The Decade of the '90s)

Chile has one of the worst income inequality records in Latin America and in the world. At the same time, during the last decade, the *Chilean model* has been considered a paradigmatic example that should be imitated by developing countries and, in particular, by Latin American countries. How can these two contrasting phenomena be reconciled?

Consensus exists with respect to the positive role education is playing in reducing income inequality. Efforts are being directed toward improving access to education as well as improving the quality. However, the results will be evident only in the long term.

Chile has a better educational level average than Argentina, Costa Rica and Mexico. How then can you explain the worst income distribution? The paper examines the different levels of educational achievement comparing illiteracy, twelve years of schooling, and university completion to income levels. It points out that a profession requiring university completion is the only mechanism that provides a standard of living that is significantly better than that provided by illiteracy. The paper also examines the inferior status of women in the Chilean labor force as well as the impact of family size on present and future income levels.

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Geographic Concentration and the Structure of Wages in Developing Countries: The Case of Uruguay

In this paper we are concerned with studying the consequences of geographic concentration of population and economic activities on the increase of wage inequality observed in the Uruguayan labor market. The external effects of geographic concentration, which characterizes most developing countries, on factor productivity should be to increase wages in these areas with respect to more dispersed regions. Using parametric and nonparametric quantile regression methods we find that the positive externality of geographic concentration translates into higher returns for the most skilled-educated workers in concentrated regions as well as a higher increase in wage inequality within these regions than within less concentrated regions.

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Inflation Targeting in Emerging Market Countries

This paper outlines what inflation targeting involves for emerging market/transition countries and discusses the advantages and disadvantages of this monetary policy strategy. The discussion suggests that although inflation targeting is not a panacea and may not be appropriate for many emerging market countries, it can be a highly useful monetary policy strategy in a number of them.

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Monetary Policy Strategies for Latin America

The paper examines possible monetary policy strategies for Latin America that may help lock-in the gains in the fight against inflation attained by the region during the 1990s. We start by calling for a refocus of the debate about the conduct of monetary policy away from thinking that it is about whether the nominal exchange rate should be fixed or flexible. Instead we argue that the focus should be on whether the monetary policy regime appropriately constrains discretion in monetary policymaking. This focus suggests that there are three basic frameworks that deserve serious discussion concerning long-run strategies for monetary policy in Latin America: a hard exchange-rate peg, monetary targeting, and inflation targeting. We look at the advantages and disadvantages of each of these strategies and then examine the recent track record of monetary policy in some Latin American countries for clues as to which of the three strategies might be best suited to economies in the region.

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Factors that Impact School Performance in Bolivia

To improve educational quality is one of the priorities in Latin America and particularly in countries like Bolivia, where education is becoming a crucial topic in the public agenda. This concern began especially at the beginning of 1994 when a new educational reform was implemented. The object of this work is to examine the factors that impact the performance of students, identifying factors associated with children and their common characteristics as well as factors associated with schools. In addition, the work compares the school performance of public and private schools based on standardized tests of performance. The statistical analysis utilizes information from the System of Measurement and Evaluation of the Quality of Education (SIMECAL) for sixth grade students in more than five hundred educational establishments.

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The Application of Clustering Analysis to International Private Indebtedness

The main goal of this paper is to apply a combination of statistical and connectionist schemes to examine, via clustering analysis, private indebtedness in different countries. Thirty-nine such experiences are used. The relationship between private debts and some macroeconomic variables are discussed in some detail. The clustering performance is improved by taking advantage of specific properties and capacities of each method. The procedures are also applied to a controlled numerical example.

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Four Decades of Economic Growth in Brazil's Center-West Region: Public Resources in Açño

This paper gives evidence that economic growth in Brazil's Center-West region was very successful in the 1960–96 period, with the per capita GDP rates being greater than any other region except the North region. The main causes of these growth rates are related to the role of the public sector. The government has invested more public capital, provided more financial credit to private investment and spent greater amounts of resources on public expenditures in the Center-West region than it has in any other region. This has resulted in important changes in the regional productive structure and an accelerated pace in the expansion of per capita income. Our estimates show that the government's share of direct and indirect investments and expenditures in the region has increased 50% since the seventies.

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Brazilian Trade Liberalization and Import Coefficients—1990/95

In 1994, the Brazilian government launched a stabilization program based on a dollar-peg exchange rate regime. In January 1999, that regime was abandoned; the result was an exchange rate devaluation of about 50%. There was a fear that inflation would come back due to the relative price change in favor of tradable goods caused by the exchange rate devaluation. That fear was based on the fact that nowadays the Brazilian economy is more open to imports. However, to reach such a conclusion, one should consider not only final products imports, but also the use of imported inputs. In order to do so, two import coefficients relating the use of imported inputs to total value of production are proposed for 29 sectors of the economy. Their analysis shows that the Brazilian economy is still relatively closed to imported inputs. That is one of the reasons why a relative price change caused by the exchange rate devaluation was not translated into permanent higher inflation. A comparison between price changes and the import coefficients is also made for the periods January/April and January/July 1999. The aim is to check whether the sectors that rely more heavily on imported inputs are the same ones that raised their prices most after the exchange rate devaluation.

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Determinants of Inflation in Bolivia

After the process of hyperinflation experienced by Bolivia during the period 1982–85, the exchange rate became a nominal anchor for inflation because of its close relation to domestic prices. It has been argued that in the past, when the rate of depreciation was high, the pass-through effect to domestic prices was also important. However, as the rate of depreciation declined, the pass-through effect diminished.

The document analyzes this hypothesis and studies other determinants on inflation in Bolivia using VAR models. The specification adopted takes into account the fact that the Bolivian economy is small, open, dollarized and exposed to supply shocks, mainly in the agricultural sector. After measuring the impact of these variables on inflation, the document suggests that there are few degrees of freedom for a more active exchange rate policy. The results show that there is a non-linear relationship between the rate of depreciation and inflation. As the pass-through effect is itself an increasing function of the rate of depreciation, exchange rate policy should aim at preserving the stability of real exchange rate in the medium term, under the restriction of maintaining the stability of domestic prices.

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Risk Perception, Dollarization, and Monetary Policy in Bolivia

This paper applies a theoretical model that clearly defines the concepts of money substitution and dollarization. Within this theoretical framework are analyzed the key determinants of the Bolivian dollarization in recent years. The main findings indicate that in spite of the fact that profits in real terms and interest rate variability have favored the financial assets in national currency, and that the depreciation pace and variability have decreased, dollarization levels have remained rigid. It is possible that the high tendency to maintain assets in dollars is due to the expectations of the economic agents that assigns a positive, though small, probability to an important change in economic fundamentals, in this case a strong depreciation of the exchange rate. In the economic literature, this is known with the name of *peso problem*. In this context, the best alternative to revert the dollarization process seems to be the application of policies to ensure and promote the use of the national currency.

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Equilibrium Indeterminacy in an Endogenous Growth Model: Debt as a Coordination Device

This paper presents a two-sector endogenous growth model where public spending—which is endogenous and productive—may generate equilibrium indeterminacy. Under certain mild conditions, there exists a continuum of expectations-driven equilibrium paths approaching a common balanced growth path. We show that the welfare-maximizing equilibrium path is associated with a labor supply as large as possible at time zero. Furthermore, the welfare cost of indeterminacy can represent more than a 2.1% of total consumption. It is also shown that public debt may be used to coordinate private expectations on current and future prices, and therefore, may break down the indeterminacy result. The equilibrium selection mechanism works through the amount of debt issued at time zero.

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International Trade and Sustainability of the Chilean Forestry Sector

In this paper the vulnerability of Chile's forestry trade to environmental threats is explored. The increasing concern for the environment by consumers, together with the life cycle approach to products has created a new context for forest exploitation. The paper discusses the new trend in consumer based voluntary instruments, which is requiring an increase in the use of eco-labels and forestry certification schemes that can be used as trade barriers. In particular the uncertainty related to the definition of sustainable forestry management is examined. The link between this trend and the interests of social and environmental NGO's, represents a potential threat to forestry sector development. As exemplified in recent years by Chile's forestry sector development, these are not theoretical concerns. At the production stage, the use of chlorine has been banned increasing production costs; native forest exploitation and plantations have come under increasing scrutiny, based on allegedly, unsustainable forestry practices; forestry development in Magallanes is being put under intense pressure by NGO's. The result is an abandonment of native forest by forestry firms, and the reduction in new plantations, even though most allegations have a weak base.

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Pollution of Santiago's Air: Current State and Solutions

The paper discusses the problem of air pollution in Santiago and the current attempt to find a solution to the problem. It examines the Prevention and Decontamination Plan for the Metropolitan Region (PPDA). The paper begins by defining terms and concepts utilized in the PPDA, those terms which are frequently used in the field of urban pollution. The paper then analyzes the current situation including observations of primary and secondary air pollutants in conjunction with the emission standard of the PPDA. It discusses in detail the effectiveness of specific measures contained in the plan. The paper concludes by making recommendations, which address the weaker measures of the plan: its insufficient focus on the existing institutional capacity and the lack of priority given to the structural causes of pollution.

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Essay on General Equilibrium Analysis: Theory and Applications

This work presents a review of the conceptual and applied literature on general equilibrium analysis models (EGC). It examines the principle characteristics of EGC, the forms in which they are constructed, the data required and the methods of calibration, as well as their advantages and disadvantages. The paper discusses their main applications both in the world and in Chile. The work concludes by presenting potential environmental applications of EGC models as well as addressing the debate over environmental double dividends.

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Exchange Rate Devaluation and Its Impact on Industry Prices in Brazil—An Analysis of the Effects in the Productive Sector

This paper analyzes the impact of the exchange rate depreciation on the costs of the Brazilian main economic sectors, using data from the input-output matrix of 1995. It establishes a new methodology to focus on the feedback effect of cost increase in the productive sector indicating the exchange rate sensibility of the main sectors cost structures. The exchange rate change induces a direct cost increase in the sectors that rely on direct input imports. The exchange rate change induces a direct cost increase in the sectors that rely on direct input imports. The costs are put under pressure as well due to the effect of the exchange rate change in the prices of the domestic suppliers that demand imported inputs. The estimation follows the channels through which the cost increase caused by the exchange rate shock spread out into the economy converging to the total effect that takes into account the very lasting recursive feedback effects. It also estimates the inflationary impact of the external shock in an environment of stable mark ups and no relevant indexation mechanisms on the consumer price index in different devaluation scenarios. It indicates that a 50% nominal exchange rate depreciation would cause an inflation

cost push close to 8.2% in the consumer price index. It also discusses the evolution of the industrial mark ups in the period that immediately preceded and followed the recent exchange-rate regime change in the Brazilian economy, in January 1999. At last some comments about the financial dynamics behind the overshooting of the exchange rate in Brazil are made, discussing the relevance of the speed of reversal in its inflationary impact.

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Financial Vulnerability, Spillover Effects, and Contagion: Lessons from the Asian Crises for Latin America

This paper defines *financial vulnerability* as a high probability of a successful speculative attack against a country's currency. In Asia, financial vulnerability was associated with a set of vulnerability symptoms. For example, *traditional* external sector vulnerabilities (appreciating real effective exchange rates, slowdowns in the rate of growth of export revenues, and high or widening current account deficits) signaled the market that a currency adjustment was forthcoming. An accumulation of short-term foreign debt in excess of international reserves invited the herd-like behavior of creditors who closed their credit lines to Asian debtors. At the same time, financial authorities were perceived as unable to implement timely devaluations due to high-unhedged foreign currency exposures in the financial and/or corporate sectors. They were also perceived as unable to defend the currency with interest-rate hikes due to high levels of indebtedness of corporations and over-extension of credit by banks, after prolonged credit and asset-price booms. We believe that the root cause of these *symptoms* of vulnerability was a perverse incentive structure, arising from moral hazards in domestic finance, lack of transparency in corporate governance and financial transactions, lax prudential regulation and supervision, and rigid exchange-rate regimes. This incentive structure does not always lead to excessive risk-taking by the private sector, but it did during a time of rising international capital flows in the context of ill-sequenced financial and capital account liberalization. We compare and contrast indicators of these symptoms and their root causes in Asia and Latin America during 1994-97. We reach the conclusion that financial vulnerability was greater and more generalized in the crisis-Asian economies than in Latin America.

Adjustments after Speculative Attacks in Latin America and Asia: A Tale of Two Regions

The paper analyzes the adjustment process in the aftermath of speculative attacks against the currencies of six countries-Argentina, Brazil, Mexico, Indonesia, Korea and Thailand. Even though the Mexican and Argentine crises of 1995, and the Brazilian adjustment after October 1997, were certainly costly, the Asian crises of 1997 were deeper and the recovery of the real economy was slower. The paper relies on rank-correlation analysis, economic indexing and growth decomposition techniques to evaluate the explanatory power of several hypotheses of why the recessions in Asia were more severe. The paper concludes that the larger size of short-term external debt relative to GDP, the higher incidence of leverage and currency mismatches,

the higher rates of investment, plus the regional character of the Asian crisis and the high export similarity across the Asian economies contributed to the deeper economic downturn. However, with rising regional trade and financial development, the aftermath of future speculative attacks in Latin America may look more like the recent East Asian tales of adjustment. The paper draws policy implications for reducing the costs of the macroeconomic adjustment after currency crises.

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The Difficulties Resulting from Provincial Value Added Taxes: The Magnification Effect and Invoice Sightseeing

Two difficulties arise when different jurisdictions have value added taxes at different rates. The first difficulty is the *magnification effect*, which consists of an automatic enlargement of the rate differential over and above the one established by the respective legislations. The second difficulty is a fraud known as *invoice sightseeing* which takes place when sales in one jurisdiction are declared as sales to a fictitious customer in a lower rate jurisdiction. This paper shows that either both or one of these difficulties will unavoidably appear if the jurisdictions adopt different VAT rates. Under certain arrangements, like the zero rate treatment for interjurisdictional transactions, the magnification effect disappears, but the incentives to perform *invoice sightseeing* are still present. Other arrangements are suggested under which such incentives disappear, but the magnification effect does not. Thus, the policy choice is to select a VAT procedure such that its effects upon economic efficiency and revenue are least damaging.

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Analysis of the Efficiency in the Chilean Tax System

This work evaluates the efficiency of the Chilean tax system. The paper shows that the optimal tax structure includes a tax on capital income, after deducting the net savings by firms in the period, and a tax on labor income, excluding the expenses on human capital formation. Although the Chilean system permits deduction of a great part of a company's savings from the tax base, the system has some characteristics that reduce efficiency. Some of these are the existence of limits on savings that one is able to deduct from the tax base, a very high maximum marginal rate on the wage tax, the assessment of earnings withheld in the companies, some unjustified tax credits, and the complexity of the tax structure. The work concludes with some suggestions on how to increase the efficiency of the tax system.

Subsidies in Chilean Public Utilities

This paper makes an analysis of subsidies in Chile's public utilities. Rates rebalancing have practically eliminated cross subsidies, and current subsidy programs are funded from the national budget. Over the last decade in particular, significant efforts have been made to extend public

services to rural populations, and a consumption subsidy for potable water currently benefits 17% of the population. The Chilean experience shows it is possible to design subsidies targeted to the poor that do not cause deadweight losses and that have a relatively low cost to the State. The elimination of cross subsidies has facilitated competition in some public services. Moreover, putting rural infrastructure projects out to public tender, whenever possible, has made it possible to substantially reduce government expenditure.

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Auction Design for the Colombian Electricity Market

Colombia deregulated its electricity sector and created a new market for electricity in July 1995. The spot market price is determined by a daily auction among the producers. Though the auction is designed to foment price competition, both water scarcity constraints and the relatively high utilization of production capacity at peak demand hours produce situations where the larger producers can exercise some market power. In extreme conditions, like those during the drought of 1997, prices can increase sharply, well above marginal costs.

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The 1990s in Latin America: Another Decade of Persistent Inequality

This paper argues that there is no country in Latin America where we can confidently say that income inequality improved during the 1990s. We document this fact by utilizing household surveys of 15 countries. The surveys are comparable and cover most of the population. What we observe are genuine distributive changes, which are being driven neither by differences in the characteristics of the data nor by the way in which the data is treated. In 10 of the countries, the lack of progress is driven by increases in inequality among the first nine deciles. In the remaining 5, the reason is a greater concentration among the richest 10% of the population. We also observe that in 7 countries, the dynamics among individuals with 14 years or more of schooling are the main reason why income distribution has not improved in the 1990s. However, the lack of progress in income distribution is not exclusive to this region. We compare Latin America

internationally and find that, with few exceptions, inequality has increased less in this region than in developed countries and in Eastern Europe.

What's Behind the Inequality We Measure: An Investigation Using Latin American Data

The use of income distribution indicators in the economics literature has increased considerably in recent years. This work relies on an analysis of household surveys from 18 Latin American countries with intent to explore what's behind the survey indicators and, thus, discover what information they are really conveying. We find that: a) The way countries rank according to inequality measured in a conventional way is to a large extent an illusion created by differences in characteristics of the data and on the particular ways in which the data is treated. b) Our ideas about the effect of inequality on economic growth are also driven by quality and coverage differences in household surveys and by the way in which the data is treated. c) Standard household surveys in LAC are unable to capture the incomes of the richest sectors of society; so, the inequality we are able to measure is most likely a gross underestimation. Our main conclusion is that there is an important story behind each number. This story influences our judgement about how unequal countries are and about the relation between inequality and other development indicators, but it is seldom told or known. Perhaps other statistics commonly used in economics also have their own interesting story, and it might be worth trying to find out what it is.

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Tax Base Variability and Procyclical Fiscal Policy

Based on a sample of 56 countries, we find that while fiscal policy in the G-7 countries appears to be broadly consistent with Barro's tax smoothing proposition, in developing countries, government spending and taxes are highly procyclical (i.e., government spending rises and taxes fall during expansions, while the reverse is true in recessions). To explain this puzzle, we develop an optimal fiscal policy model in which running budget surpluses is costly because they create pressures to increase public spending. Given this distortion, a government that faces large (and perfectly anticipated) fluctuations in the tax base will find it optimal to run a procyclical fiscal policy. We argue that the differences in fiscal policy between the G-7 countries and developing countries can be traced back to the fact that the tax base is much more volatile in developing countries than in the G-7 countries.

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The Concept of Transnational Corporations

Transnational corporations have been the most remarkable economic phenomena of the post-war period. They are the modern incarnation of the great corporations of the end of the XIX century. But, beyond their common characteristics, it is important to underline the specific attributes of this new type of economic agent that radically reshapes the economic system. This paper analyses them from two complementary perspectives. The first perspective comes from paying attention to the ownership and control structure of the firm over its affiliates, in association with the international flows of direct investment. The second perspective comes from emphasizing the nature of the economic space developed within the firm, its organizational forms and its strategies. Both have been the subjects of the various theories that intend to explain the way transnational corporations operate.

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Increasing Indebtedness, Institutional Change and Credit Contracts in Peru

In this paper we review the main factors that allowed the rapid growth of credit in Peru in recent years. In the last 5 years, the amount of credit allocated through formal financial intermediaries increased significantly. At the end of 1998, bank loans were around 25% of GDP, significantly higher than the 8% of GDP allocated by these institutions in 1993. This increasing amount of formal credit in the Peruvian economy results from a combination of several economic and institutional features.

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Impact of the Telecommunications Industry on Latin American and Caribbean Economies: A Case Study Approach & Analysis of Argentina, Dominican Republic, Mexico, and Venezuela

Since the mid-1980s, we have witnessed a transformation of the telecommunications industry on a global scale consisting of increasing market liberalization, the emergence of new technologies, and increasing customer sophistication. Latin American and the Caribbean are swept up in these same changes and will have to make critical economic, regulatory and policy decisions that will

shape their telecom policy landscape. Many challenges face all Latin American and Caribbean telecommunications service providers as they proceed into the next century. These challenges will be made harder given the current economic uncertainties in the region. This work uses a case study approach to analyze the telecommunications experiences and privatization processes in the Latin American and Caribbean nations of: Argentina, Dominican Republic, Mexico, and Venezuela.

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Endogenous Trade Policy and Political Contributions in A Standard-Trade Model (HOS Trade Model)

In this paper, we develop a political economy model about endogenous trade policy along the lines of the well-known contribution of Grossman and Helpman (1994). In our case, the structure of the economy is standard (neoclassical trade model instead of the specific factor trade model of the original paper) and more general (preferences are not quasilinear). In this new environment, an equilibrium of the game is derived. Two basic propositions summarize the results related to the level of the trade policy instruments set by the policy makers and the political contribution made by the active group of consumers (lobbies). This new general result is analyzed in a particular small economy abundant in a factor different from labor, e.g. natural resources. Three cases are studied to present the results of the two general propositions, which are based on the particular active lobby in the contribution game. They are: (1) labor unions that allow the income contribution of workers to influence trade policy; (2) factor owners associations that allow the income contribution of the other consumers in the other extreme of the income distribution; (3), contributions of both types of consumers, workers and owners.