Preface

The Center for Latin American Economics is pleased to present the fourteenth issue of Latin American Research Abstracts. The issue includes 119 abstracts written by 177 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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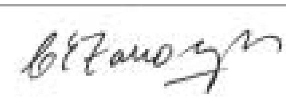

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Household Welfare Developments 1994-1997: What do Household Surveys Show?

This paper examines the change in Peruvian household welfare based on a set of selected indicators from the Living Standards Measurement Surveys (LSMS) for 1994 and 1997. The report estimates and analyzes variables regarding poverty, household expenditure, income and employment. The results show that the increase in family incomes and expenditures has contributed to bringing down the incidence of poverty with extreme poverty decreasing 18.4 percent. The most important outcomes regarding poverty reduction are recorded in urban areas, mainly in metropolitan Lima. Poverty variations are analyzed using a method that decomposes them into their growth and distribution components. The paper shows that, in addition to improving household incomes, economic growth has resulted in higher employment and the allocation of more public resources to poverty-reduction strategies, mainly programs on nutrition. Additionally, the identification of variables that influence the level of poverty can help improve the design of poverty reduction policies and set criteria to rank them. Notwithstanding the positive social welfare trends, the article points out several worrisome developments, notably that almost half of the population still live below the poverty line. Extreme poverty, which has increased during the period under study, is concentrated more in rural areas.

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Migration Flows in Brazilian Medium-Sized Cities and Metropolitan Regions

This study has two objectives. The first one is to show how immigration has played a significant role in the demographic growth observed in the medium- sized cities in the period 1980/91. The intention is to evaluate the importance of these cities, as alternative places to locate the flow of population that otherwise would choose to live in the Brazilian metropolitan regions. The results obtained in this study confirm this expectation. The second objective is to compare how immigrants were absorbed in the labor market of these metropolitan regions and intermediate-sized cities. Data show that metropolitan regions were able to offer better conditions to their immigrants, which can explain the importance of these areas as the preferred destination.

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The Current Account in Peru: A Consumption-Smoothing Approach, 1960-1996

Capital reversal is one of the most conspicuous aspects of the recent international financial crises. It affects emerging economies by reducing external funds, which sustain current account deficits and higher growth rates than internal savings alone. In this context, the relationship between the current account and changes in the international environment is a key aspect of the macroeconomics of a small open economy. For example, a common characteristic of all countries affected by the Asian crisis was the presence of high current account deficits. Peru has had recorded deficits higher than 5 percent of GDP since 1992. This paper tries to answer the question: Is the current account a problem? According to the consumption-smoothing approach, a high degree of capital mobility implies that the economic agents

can smooth out their consumption in the presence of shocks. In general, the model fits the data quite reasonably, in the sense that the optimal current account balance is highly correlated with the actual current account, including turning points. The statistical results suggest that the model takes into consideration the economic and statistical aspects of the behavior or the current account. This illustrates how the current account may respond to a variety of shocks, including productivity growth, an investment boom or a fiscal consolidation. In other words, expectations regarding an increase in future income seems to be a significant determinant of the behavior of the current account in Peru.

The Role of Central Bank Intervention: Determination of the Exchange Rate, Reduction of Exchange Rate Volatility, or Both? The Case of Peru, 1991-1998

Using theoretical models of nominal exchange rate determination, this paper evaluates the statistical effect of monetary aggregates on the exchange rate. The paper concludes that the Central Bank is able to affect the exchange rate level. However, it stresses that it does not pursue a fixed exchange rate policy because its monetary targets are not linked to any exchange-rate objective. Another conclusion is that Central Bank intervention has been effective in reducing exchange rate volatility.

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Mexico: Women and Full Employment

This paper proposes the implementation of the Full Employment Program to offer unlimited paid employment for unskilled Mexican women. The program is designed not only to wipe away unemployment but also to produce public goods, contribute to poverty decline, and increase work qualification levels. Its implementation will create a salary and occupational floor to stop increased poverty; produce indispensable goods and services to elevate social welfare; increase the paid work culture; and combat gender inequalities as well as prevent illegal migration. The first part of the paper analyses an occupational panorama of women in Mexico. Data are utilized concerning women's occupational levels in which only one-third of women fifteen years or older are employed. From this group, less than one-third has an educational level of nine years or less, a half has no fixed income, two-thirds have no fringe benefits and work more than forty hours a week.

The second part of the paper describes the main characteristics of the program. The program establishes unlimited employment supply with minimum salary, plus benefits for a 6-hour workday. At its maximum, the program can accommodate approximately ten million women. The employment program can be applied to road building, water supplies, public services, schooling programs, environmental care, childcare, as well as public school assistance and security. Main sources for program financing can be achieved through: increasing taxes, allowing a public deficit of 2 per cent of GDP; creating special taxes for real financial profits; and discounting foreign debt real interests. An employment and demand increase, which is created through this program, also raises public income and establishes the program's expenditure. Women represent 37 per cent of the active economic population in Mexico, while their income participation represents only 22 per cent of the total. This clearly reflects gender inequalities in the country.

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Household Saving in Developing Countries - Inequality, Demographics and All That: How Different Are Latin America and South East Asia?

East Asia and Latin America have diverged in several dimensions in the past three decades. This paper compares household saving behavior in two countries in each region (Mexico, Peru, Thailand and Taiwan). We make four contributions. First, we provide the first comparisons of savings in these two regions at the micro level using synthetic cohort techniques. Second, rather than focusing only on total household saving, as is common in the literature, we disaggregate the population into education groups to determine whether there are differences in saving behavior along the distribution of income. Third, we construct forecasts of future aggregate household saving rates, based on demographic projections. Fourth, we provide evidence that allows for testing the relevance of the life cycle model for explaining the differences in saving behavior.

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Methodological Proposal to Estimate the Required Size of Coin Purchases by the Central Bank for the Costa Rican Economy

This paper presents a methodological proposal to estimate the required size of coin purchases for Costa Rican economy by its central bank. The proposal considers the estimation of a demand function for coins. The approach to find the coin demand pattern was based on the circulating coins value variable. The model estimates the coins demand value both as a function of the consumer price index (CPI) and of GDP in nominal terms with a lagged period. The method used was OLS after applying a logarithmic transformation to both variables. Other factors considered by the methodological proposal are: the continuous replacement of old or damaged currency, the non return (the economic agent's behavior that involves other types of currency uses that differ from its function as an exchange instrument in economic transactions), the bank's coin inventories, and finally, the effect resulting from the substitution of notes for coins. The results obtained were robust, and the forecast performance was evaluated through standard methods and application of the model to a real case situation.

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Costa Rica: Estimation Of Structural and Cyclical Fiscal Deficit

In this article, a methodology used by CEPAL to estimate the structural and cyclical fiscal deficit is applied to Costa Rica for the 1983-1999 period. It is a useful tool to evaluate the fiscal policy performance in the medium term. The methodology tries to identify those deficit components that respond directly to policies of the budgetary authorities. The structural deficit is calculated by substracting from the overall budgetary balance the business cycle effect, which is a denominated cyclical deficit. Estimated data show that the structural component is the main aspect that influences fiscal disequilibria for both the central government and the non-financial public sector. They also show that the average size of Costa Rica's structural deficit is very high when compared with other Latin American economies and is also highly volatile. Finally, calculations of primary structural deficit show that internal debt is the main problem of the Costa Rican fiscal deficit.

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The Russian Default and the Contagion to Brazil

This paper investigates the contagion from Russia to Brazil in late 1998 utilizing two factors—players involved and the timing of events. The data does not reflect a compensatory liquidation of assets story by international institutional investors. It does contribute, however, to the suspicion that the contagion was triggered by foreign investors panicking from the Russian crisis and joining local residents in their speculation against the Brazilian real. Adjusted correlations in the Brady market increased significantly during the crisis, which lends support to the view that if there was a contagion from Russia to Brazil, the most likely place of the transmission was the off-shore Brady market. Finally, the paper does not support the hypothesis that it was the liquidity crisis in mature markets, and not the Russian crisis that timed the crisis in Brazil.

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Transmission Mechanisms and Rules of Monetary Policy: The Role of Monetary Policy as a State Variable

In order to achieve the long-run objective of preserving price stability and the short-run objective of maximizing social welfare, what are the requirements of a disciplined discretionary monetary policy aimed at partially balancing fluctuations generated by shocks? This paper attempts to answer this question by utilizing a model based on a minimum space state design (MSSM), a type of parsimonious, Lucas critique-free dynamic model that can be interpreted in structural form (see Aoki and Havenner, 1991). These parsimonious state space representations have a greater prediction capability than alternative methods (structural VAR models or semi-structural), and in this way, they constitute the tool to develop a forecasting system suitable for the design of a disciplined discretionary monetary policy that makes short- and long-term objectives compatible. In the design of the MSSM for Peru, the capability to forecast objective variables—in particular inflation—has been maximized, starting from the selection of the best information set. Once this parsimonious representation is attained, the paper builds a feedback rule that defines an evolution for the more instrumental monetary policy variable—the interest rate on Central Bank Deposit Certificates—compatible with the objective of price stability, by means of lineal-quadratic stochastic control techniques. The paper concludes that indirect central bank intervention in the interbank funds market involves actions of inflation control that do not require refinements in terms of the estimated MSSM approach.

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Poverty, Inequality and Macroeconomic Instability

Over the past seventeen years, the Brazilian macroeconomic performance has been considerably weaker than in previous decades. Inflation reached unprecedented levels, and economic growth declined considerably. Despite the overall perception that macroeconomic performance is closely related to poverty and inequality, very few quantitative estimates are available in Brazil and elsewhere about the relationship between macroeconomic performance and income distribution. In this study, we use monthly time series to access the relationship between the weak and unstable macroeconomic performance in poverty and inequality. The estimates using aggregated and pooling time series reveal that inflation seems to have little association with inequality and particularly with poverty. However, since the variation in the monthly inflation rate over the past seventeen years has been very substantial, the associated variation of poverty became quite significant. As far as the impact of unemployment is concerned, the estimates indicate relatively weak relationship between this variable and poverty or inequality. Finally, time-varying regressions indicate that the major results of this study, although applicable to most of the period analyzed, may not necessarily reflect the current situation. In fact, the time-varying estimates reveal a sharp recent decline in the association between unemployment and poverty or inequality, consistent with the drop in poverty and inequality in 1995, despite a considerable increase in the unemployment rate. There is also evidence that the relationship between inflation and poverty or inequality declines as inflation accelerates.

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Contagion of International Financial Crises: The Case of Mexico.

In this paper we study the contagion suffered by Mexico's national markets during the crises in Asia, Russia and Brazil, in the 1997-1999 period. We assess the amount of contagion to Mexico's financial markets using different statistical methods. We then study possible channels of contagion to the Mexican economy and discuss how the economy has dealt with these shocks.

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Economic Reform and Wage Differentials in Latin America

This paper develops and applies a new approach to the estimation of the impact of economy-wide reforms on wage differentials, using a new high-quality data set on wage differentials by schooling level for 18 Latin American countries for the period 1980-1998. The results indicate that reform overall has had a short-run disequalizing effect of expanding wage differentials, although this effect tends to fade over time. This disequalizing effect is due to the strong impact of domestic financial market reform, capital account liberalization and tax reform. On the other hand, privatization contributed to narrowing wage differentials, and trade openness had no effect on wage differentials. Technological progress, rather than trade flows, appears to be a channel through which reforms are affecting inequality. The paper also explores the effects of reforms on wage levels; tentative results suggest that reforms have had a positive effect on real average wages but a negative effect on the wages of less-schooled workers.

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The Uruguayan Labor Market (1986-1997): A Dynamic Factorial Analysis Perspective

This study aims to describe and analyze the Uruguayan labor market during the period 1986-1997 using Dynamic Factorial Analysis techniques. This multivariate method offers the possibility of analyzing the structural characteristics of the market along with its evolution. The sources of information were the continuing Household Surveys. It was found that the labor market indicators showed positive growth until the middle nineties. After that, an increase in the levels of unemployment and underemployment and a decrease in the earnings were observed. Level of education was the most significant factor in explaining earnings and stability. Age, which can be a proxy for labor experience, was the second most significant factor. Gender was an excellent explanatory factor for the hours dedicated to work (full-time or part-time), and age influenced the way people entered the labor market (independent or subordinates). The regional indicator (the capital, Montevideo, or the rest of the urban country) did not contain relevant information. Finally, it was noted that the gender gap reduced over the observed period and the mobility in the labor market increased with the level of education.

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Implementing Inflation Targeting in Brazil

Brazil put in place an inflation-targeting framework for monetary policy in mid-1999, less than six months after moving to a floating exchange-rate system. This paper presents the macroeconomic background that led to the shift in monetary policy regime and describes the general institutional arrangements and operational framework that has been adopted. The paper also discusses the basic modeling approach that has aided the decision-making process in the initial phase of inflation targeting in Brazil. We describe the family of small-scale macroeconomic models that has been used for informing and disciplining discussions about monetary policy within the Central Bank. These models contain few equations and few variables but carry a considerable theoretical content and provide a stylized representation of the monetary policy transmission mechanism. They are easily understood, and especially suitable for stimulation of a wide range of issues. We conclude with the main lessons that can be drawn from the initial Brazilian experience with inflation targeting.

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A Dynamic Analysis of Household Decision Making in Latin America: The Uruguayan Case

Uruguay has witnessed a decline in the birth rate and an increase in feminist activity as well as educational levels of the population. This study examines these changes from the perspective of household decisions. It uses microdata from the Household Continuous Questionnaire from 1986-1997. The analysis indicates that the changes related to the allocation of women's time correspond to variations of behavior among generations. For the newer generation, there is an investment in educational capital with more time dedicated to study. These educational decisions are interrelated with marrying at an older age, reduction in the number of children, and increase in the employment activity of married women. These changes are accompanied by the increase in divorce and the formation of single-parent households. With respect to the investment in human capital of the recent generations, the study finds that in the last few years, the high school drop-out rate depends primarily on age and the home situation. The increase in high school graduates has given rise to the numbers who opt to pursue higher education based on the monetary rewards of advanced education.

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Potential Output Estimation: Peru 1950-1997

This paper presents six methods for estimation of potential output in Peru during 1950-1997. In the first three methods, potential output is defined as GDP attained by the maximum use of production factors. The other three are based on the permanent component of GDP. The first set of methods suggests the existence of considerable gaps between actual GDP and potential GDP. They are unreliable due to their oversimplification: two of them do not include labor as the limiting factor, and none of them consider bottlenecks such as the effect of foreign currency scarcity on the acquisition of intermediate and capital goods. In the second set of methods, potential output is treated as a permanent component. The output function method is considered to be closer to the Peruvian experience. Results using

this method suggest that actual GDP has exceeded potential GDP since 1994. However, the gap is smaller than in the critical years, 1974 and 1987.

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Can Emerging Market Bank Regulators Establish Credible Discipline? The Case of Argentina, 1992-1999

In the early 1990s, after decades of high inflation and financial repression, Argentina embarked on a course of macroeconomic and bank regulatory reform. Bank regulatory policy promoted privatization, financial liberalization, and free entry, limited safety net support, and established a novel mix of regulatory and market discipline to ensure stable growth of the banking system during the liberalization process. Argentina suffered some fallout from the Mexican tequila crisis of 1995, but its response to that crisis (allowing weak banks to close) and the redoubling of regulatory efforts to promote market discipline after the crisis made Argentina's banking system quite resilient during the Asian, Russian, and Brazilian crises. Argentina's bank regulatory system now is widely regarded as one of the two or three most successful among emerging market economies. This paper traces the evolution of the regulatory policy changes of the 1990s and shows that the reliance on market discipline has played an important role in prudential regulation by encouraging proper risk management by banks. There is substantial heterogeneity among banks in the interest rates they pay for debt and the rate of growth of their deposits, and that heterogeneity is traceable to fundamental attributes of banks that affect the riskiness of deposits (i.e. asset risk and leverage). Moreover, market perceptions of default risk are mean-reverting, indicating that market discipline encourages banks to respond to increases in default risk by limiting asset risk or lowering leverage.

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Inflation Targeting in Brazil: What Difference Does a Year Make?

The adoption of inflation targeting as a monetary policy strategy in Brazil was a convenient way to replace the exchange-rate rule in an effort to anchor inflation expectations. This paper briefly evaluates the inflation target experience from three viewpoints: reasons behind the success, difficulties regarding forecasting and the risks ahead. It analyses the factors behind the success as well as the initial doubts and a second round of mistrust. It looks at the empirical difficulties to estimate a reliable demand function and examines evidence on the persistence of high interest rates as captured by a Taylor rule. It points out possible signaling problems in the transmission mechanism that might lead to a weakening of the confidence in the strategy in the future. It also draws conclusions on risks that emerged the first year.

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The Effect of the Variation of the Money Balance Target on the Interest Rate Term Structure

This document measures the impact of Banco de México's monetary policy on the interest rate term structure by looking at the variation of its money balance target for commercial bank accounts. It focuses on the daily (funding) interest rate and on the CETE interest rates with 28, 91, 182 and 364 days maturity, respectively. Besides the money balance target, the interest rate models include the nominal exchange rate, the interest rate of the 30 year United States Treasury Bonds, the spread between this rate and that of Mexico's Brady Bonds, and some stock indexes of foreign countries experiencing financial turmoil during the analysis period (September 1995 to January 2000). For the CETE interest rates, in addition to these variables, the spread between the CETE rates and the daily interest rate is included, in order to consider the long term adjustment dynamics of the interest rates through error correction models. Results show that, in general, a reduction of the money balance target or corto is associated with a statistically significant interest rate increment, which itself tends to be larger on the shorter term rates. However, the analysis shows change, indicating some coefficient instability during June-December 1998.

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Leading Indicators of Inflation for Brazil

The goal of this project is to construct leading indicators that anticipate inflation cycle turning points on a real time monitoring basis. As a first step, turning points of the IPCA inflation are determined using a periodic stochastic Markov switching model. These turning points are the event timing that the leading indicators should anticipate. A dynamic factor model is then used to extract common cyclical movements in a set of variables that display predictive content for inflation. The leading indicators are designed to serve as practical tools to assist real-time monitoring of monetary policy on a month-to-month basis. Thus, the indicators are built and ranked according to their out-of-sample forecasting performance. The leading indicators are found to be an informative tool for signaling future phases of the inflation cycle out-of-sample, even in real time when only preliminary and unrevised data are available.

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Monetary Policy in Latin America in the 90s.

This paper analyses Latin American monetary policy during the 90s. It discusses monetary policy options and the actual mechanisms chosen by individual countries. The paper studies the main determinants of monetary policy in six countries: Chile, Colombia, Costa Rica, El Salvador, Nicaragua and Peru. It then estimates reaction functions for each. These estimations are based on reaction functions of the form introduced by Taylor (1993) and extended by Clarida et al. (1998) in terms of forward-looking rules. We modify the framework of Clarida et. al. by using the gap between the expected and a time-dependent target inflation. The results show that only in the case of Chile does the monetary authority use monetary policy with a clear commitment to achieve the target inflation.

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Financial Crisis or Financial Cooperation for a Global Economy

This paper analyzes some of the problems brought about by financial liberalization and deregulation, pointing out that the multiple financial crises around the world during the last 15 years are leading to a growing financial instability that jeopardizes developed countries and less developed ones alike. The work proposes a revision of the financial globalization stages after Bretton Woods. It looks at the financial mechanics that are blocking a global deflation in financial circuits as well as the unstable relationship between interest rates and profit rates in the financing process. Finally, the paper examines international cooperation objectives for achieving financing stability and low cost flows for development.

New Architecture in a Conglomerate Financial World

This paper analyzes the presence of highly concentrated and unstable financial structures. The intention is to explore some elements of organizational and operational changes in the financial markets, particularly those of the mega-conglomerates that have a decisive influence on the transformation of financial structures. The first part of the paper describes the economic magnitude of the world financial sector. Next, it analyzes trends toward world financial concentration especially in the developed economies, which represent the greatest volume of resources in the financial markets. The paper finishes with the analysis of what has been called the new international financial architecture, which although is the result of an attempt to expand market discipline in competitive financial markets, faces a high level of sector concentration and the strong market power of a few conglomerates.

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The Administration of Brazilian Bond Debt between 1994 and 1997

Due to the high levels of uncertainty arising from high inflation on the eve of the Real Plan, Brazilian public debt was mainly composed of indexed bonds with very short maturities. As the stabilization program proved successful, it became possible to start changing the debt's composition; thus, between July 1994 and October 1997 public debt-managing authorities aimed to increase the debt's average maturity by issuing nominal securities with increasing maturities.

In this paper we analyze this debt-management strategy. The underlying argument is that the increase in the debt's average maturity must lead to higher debt-financing costs, as longer-term securities pay higher interest rates. We first discuss the theoretical reasons for the higher risk premium in long securities as compared to shorter ones and show that in order to increase the proportion of long-term securities in total debt, government must raise interest differentials even further. We then estimate the effects of such strategy in Brazil in the period following the Real Plan.

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Industrial Organization and Strategy in the Costa Rican Banking System

This investigation contains an analysis of the Costa Rican banking system. The main instrument of analysis is an opinion poll regarding strategy and competition of 25 banks. Regardless of their size, the majority of the banks participate in both corporate and personal markets. The paper points out that there are still unexplored important market niches that have considerable possibilities for growth. Because of their technological limitations, the Costa Rican banks' greatest threat comes from foreign competition. Nevertheless, they have a very identifiable competitive advantage in their human resources. The rivalry inside the system has been increasing and is perceived as very intense. In order to confront this greater competition, most of the banks follow a product differentiation strategy of personalized attention to differentiate their product. The analysis finds that five banks are considered leaders in the competition and very possibly determine prices.

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The Evolution of Foreign Loan Spreads: The Case of Peru, 1991-1997

As a component of interest rates, financial spreads reflect a country's credit risk. This paper describes the reduction of the financial cost of foreign loans during the 1990s, due to the fall of financial spreads faced by Peru. It shows how the base rate change from the prime rate to LIBOR contributed to the cost reduction. Additionally, it provides an estimation of the total benefit obtained by the economy in the period under study (from the launching of structural reforms in the early 1990s to the beginning of the international crisis). Finally, it deals with aspects such as reduction of spreads by economic sector and the relationship between the spread and variables such as the degree of openness of companies and the maturities of loans.

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Educational Impact of a School Breakfast Program in Rural Peru

The purpose of this paper is to present data on the evaluation of the educational impact of a school breakfast program implemented in rural schools in the highlands of Peru. Specifically, measurements in weight, height, school enrollment, dropout, attendance, cognitive abilities, and achievement in mathematics, vocabulary and reading comprehension in a treatment (breakfast) and contrast (no breakfast) groups are compared. The results show no positive effects of breakfast consumption on height for age, body mass index, memory, or achievement. Positive effects were found on hemoglobin, dropout rates and attendance. The lack of effects in achievement tests can possibly be explained by two factors. For one, the time the students spent in the classroom with the teachers went down after the school breakfast program was introduced Secondly, there was a differential dropout rate in the treatment and contrast groups. The drop-out rate was higher in the contrast group during the three previous years prior to the evaluation. International agencies funding the program requested the evaluation by a third party. The results are of interest to the stakeholders involved in the program. Some of the results might be of interest to a wider audience of evaluators and researchers interested in determinants of educational performance in poor areas in developing countries.

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Inside the Crisis: An Empirical Analysis of Banking Systems in Distress

Using aggregate and bank level data for several countries, the paper studies what happens to the banking system in the aftermath of a banking crisis. Contemporary crises are not accompanied by declines in aggregate bank deposits, and credit does not fall relative to output, although the growth of both deposits and credit slows down substantially. Output recovery begins in the second year after the crisis and is not led by resumption in credit growth. Banks, including the stronger ones, reallocate their asset portfolio away from loans.

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The Electrical Crisis of 1998-1999: Causes, Consequences and Lessons

This paper analyzes the Chilean electrical crisis of 1998-1999. Its main conclusion is that the cause was not what has so often been given: lack of investments by companies or the regulator's lack of power. The authors argue that the hydraulic variability to which central Chile is subject makes consumption reductions inevitable in very dry years. The crisis happened because the system of prices is both inflexible and inadequate, which inevitably results in power shutdowns. In addition there is a moral hazard that encourages the inefficient use of the reservoir water and makes a shortage more probable. The paper affirms the need for regulatory liberalization.

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Monetary Rules for Peru

This paper investigates the properties of explicit monetary rules during the period 1994-1999 through historic simulations using VAR models. Two rules are considered in the analysis: nominal GDP growth objectives and inflation targets. The simulation results using the inflation target rule show a closer approximation to the objective path—especially when the objective is defined as the core inflation—and is associated with lower variability in the monetary base growth. The simulations are used to evaluate the monetary policy in Peru during the period 1994-1999. The analysis suggests that from July 1994 to June 1995, the monetary policy could have been more expansive while from May 1998 to August 1999, it could have been more restrictive. The article includes an evaluation of implicit monetary rules (forward-looking rules) with an inflation objective. It concludes that explicit monetary rules render a closer approximation to the objective path than implicit rules.

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Poisoned Grapes, Mad Cows and Protectionism

This paper studies two episodes in which a ban on imports was imposed to safeguard people's health. The first case is the poisoned grape crisis involving Chile and the United States in 1989. The second is the mad cows dispute, which broke out in 1996, between the United Kingdom and the European Union. These case studies motivate a new definition of protectionist measure, which is applied to argue that the European Union's ban on British beef exports was not protectionist, while the US ban on Chilean fruit possibly can be classified as such.

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Franchising of Infrastructure Concessions in Chile: A Policy Report

This report describes and evaluates the present state of the Chilean infrastructure concessions program. This program, which has recently been extended to seaports, is intended to completely upgrade Chile's highway system. The main principles underlying the economics of franchising are examined and used to evaluate the program of privatization of highways and seaports. Compared with experiences in other countries, the results are fairly good. The infrastructure deficit has been greatly reduced, innovative ideas have been used successfully and several pitfalls have been avoided. However, since franchise terms are long, the final verdict will not be in for at least a decade.

Regulating an Essential Facility à La Demsetz When Underhand Agreements Are Possible

This paper studies whether franchise auctions for seaports, which include restrictions on vertical integration, are effective in restraining monopolies when underhand agreements with shippers are not observable. The port is modeled as an essential facility awarded in a competitive auction with many identical bidders who compete by submitting their fee for handling cargo. The shipping market is competitive, but an underhand agreement coupled with unobservable quality degradation may enable monopolization of traffic through the port. We assure that the costs of non-integrated shippers are unobservable. We obtain the following results: First, a competitive shipping market is more likely under vertical separation when the minimum possible bid on the cargo handling fee is sufficiently high. Second, underhand agreements are inefficient because incentive-compatibility constraints force the port to pay an informational rent and distort production decisions. Third, a low floor on the cargo handling fee leads to excessive competition in the auction by increasing the likelihood of an inefficient underhand rent-sharing agreement between the shipper and the port operator. Fourth, monopolization of the downstream market may reduce welfare below what is achieved with an unregulated port that is free to exploit its monopoly power over competitive shippers.

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Optimal Fiscal Strategy for Oil Exporting Countries

This paper develops simple guidelines for fiscal policy in oil producing countries, focusing on three issues: intergenerational oil distribution, precautionary savings, and adjustment costs. The paper presents a framework to analyze how the revenue generated by an exhaustible source of wealth belonging to the government should be distributed between current and future generations. This framework, which motivates a new approach for dealing with this question, is used to show the strengths and limitations of existing answers. The paper derives simple, closed form approximations generated by an uncertain and exhaustible natural resource such as oil. Price uncertainty, budget uncertainty, and the (possibly asymmetric) cost of adjusting expenditure levels are considered.

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Structure of Interest Rates in Chile: A Good Prediction of Growth and Inflation?

Based upon Granger causality and Pesaran-Shin's generalized impulse-response functions, this paper studies the link between the term structure and economic growth, and the link between the term structure and actual and expected percent changes of the Consumer Price Index (CPI) in Chile. Our measure of economic growth is the percent variation in the Monthly Indicator of Economic Activity of the Central Bank of Chile (IMACEC). The spread of long- and short-term interest rates—in real and nominal terms—and the short real rate capture the slope and the level of the term structure, respectively. Our main findings can be summarized as follows: First, when considering a short-term horizon, the relationship between the percent change in the IMACEC, the spread of nominal and real rates, and the level of the short real rate is, in general, weak in statistical terms. For a longer-term horizon, the strongest relationship is that observed between the level of the short real rate and the 12-month percent variation in the IMACEC. Second, the link between inflation and the nominal spread of interest rates is weak, especially for a long-term horizon. Moreover, changes in the CPI seem to have more predictive power to explain changes in the spread of nominal interest rates than vice versa. We believe that one explanation may be the price inertia existing in the Chilean economy due to indexation. Indeed, it is possible that changes in expected inflation transmit to the spread of nominal interest rates faster than they do to actual inflation.

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Rural Non-Agricultural Activities and Poverty in the Brazilian Northeast

This paper combines two complementary data sets to present a desegregated spatial profile of poverty in the Brazilian Northeast and to investigate the importance of non-agricultural activities for its rural dwellers. We present both univariate and multivariate profiles of non-agricultural employment and discuss their determinants. While the main occupational difference between the rural poor and the rural non-poor in Brazil seems to be the greater reliance of the former on paid agricultural employment (vis-à-vis own cultivation), rather than access to non-agricultural activities, the evidence nevertheless suggests that diversification into this growing sector provides both an important complement to the budgets of the poor, and possibly a self-insurance mechanism against negative shocks. Despite the substantial heterogeneity of the sector, two general findings are robust: returns to education are comparatively high; and location in relation to urban areas is an important determinant of both employment and earnings in rural non-agricultural activities.

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

This paper contains a poverty profile for Brazil, based on 1996 data, Poverty measures and shares are 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 sized towns and the metropolitan peripheries of the North and Northeast regions being the poorest. In addition, education, race and the labor status of the household head are important correlates of vulnerability. The marginal impacts of 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 households experience poverty. Some tentative recommendations to improve the quality of the available data sets are also made.

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The Globalization of Financial Volatility: Challenges for Emerging Economies

Over the past quarter century, a new variety of financial crises has evolved in Asia and Latin America, with four features that differentiate them from the old type. First, the international capital market has been the major source of both positive and negative shocks. Second, flows have originated and have been received mostly by the private sector. Third, fiscal deficits have, on the contrary, played a secondary role and in most experiences, public finances have been sound. Forth, the subjects of these financial crises have been emerging economies usually considered highly credible and successful. Flows have been characterized by a deficit of regulation, both on the supply and on the demand sides.

This paper sketches the three capital surges experienced by Latin American countries since the 1970s and reviews the main macroeconomic effects generated by capital surges and their policy implications. It compares specific experiences of emerging economies: three cases that were regarded as highly successful until they suddenly faced severe crises: Korea and Mexico in the 1990s and Chile in the 1970s. In contrast are Chile in the first half of the 1990s and Taiwan during the last decades, both of which implemented a set of prudent macroeconomic policies that avoided domestic disequilibria and mitigated contagion. The paper ends by summarizing some robust lessons for domestic policies and reform of the international financial architecture.

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Measuring Core Inflation as the Common Trend of Prices

In recent years, many central banks have adopted inflation targeting policies starting an intense debate about which measure of inflation to adopt. The literature on core inflation has tried to develop indicators of inflation that would respond only to significant changes in inflation. This paper defines a measure of core inflation as the common trend of prices in a multivariate dynamic model, which has, by construction, three properties: it filters both idiosyncratic and transitory macro noises, and it leads the future level of headline inflation. We also show that the popular trimmed mean estimator of core inflation could be regarded as a proxy for the ideal GLS estimator for heteroskedastic data. We employ a symmetric trimmed mean estimator to take account of possible skewness of the distribution, and we obtain an unconditional measure of core inflation.

Measuring the Stability of the Price System

For a stabilization program to succeed, it must be backed by a consistent fiscal policy. Fiscal policy, however, is not the entire story. Choices have to be made concerning sound monetary and exchange rate policies. Also, in countries with a long history of high inflation and widespread indexing mechanisms, an important component of the stabilization program is the elimination of these indexing mechanisms. This paper specifically examines the stability of the Brazilian price system and, more briefly, the cases of Argentina, Israel, Mexico and the United Kingdom.

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Regulatory Governance and Chile's 1998-1999 Electrical Shortage

In the early eighties Chile completely reformed its electricity sector, introducing a regulatory framework that became extremely influential in the rest of the world. In 1998 and 1999, however, when the la Niña phenomenon brought one of the worst droughts on record, the price system collapsed. Random outages and three-hour long rotating electricity cuts occurred.

This paper studies the interaction between regulatory incentives and governance during the 1998-1999-electricity shortage. We present evidence showing that it was feasible to manage the supply restriction with no outages. The shortage can be blamed on the rigidity of the price system, which was unable to respond to large supply shocks, and on deficiencies in regulatory governance, which led to a weak regulator that proved unable to make the system work. We show that the weakness of the regulator did not stem from lack of formal powers. The problems originate in the vulnerability to lobbies and lack of independence. Moreover, the regulator seems not to have fully understood the nature of the incentives in the price system during supply restrictions. We conclude that the Chilean shortage shows the limitations during the crisis of a rigid price system requiring heavy regulatory intervention. This suggests that countries where governance structures are ill suited to fill in loopholes left by the law should rely as much as possible on market rules that clearly allocate property rights ex ante and leave the terms of contracts to be freely negotiated by private parties.

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Regulating the Electricity Sector in Latin America

During the past decade most Latin American countries reformed and liberalized their electric sectors. This paper examines these reforms, providing a critical examination of the effects. Late reformers learned from the experience of earlier reforming countries, and in particular from the Chilean experience. This evolutionary process has meant less regulation of segments that are or can be made to be competitive (generation and commercial services) and more regulation of the non-competitive sectors (transmission and distribution) combined with the vertical disintegration of competitive and noncompetitive segments of the industry. Nevertheless, a market approach to generation must be concerned about the possibility of strategic behavior by generating companies. Some open questions remain, for example, how to solve the problem of the expansion of the transmission system and how to strike a balance between a regulator that has some freedom of action to react to unforeseen events, and the corresponding fear of regulatory takings.

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An Interest Rate Defense of a Fixed Exchange Rate?

This paper is about the possibility of an active interest-rate defense in the Krugman-Flood-Garber (KFG) model of speculative attacks. Our goal is to find the scope for policy tradeoffs involving a number of potential policy tools as they arise in the KFG model—interest rates, nominal-liability growth (money and bonds), the real government deficit and international reserve management. We evaluate policies-on an equal footing-in terms of how long the policies preserve a given fixed exchange rate. This analysis is supported by numerical simulations parameterized with data from Mexico in the 1990s. We also apply the model in a heuristic way to the East Asian crises of the late 1990s.

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The Public-Private Wage Gap in Brazil

Recent changes in public employment in Brazil generate costs to workers who leave the public sector. In this study, we investigate the wage loss that leaving public employees may experience if they were absorbed by the private sector. Using micro data from the Pesquisa Nacional por Amostra de Domicílios of 1995, we calculate the gross and controlled wage gaps between the two sectors. The results show that both wage gaps are relatively high, although significantly lower for the second measure. The latter indicates the presence of important differences in the composition of the labor force between the two sectors. In fact, public employees tend to be on average better educated, older and have longer tenure than workers in the private sector do. Also, the study shows that there is a significant heterogeneity within the public sector: the wage gap is higher for federal public employees, decreasing for the state and municipal levels.

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Social Security Policy and Reforms in Latin America

Social Security systems in Latin America prior to reforms exhibited some problems that have been reported also in other parts of the world, including OECD countries. This is the case for instance of the increasing pressure that the pension systems put on fiscal accounts. Other problems that are frequent in the region do not seem to be present in developed countries. Widespread evasion, low coverage, informality, lack of transparency and unclear rules of the game are problems usually quoted in reports and studies about Latin American countries but not about OECD countries. This essay presents some preliminary results of a research program aimed at determining the nature of these problems, gathering empirical evidence, proposing some explanatory hypotheses and analyzing the implications for the design of reforms. One of the main hypotheses analyzed in this paper is that Social Security systems in the region were managed with a clientelistic logic characterized favored by the lack of transparency and discretion of the administrations. On the normative side, it is hypothesized that recent reforms in Latin America reduced the scope for client behavior in Social Security.

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Estimating the Effect of Currency Unions on Trade and Output

Gravity-based cross-sectional evidence indicates that currency unions stimulate trade; cross-sectional evidence indicates that trade stimulates output. This paper estimates the effect that a currency union has, via trade, on output per capita. We use economic and geographic data for over 200 countries to quantify the implications of currency unions for trade and output, pursuing a two-stage approach. Our estimates at the first stage suggest that belonging to a currency union more than triples trade with the other members of the zone. Moreover, there is no evidence of trade-diversion. Our estimates at the second stage suggest that every one percent increase in trade (relative to GDP) raises income per capita by roughly one-third of a percent over twenty years. We combine the two estimates to quantify the effect of currency union on output. Our results support the hypothesis that the beneficial effects of currency unions on economic performance come through the promotion of trade, rather than through a commitment to non-inflationary monetary policy, or other macroeconomic influences.

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Empirical Models for Secondary Market Debt Prices

This paper extends earlier research regarding predictability of secondary market prices for sovereign debt certificates issued by developing countries. Due to the existence of a thinly traded market subject to potential outliers, parameter estimation is accomplished by means of a least absolute deviations methodology. Simulation results are compared with previously published forecasts where model coefficients were generated via three-stage least squares. Both methodologies appear to be useful and combined forecasts may prove helpful in situations where neither technique dominates.

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Inflationary Studies for Latin America

This material examines inflationary analyses carried out for various Latin American economies during the stabilization period of the 1990s. Detailed econometric results and general overview materials are combined for several countries including Mexico, Colombia, Ecuador, and Venezuela. Methodologies employed include structural econometric models, large-scale macroeconometric analysis, univariate ARIMA modeling, and transfer function time series analysis.

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Financial Structure in Chile: Macroeconomic Developments and Microeconomic Effects

The objectives of this paper are, first, to describe the developments in Chilean financial markets at the macroeconomic level and, then, to examine their effects at the firm level. After reviewing the main government policies towards financial markets in the last three decades, the paper describes the remarkable changes in the size, activity, and efficiency of the banking sector and other capital markets (bond, stock, pension and insurance markets) during 1980s and 1990s. Then, the paper analyzes econometrically the access to financial markets, the financing (balance-sheet) structure, and the revenue growth performance in a sample of 79 Chilean firms during the period 1985-1995.

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Evolution of Consumption and Purchases of Durable Goods in Chile, 1981-1999

The objective of this paper is to develop a methodology to build a statistical series based on purchases, consumption, and stocks of durable goods for the Chilean economy in the 1981-1999 period. The estimated series—both nominal and real—are presented in quarterly and annual frequencies. In addition, the paper explores the differences in their dynamic structure with regards to the evolution of non-durable consumption, interest rates, real wages, employment, and real output.

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The Many Reforms of the Social Security System

This article tries to explain why it is necessary to continue to change the Brazilian social security system. The so-called social security reform must be seen as a set of reforms: every step that is made means that the system is moving to a situation of equilibrium. Some important advances have already occurred, but the effort has to continue over the next years. Based on this, an agenda of reforms related to social security is suggested for the decade.

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Mexican Financial Crisis Consequences over the Local Currency

The most recent Mexican banking crisis was triggered by the currency crisis of December 1994. Bank currency mismatching was solved by emergency loans. However, the severity of the banking crisis may result in a fiscal crisis, probably linked with a new currency crisis. Why does a financial crisis suggest about the banking system and the local currency role? Is Mexico a good candidate for a currency board? Can dollarization in Mexico solve the exchange-rate instability? This paper considers the need to strengthen the Mexican peso through establishing a cooperation mechanism, which gives both long-term certainty to domestic and foreign investors and a sound and safe banking industry. The paper concludes that neither a Currency Board (CB), dollarization nor market dollarization would result in a stable long-term monetary and financial relationship.

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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, nor does the elimination of currency risks 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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The Pass-Through from Depreciation to Inflation: A Panel Study

The paper studies the relationship between exchange-rate depreciations and inflation using a sample of seventy-one countries in the period 1980-1998. The main determinants of the extent of inflationary pass-through of the depreciations (appreciations) are the cyclical component of output, the extent of initial overvaluation of the real exchange rate (RER), the initial rate of inflation, and the degree of openness of the economy. The paper finds that the pass-through coefficients increase the larger the horizon measured is, with its peak at 12 months. It also finds that RER misalignment is the most important determinant of inflation for emerging markets while the initial inflation is the most important variable for developed countries. Using the estimated model, the paper predicts somewhat higher inflation than actually observed in several well-known large depreciation cases, even if one takes into account existing measures of exchange rate expectations. This suggests that policy makers should use caution when using past models to predict future inflation in the aftermath of large depreciations.

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Flexibility, Labor Day and Systems of Turns: Effects of Legislation on Use and Product

The liberalization of the job market is a requirement to obtain higher employment and better adaptation of the work force to changing economic conditions. This article identifies the restrictions that the Chilean labor norm with respect to the workday imposes, especially regarding work in continuous turns. It also considers the impact of legislation on different economic variables, for example on the use and the product.

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Polarization and Wage Inequality in Uruguay, 1986-97

This work analyzes the evolution of wage polarization in Uruguay during the last twelve years. It shows that the distribution of wages has become progressively more unequal and, most of all, more polarized. Increased attention to skill and experience, together with increased wage differentials by economic sector, are the root of this inequality and polarization.

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A Core Inflation Estimation for Monetary Policy in Peru

The Central Reserve Bank of Peru has a constitutional mandate to preserve monetary stability. Thus, it is committed to develop policies to achieve low inflation. Since 1994 the Central Bank has been announcing inflation target ranges in order to guide public expectations. In order to eliminate the one-off effects of price changes that are not related to monetary policy, some central banks use a core inflation indicator. This paper intends to estimate core inflation according to this definition.This paper develops an extension of Quah and Vahey's technique (1995) to measure the core inflation from the hypothesis of neutrality of money in the long run. Core inflation is thus defined as the component of inflation that does not have an effect on real GDP in the medium and long run. In order to incorporate these hypotheses, dynamic restrictions are imposed on a system of autoregressive vectors in order to discriminate the transitory and permanent components of inflation as measured by the consumer price index. A core inflation series is then generated.

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Capital Account Liberalization and Disinflation in the 1990s

This paper addresses two economic puzzles of the 1990s: global disinflation and open capital accounts. Why did inflation fall so quickly, even in countries with long histories of high inflation? And, why did so many countries open their capital accounts—despite the misgivings of many economists and the evident risk of currency and banking crises? This paper explores the extent to which these two phenomena may be related.

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The Central Bank's Monetary Policy: A Historic Perspective

The Peruvian economy in the twentieth century was characterized by the presence of strong fluctuations in the main macroeconomic aggregates. This article reviews the performance of the Reserve Bank of Peru (created in 1922) and the Central Reserve Bank of Peru (created in 1931). It concludes that protracted macroeconomic instability originated from the fact that monetary policy was typically subservient to fiscal policy.

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Getting it Right: What to Reform in International Financial Markets

Our review of the main proposals on international financial architecture currently under consideration gives reasons for concern that excessive emphasis on improving stability by impeding capital flows will have a deleterious development impact. Sustainable development requires initiatives addressing the failures of international financial markets that make capital flows so small and volatile. Our analysis identifies a number of alternative initiatives and principles to get right in connection with official support, private sector participation, and reforms to the institutional framework. However, the fact that some of these efficient reforms entail financial risks to supporting developed countries contributes to lack of consensus.

What's Wrong with International Financial Markets?

Recent financial crises and contagion puts into question the wisdom of capital account liberalization. There is consensus that something is terribly wrong in the way international financial markets work for developing countries and that fixing is urgent. But what is wrong? Most views in developed countries identify the problems with too much capital flows, attracted by moral hazard. However, our analysis shows that the role of this distortion is being grossly exaggerated and that, in contrast, the main distortions in international financial markets are associated with capital flows being too little, restricted by sovereign risk, and too volatile because of market failures.

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Chile's Rapid Growth in the 1990s: Good Policies, Good Luck, or Political Change?

Chile's average economic growth between 1990 and 1998 was above 7 percent per year, more than double that of previous decades and higher than in any other Latin American country in the same period. This paper assesses empirically the main hypotheses suggested in the literature about the factors underlying this rapid growth: good economic policies, good luck in the external sector, and the country's return to a democratic system of government. The statistical and quantitative results indicate that Chile's rapid growth during the 1990s was due to good policies and the improved political situation.

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Inflation, Debt, and Default in a Monetary Union

Depending on the preferences of the central bank, countries in a monetary union tend to accumulate less debt. This reduces the need for fiscal criteria such as debt ceilings. In a monetary union with an independent central bank and a sufficiently large number of relatively small members, investors will begin rationing credit to the government more rapidly, and equilibrium with no inflation and no default exists. However, highly indebted countries are more likely to default once they join a monetary union.

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A Switching Model for Growth in Chile

This article presents a historical analysis of the Chilean monthly growth rate from 1987 to 2000, applying the Switching Regime methodology design by Hamilton (1989). Three scenarios were considered, which imply a number of parameters estimated using the expected maximization iterative procedure (EM). There is a characterization of the conditional density function for each state of the economy, defined by boom, sustainable growth, and finally, an economy in recession. The estimation procedure shows that the economy moved into a recession density function scenario when the Asian Flu was evident in 1998. Currently, we are in the sustainable rate of growth scenario, without inflationary risks. The analysis reveals that the current monetary policy is correlated with the indications of the monetary policies proposed by the switching model. The mean growth in the three scenarios is 10%, 6%, and -0.1%, implying a potential non-accelerating inflationary rate of growth of around 6%. Based on the conditional probabilities generated from the model, an artificial monetary index is built, that will work as an early warning indicator to help avoid misalignments and signal potentially required future monetary movements.

Liquidity Adjusted Value at Risk: An Application to the Chilean Sovereign Bond

International capital market integration together with increasing international volatility, requires an accurate evaluation of the potential losses that portfolio managers may face as a result of nternational turbulence. Assets with high liquidity standards can be evaluated by the traditional Value at Risk approach (VaR), however, this statistic underestimates the true value of the potential losses when the instrument is not liquid. This paper applies the methodology of liquidity adjusted VaR to the Chilean sovereign bond by incorporating bid-ask spread fluctuations when evaluating a portfolio risk.

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Balance of Payments Crises: The Role of Short-Term Debt

This paper presents a dynamic general equilibrium model of balance of payments crises to analyze the role of sterilization policies during speculative attacks. It is shown that if domestic bond interest rates are not allowed to rise, real money balances increase and the attack takes place entirely in the domestic bond market, leading to a sharp increase in central bank domestic credit. Data for the 1994 Mexican crisis are consistent with this theory.

Balance of Payments Crises Under Inflation Targeting

The paper analyzes an open economy where fiscal deficits are incompatible with an inflation target, ultimately leading to a speculative attack. There are two differences to the exchange rate targeting case: (i) The attack takes place over a short period of time as opposed to instantaneously. (ii) Reserve losses attributable to the attack are smaller, and increasing in the share of tradable goods in total consumption.

Inflation Targeting Under Imperfect Credibility

The use of an inflation target as a nominal anchor for an imperfectly credible inflation stabilization program is analyzed and compared to exchange-rate targeting. Inflation targeting leads to larger and more persistent deviations of nominal interest rates, current account balances, real exchange rates and domestic output from their steady state values, and consequently to greater welfare losses. These effects are more severe if price stickiness is high.

Sterilization of Short-Term Capital Inflows—Through Lower Interest Rates?

Reductions in international interest rates are a major cause of capital flows to emerging economies. Increases in domestic interest rates are a frequent policy response to the resulting price increases. This is often unsuccessful. The paper suggests a theoretical explanation based on distinctive features of emerging financial markets, including imperfect asset substitutability and imperfect capital mobility for some sectors of the economy. It concludes that the appropriate policy response to capital inflows may be lower interest rates.

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Effects of the Completion of Mercosur on the Uruguayan Labor Market: A Simulation Exercise Using A CGE Model

The Mercosur was born as an imperfect Customs Union. During the transition phase to a complete Customs Union, starting in 1995, each country established some exceptions to trade liberalization within the region and to the external common tariff. This paper deals with the possible effects on the Uruguayan labor market of the elimination of those exceptions. With that purpose, the changes in tariffs during the transition are simulated with a Computable General Equilibrium model. The model is specified for the Uruguayan economy, but three other regions are considered: Argentina, Brazil, and the rest of the world. There are nine sectors in the model, six of which are assumed to work under imperfect competition while the rest are perfectly competitive. In the sectors with imperfect competition, a Bertrand type behavior is assumed. The labor market is segmented in skilled and unskilled labor, and wages are flexible. The results show that the overall effects on the main variables and on the labor market are not important. The most significant changes are found in trade flows. However, at the sectoral level, relevant changes are found in: consumption; output; trade; and factor allocation in those sectors that are most affected by the intra-zone liberalization or by the complete enforcement of the Common External Tariff.

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Should Interest Rates Be Raised to Fight Currency Depreciation?

Central banks typically raise short-term interest rates to defend against currency depreciations. Higher interest rates, however, often lead to a credit crunch and an output contraction. We model this trade-off in the context of an optimizing model where higher interest rates may succeed in appreciating the currency. However, the associated output costs imply that welfare is generally 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 appreciate the currency but not optimal to do so. Lastly, in the presence of a fiscal constraint, we show that the nominal exchange rate may also be a non-monotonic function of the domestic interest rate—appreciating for small increases in rates but depreciating beyond a certain point.

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Does IMF Financing Result in Moral Hazard?

The view that the IMF's financial support gives rise to moral hazard has become increasingly prominent in policy discussions, particularly following the 1995 Mexican crisis. This paper seeks to clarify a number of conceptual issues and bring some basic empirical evidence to bear on this hypothesis. While some element of moral hazard is a logical consequence of the IMF's financial support, such moral hazard is difficult to detect in market reactions to various IMF policy announcements. There is no evidence that such moral hazard has recently been on the rise.

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Combining Compensatory and Redistributive Programs in Brazil: The Challenge of Social Policy in Brazil

The purpose of this article is to analyze several compensatory food programs implemented in Brazil, discussing their design and results. As the object of analysis, we chose the federal program entitled Prodea and a State program called Cesta do Povo (People's Foodbasket).The underlying idea is that current program designs are ineffective and inefficient and that a direct income transfer to the poor population would have a greater redistributive impact, in addition to fostering higher levels of economic efficiency.

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Macroeconomic Results of the Administration of Eduardo Frei and Ruiz-Tagel: A Comparative Evaluation

This study undertakes a balance of the macroeconomic results of the Frei/Ruiz-Tagle Administration compared with other Chilean administrations from the last third of the 20th century and with a group of other emerging economies. In both comparisons, the Frei/RT Administration enjoys among the best results according to the constructed macroeconomic performance indicator. Its principal strengths included control of inflation, economic growth, capital formation and savings, while its relative weaknesses were export growth and the unemployment rate. The results varied over time since contagion from the Asian crisis resulted in a weakening of overall performance. This experience demonstrates that, to prevent contagion from external crises, it is not sufficient to maintain a healthy financial system and low and stable inflation. Vulnerability to contagion can result from an excessive expansion in private expenditure.

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The Information Contained in Monetary Aggregates: The Case of Peru

This paper deals with the question of whether the information provided in monetary aggregates can be used to forecast the future value of both real GDP and inflation. A general analysis from a set of several econometric tests shows that restricted monetary aggregates (those denominated in domestic currency) contain a higher degree of information about the future evolution of the CPI, and so, they are good leading indicators of inflation. Broad monetary aggregates (i.e., those including aggregates denominated in foreign currency) can predict inflation but are less robust as predictors of GDP. Data used are monthly and cover the period June 1991-June 1998.

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Optimal Currency Composition of Uruguayan Public Debt

We use an optimal taxation model to analyze the optimal currency composition of Uruguayan public debt. Three possible instruments are examined: a nominal bond, a CPI indexed bond and a dollar-denominated bond. In the model, the optimal decision arises from the resolution of a trade-off between cost considerations and the requirements of optimal currency risk management of the government's budget. In the Uruguayan case, this dollar denominated debt has two undesirable features. On the one hand, dollar instruments are associated with a highly volatile real yield. On the other hand, the cost of dollar-denominated debt is negatively correlated with the rate of GDP growth and, thus, with government revenues. Thus, the current full dollarization of the debt portfolio is sub-optimal. The paper makes a case for the inclusion of CPI indexed debt in the Uruguayan government's portfolio of liabilities. Indexed bonds provide government with a hedge against high ex-post real borrowing costs. The issue of this kind of instruments would help to reduce the variability of public deficit, and, thus, it would be a way of diminishing fiscal vulnerability. Moreover, in the case of Uruguay, nominal debt should be discharged not only because of its high cost but also because of its undesirable stochastic properties.

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The NAIRU, Unemployment and the Rate of Inflation in Brazil

This paper estimates the Brazilian NAIRU (Non-Accelerating Inflation Rate of Unemployment) and investigates several empirical questions: the behavior of NAIRU over a long period, error bands for NAIRU and the usefulness of NAIRU for conducting monetary policy in Brazil. This article expands on previous studies by adopting an econometric model that, in our judgment, more adequate deals with the present instability of the Brazilian economy. We estimate two different state-space models: one with ARCH residuals and another with a Markov-switching regime. The article presents some new evidence on several questions. It shows that the NAIRU has been increasing since 1995. It concludes that there is a statistically significant relationship between deviations of unemployment from the NAIRU and inflation. It also shows that the usefulness of the NAIRU in conducting monetary policy is very limited because its error bands are too wide.

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A New Domestic - Currency Monetary Aggregate for the Peruvian Economy

Several economists have suggested that the traditional liquidity measure (the sum of the economic agents' money holdings) lacks economic meaning because it is not an effective measure of the quantity of money available in the economy for transactional reasons (Barnett 1980). In response, three approaches have been developed to achieve a liquidity aggregate that makes economic sense: turnover, monetary equivalence and currency. This paper presents a new monetary aggregate in domestic currency built according to the turnover approach, and compares it with the traditional one. The new aggregate is used to estimate a stable money demand function, which could not be obtained with the traditional aggregate. The demand for money function shows stable coefficients, a non-correlated error and a high determination coefficient (0,8), and so it could be considered in the design of monetary policy.

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What Makes Reforms Likely? Timing and Sequencing of Structural Reforms in Latin America

The wave of structural reforms in Latin America and elsewhere has stimulated the development of a theoretical literature on the political economy of reform. The leitmotif of this literature is the recognition that what is efficient in economic terms may not be politically viable. The literature has consisted mainly of case studies and theoretical models that defy systematic empirical testing because of the difficulty of defining, let alone measuring, the progress of structural reform.

The purpose of this paper is to test some of the hypotheses associated with these theoretical models, using a set of structural reform indicators for about twenty Latin American countries for the period 1985-1995. The paper finds that although there is very strong support for some of the theoretical hypotheses, much of the wave of recent reforms in Latin America cannot be explained without either better theories or better data. The work concludes that a definite chasm exists between the richness and sophistication of the theories and the paucity of the data and empirical analyses.

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Monetary Policy and Banking Supervision Functions of the Central Bank

This paper analyzes the advantages and disadvantages of Brazil's central bank maintaining its supervisory functions. The debate is viewed from the point of view of both monetary policy and banking supervision. The paper also discusses the question of international tendencies as related to central bank reforms and the respective supervisory systems. For a structural reform that involves monetary policy and national financial system supervision, due consideration must be given to the two major and universal tendencies – central bank independence and consolidated supervision of financial groups.

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Regional Inequality in Mexico: The Effect of NAFTA and Other Structural Reforms

The objective of this work is to analyze the impact of the recent structural reforms and the signing of NAFTA on an increase in regional inequality in Mexico. In general, it is believed that such structural changes benefit, to a greater degree, the northern states of Mexico. Given that these are precisely the states with the greatest income per capita, then it stands to reason that these changes would generate a greater inequality among regions. Convergence regressions and dispersion indicators employing data of product per capita for the period 1993-1999 show an increase in the absolute inequality beginning in 1993, although the relative dispersion did not increase. Nevertheless, these general indicators of dispersion do not allow analyzing the causes of the changes themselves.

This study finds that the structural changes appear to have had two effects. The first has a sectoral character, occurring in all the states of the Republic. The growth rate of the manufacturing sector has increased substantially beginning in 1993, increasing more than any other sector, with the exception of the transportation, warehousing, and communication sectors. Due to this, the states, in which manufacturing represents a large portion of production, have grown at a greater rate. Evidence of relative divergence is not found in the period examined. There are states in the north for which manufacturing does no represent a large portion of production, such as in Sonora and Sinaloa, while production in some southern and central states, such as Puebla and Tlaxcala, have a high manufacturing participation. The second effect has a regional character. It is found that the northern states have had a better performance than hoped given the structure of their production. Although important, this regional effect seems to be less than the structural effect, which is the principal determinant of the relative performance of the states during the period 1993-1999.

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System Incentives in Education and the Experience of SNED in Chile

This article discusses the importance of the Chilean system of evaluation and incentives applied to education. In particular, it analyzes the design and implementation of the National System of Performance Evaluation of the Subsidized Educational Establishments (SNED), which has been in effect since 1996. The work describes the SNED and discusses the methodological challenges that confront the system of incentives.

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What Factors Determine Various Scholastic Results in Chile's Average Education?

The objective of this study is to investigate the educational variables, both institutional and social, that are at the basis of educational successes in Chilean secondary education. The study uses data from the 1998 SIMCE second year average instruction test and information from the MINEDUC. The study shows that in the upcoming years, one of the fundamental challenges of Chilean educational policy is to reduce the existing discrepancy between the lower and higher socioeconomic levels in educational achievements. There is a need to improve educational gains made by lower socioeconomic students. It is important to emphasize that closing the discrepancy in educational quality does not imply a disregard for those establishments that have achieved a high level of educational success. It is precisely this type of school that plays a fundamental role in social mobility.

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The Cost of the National Pension Fund Reform: An Overlapping Generations Approach

The reform of the National Pension Fund (NPF), launched in 1992, was one of Peru's most important efforts to modernize the economy and promote market-based solutions. The new private pension system complemented the old state-run one, and partially relieved the government of its future obligations to the NPF. The reform was intended to increase domestic savings through the activity of the Private Pension Administrators (AFP), the development of the capital market, and the direct benefits to workers, who receive pensions according to the contributions made during their working life. However, there is a fiscal cost involved in the redemption of bonds resulting from previous contributions to the NPF, as well as Public Treasury transfers to attend pensioners who remained in the NPF.

This paper develops a micro-founded analysis of the reform's impact on the welfare of individuals, identifying the effects on each generation through the adaptation of the overlapping generations model. The results show that the reform does not necessarily increase domestic savings in the short run due to the transition costs, and that individuals are better off compared with a no-reform scenario.

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Chile's Peso: Better Than (Just) Living with the Dollar?

The choice between maintaining or giving up the national currency is determined by putting on balance the benefits of macroeconomic flexibility derived from a floating exchange rate and an independent monetary policy, and the microeconomic benefits derived from joining a currency union or adopting unilaterally a foreign currency. This paper assesses this choice for Chile. The country's financial development and macroeconomic stability imply low microeconomic and efficiency costs in sticking to the peso. An evaluation of optimal currency-area criteria shows that Chile is not a natural candidate for joining a monetary union with prospective partners in Latin America, NAFTA, or the European Union. Unilateral dollarization is even less beneficial. Among Southern Hemisphere countries with various exchange-rate regimes, Chile would gain the least from giving up its national currency. For a country like Chile, subject to large idiosyncratic shocks and significant temporary price and wage rigidity, a flexible exchange rate and an independent monetary policy anchored to an inflation target comprise the dominant regime choice.

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Uruguayan Trade and the Real Exchange Rate-VAR Analysis 1990-1998

This paper analyses the relationship between the Uruguayan trade and the real exchange rate through a VAR (vector autoregressive) analysis. It assumes an open economy model and investigates the possible influence of the different shocks on the variables. In order to examine the results of the VAR model, the particular economic situation exposed to a stabilization program and to a progressive openness process must be taken into account. The period analyzed is the 1990 decade in Uruguay. In this period, the Uruguayan authorities applied an economic policy that affected significantly the external sector. In particular, it affected the real exchange rate and the competitiveness of the economy. The external sector was not only affected by these applied policies but also by the policies of Argentina and Brazil, the bigger neighbors of Uruguay. Analyzing these data, the most important conclusion is that the movements of the real exchange rate have a permanent effect on exports and imports.

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The Technological Behavior of the Argentine Auto Part Firms

Since the beginning of the 90s, with the incorporation of the flexible production model, various changes took place in the automobile industry in Argentina. These changes impacted processes of production, organizational practices, models produced, characteristics of the process of innovation, as well as learning processes or ways to accumulate knowledge. In this paper, we analyze the new technological behavior of the Argentine auto part firms. We used the firm's expenditures on technological capacity improvements as inputs and as outputs (or performance indicators), we use the percentages of mean costs reductions as well as the number of introduced improvements. Data were obtained from the National Poll on Technological Behavior of the Argentine Industrial Firms, 1992 – 1996 (INDEC), working specifically with a sample of 53 auto part firms.

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Banking System Portfolio Quality and the Business Cycle: An Econometric Approach to the Case of Peru

To a considerable extent, the soundness of the banking system reflects the economy's health. The literature on banking crises usually focuses on the particular characteristics of bankrupt institutions or the deficiencies of the supervisory and regulatory systems. This paper evaluates the impact of economic growth on bank solvency and the effect of fast credit expansions on the system's vulnerability. Furthermore, the paper measures the incidence of the average credit cost and exchange-rate volatility on the deterioration of the banks' portfolio indicators. The empirical evidence for Peru during the period 1993–1998 seems to be consistent with economic intuition: business-cycle fluctuations are important to a bank's portfolio quality. In particular, non-performing loan indices seem to be countercyclical.

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Labor Market in the 1990s: Stylized Facts and Interpretations

During the 90s, the Brazilian economy went through important changes. The economy was opened to international commerce and capital flows, 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 decline of industrial employment was compensated by the increase in commercial and service employment. However, after 1997, this increase subsided, leading to an increase in the unemployment rate. This paper analyses labor market performance in the 90's, showing the evolution of the employment level and structure, the real labor profitability and work productivity in 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 increase in marginal labor productivity compensated the relative price changes that occurred during the stabilization of the economy. The paper also concludes that there was a great increase in the structural unemployment, suggesting that labor legislation modifications are needed.

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The Correlation Matrix of the Brazilian Central Bank's Standard Model for Interest Rate Market Risk

The Central Bank of Brazil is implementing a Value at Risk (VaR) methodology to establish minimum capital requirements for financial institutions to bear market risk derived from interest- rate fluctuations. This article shows that the construction of the correlation matrix of the Brazilian Central Bank's Standard Model for Interest Rate is coherent, in the sense it is positively defined.

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Optimal Interest Rate Rules in Inflation Targeting Frameworks

This work describes the main characteristics of an inflation-targeting regime and derives the optimal solution for interest rates according to an original methodology for two models based on the Phillips and IS curves containing general exogenous variables and a complete loss-function.

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Creation and Destruction of Jobs by Firm Size in Brazilian Industry

The objective of the work is to analyze the process of job creation by firms in the Brazilian industrial sector from 1986-1995. The data used is from the Industrial Research Annual (PIA) which comes from the Department of Industry at the IBGE. In accordance with recent studies for other countries, the capacity of creating jobs by small firms is over estimated and at times the results are subject to statistical errors. In particular, the estimations of creation and destruction of jobs by size of firms are constructed beginning with longitudinal data and the criteria used in order to classify the firms are annual observations. This article also analyzes the relationship between the quality of work generated and the size of the firm in Brazilian industry. We concentrate on the analysis of the value of wages and the paid benefits to the workers and the stability

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The Cost of Job Security Regulation: Evidence from Latin American Labor Markets

This paper documents the high level of job security protection in Latin American labor markets and analyzes its impacts on employment. The authors show that job security policies have a substantial impact on the level and the distribution of employment in Latin America. These policies reduce employment and promote inequality. The institutional organization of the labor market affects both employment and inequality.

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The Impact of Privatizations in Peru

The structural reforms launched in 1990 were intended to lay the foundations for sustained, private sector-led growth. One of the main features of this process of economic reform was the withdrawal of government from production activities and the privatization of state-owned enterprises. This paper examines the impact of the privatization process during the period 1991-1998, in which more than 180 privatizations were carried out. Sales of state-owned assets yielded US$ 7.7 million, and investment commitments amounted to US$ 7.9 million. The privatization process contributed to economic stability through the fast decline of the public deficit and the increase in the country's productive potential. The privatization process brought important benefits to Peruvian consumers through access to higher-quality goods and services. It also improved employment perspectives through the chain effect resulting from the greater dynamism of privatized companies.

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The Public Sector Premium and the Gender Gap in Latin America: Evidence from the 1980s and 1990s

This paper exploits a rich collection of household surveys to investigate the wage differential between the public and private sectors in 17 Latin American countries during the 1980s and 1990s. The paper also studies how the sector of employment affects the gender wage gap. The paper finds a very small premium for male workers and a large and significant premium for female workers. The paper also finds that, on average, Latin American women earn 30 percent less than men with similar skills and that approximately one third of this gender gap results from lack of access to formal sector employment.

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Fiscal Rules for Peru

One of the main reasons to introduce fiscal rules and transparency procedures is to establish a macroeconomic framework to achieve stability in the medium and long run, offer confidence to economic agents and contribute to sustain growth. Empirical evidence drawn from the United States, the European Union and Latin America suggest that fiscal rules are not relevant to fiscal performance. Nevertheless, the results are not clear regarding which model could be used to evaluate the relative importance of fiscal or budgetary rules, or what effects they could produce in the future. This paper examines theoretical contributions on the effects of fiscal rules and transparency procedures in fiscal performance, exploring several country experiences, as well as the prospects arising from the enactment of the Fiscal Responsibility and Transparency Law in Peru.

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Bilateral Trade Flows of Regional Trade Blocks

In this paper, the authors analyze the evolution of the bilateral trade flows among forty-four countries, from 1986 throughout 1997, focusing on the effects of the preferential trade arrangements (PTAs) joining most of those countries in six important trading blocs. The analysis is done by estimating an equation of a gravity model, whose basic determinants are the geographical distance, the GDP and the GDP per capita of the countries. Other variables are included, such as common borders and languages, in addition to dummies representing the preferential trading blocs. A relative distance variable is also included, in order to prevent the PTA's dummies from capturing part of the intense trade that usually prevails among very remote countries. Finally, the analysis is segmented into four sub-periods (1986/88, 1989/91, 1992/94 and 1995/97) to allow an evaluation of the impacts generated by the more recent agreements, such as Nafta and Mercosur.

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Characteristics of Stochastic Volatility for Latin America's Par Bonds

This paper uses a quasi-maximum likelihood procedure to estimate the non-stationary stochastic volatility for the par bonds of four Latin American countries (Brazil, Argentina, Mexico and Venezuela). The aim is to investigate the possible presence of co-movements in volatility across these countries. The estimation period goes from August 1994 until September 1999, therefore, including the Asian and Russian crises. The estimated volatility for the univariate model does not show any slope and is highly persistent. The multivariate model gives a good fit to the data and shows that there is common movement.

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Contract Enforcement and the Size of the Informal Sector

This paper describes a model of informality in which the size of the informal sector decreases as the degree to which financing contracts are enforced in the regulated sector rises. In this environment, formal establishments tend to be larger and older. This and other quantitative implications of the model are compared to the evidence on informal sector production in Latin America, including some new evidence on the link between informality and the size distribution of production establishments in Argentina.

Limited Enforcement and the Organization of Production

This paper describes a dynamic, general equilibrium model designed to measure the economic impact of the imperfect enforceability of financing contracts. In the model, contractual imperfections in the form of limited enforcement distort the allocation of resources across production establishments, with negative consequences on output and labor productivity. Limited enforcement also has an impact on the size distribution of establishments by constraining some managers to operate establishments below their optimal scale. Calibrated simulations of the model reveal that these effects can be large and account for a sizeable part of the observed differences in the size distribution of establishments between Mexico and the United States.

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Monetary Policy in a Partially Dollarized Economy: The Case of Peru

During the 1990s, the monetary policy of the Central Reserve Bank of Peru proved to be effective in reducing inflation, maintaining it within or close to the target ranges announced since 1994 and achieving a rate of 3.7 percent in 1999. This trend towards price stability has been achieved through fiscal and monetary discipline, in spite of the fact that two-thirds of deposits in the banking system are denominated in U.S. dollars. This paper shows evidence that dollarization in Peru is the result of an asset-substitution process, which allows monetary policy to maintain its effectiveness. Estimations using recursive and structural time series analytical methods show that the inflation variance is mainly explained by narrow monetary aggregates in domestic currency, which are relevant for current transactions and can be effectively influenced through monetary control.

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What Does a G-3 Target Zone Mean for Emerging-Market Economies?

While fashions concerning appropriate exchange-rate arrangements have shifted over the years, advocacy of establishing a target zone surrounding the world's three major currencies has remained a hardy perennial. Work on target zones (pioneered by McKinnon, 1997, and Williamson, 1986, and recently summarized by Clarida, 1999) has mostly emphasized the benefits of exchange-rate stability for industrial countries. More recently, though, analysts have apportioned some of the blame for financial crises in emerging markets back on the shoulders of the volatile bilateral exchange rates of industrial countries (as in Goldstein, 1999, for instance). With many emerging market currencies tied to the U.S. dollar either implicitly or explicitly, movements in the exchange values of the currencies of major countries—in particular the prolonged appreciation of the U.S. dollar vis-a-vis the yen and the deutsche mark in advance of Asia's troubles—is argued to have worsened the competitive position of many emerging market economies. One solution to reducing destabilizing shocks emanating from abroad, the argument runs, would be to reduce the variability of the G-3 currencies by establishing target bands. This paper examines the argument for such a target zone from an emerging market perspective but will be silent on the costs and benefits for industrial countries.

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Minimum Price Policy in the Decade of the 90s: The Old and the New Instruments

This paper deals with the reactivation of the Brazilian minimum price policy in the agricultural year1991/92,in a model based on the traditional instruments and that lasted until the agricultural year1994/95,afterwhich a new model, based on new instruments, was progressively created. The paper offers a theoretical perspective on the role of the policy adopted between the agricultural years 1991/92 and

1994/95 and presents a corresponding empirical analysis. One of the main conclusions of this analysis is that the lack of indexing of the minimum prices by the TR in 1995 did not contribute to the fall of agricultural prices in that year, contrary to what most analysts stressed at the time.

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The Option Value of Leasing in Amazon National Forests

The Brazilian government is now planning to implement natural forest concessions for timber extraction. In addition to the legal requirements imposed on the management of concessions (minimum reserves, maximum extraction rates, etc.), the value of concessions is closely linked with uncertainties in estimates of the volume of commercial logs within the concession area and on future timber prices. This paper proposes a method to appraise the value of forest concessions based on the real option theory (ROT). By combining the hypothesis of uncertainties in the volume of logs in a concession and future wood prices with inter-temporal maximization of profits, the method provides a more realistic estimate of the market value of concessions than does Net Present Value, which does not take these uncertainties into account. Comparison between estimates using NPV and ROT show that the latter are systematically higher. For the reference case, for example, the values using ROT are 140% higher. Since forest concessions are public resources, differences of this magnitude cannot be neglected. The paper also proposes methods to estimate the probability distribution of logging volumes in concession areas along with future prices. The volume distribution is specified in a spatial model as a function of geographic characteristics of the area as well as of the neighboring areas.

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Applying Minimum Income Programs in Brazil: Two Case Studies, Belem and Belo Horizonte

This paper examines the recent experiences of Belem and Belo Horizonte, two metropolitan areas where minimum income programs have been implemented. The goal is to verify to what extent the financial conditions in each of these municipalities are compatible with the implementation of this program, which benefits the local poor. Alternatives are considered for defining the target population in terms of income and family characteristics, as well as for establishing the value of the monthly transfer. The paper initially focuses on Brasilia's experience as the basis for adopting the same policy in Belem and Belo Horizonte. Next, it describes the characteristics of program design and operation in Belem and Belo Horizonte. Despite the fact that the two municipalities present quite different characteristics, which are quite diverse from Brasilia's, both programs essentially adopted most operational parameters from the Federal District's program. Data from the National Household Survey are used to calculate the operational limits, which the program faces in these two municipalities, given the size of the target population and the financial restrictions. Specific recommendations are presented to improve the program's efficiency in each case.

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Cultural Complex SODRE of Montevideo: The Disposition to Pay for a Good Public Compound

The paper is concerned with the results of Contingent Valuation (CV) analysis of a public project to rebuild the SODRE Theatre, a traditional lyric theatre in Montevideo, which burned in 1971. This paper presents some methodological issues concerning the valuation of a public property, with the focus on the result of the econometric analysis of the data generated by a CV survey. The CV analysis reveals that the consumers of classic music, ballet or opera represent a small percentage of citizens in Montevideo. In spite of this statistic, the econometric analysis identifies a positive willing-to-pay attitude among non-users, which is related to pride in the cultural heritage of the city and a need for the option to attend performances in the future. Montevideo's citizens support specific taxation for the reconstruction of a new theatre.

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Analysis of the Public Expenditure in the Panamanian Education System

The aim of this paper is to analyze the changes in formal education in Panama during the period 1980-1997. We study the redistributive role played by the government in education, focusing on externalities, especially in economic development and social welfare. We examine the growth of public expenditure in education. We observe increments from 3.95 per cent of GDP in 1990 to 4.91 per cent in 1998. We found a relationship between public expenditure in education and GDP. Public expenditure dependence on GDP is observed in both secondary and higher education. We conclude by introducing three econometric models: the first one explains the education in a global sense, the second one analyses secondary education, and the third one studies the higher education system. We use linear regression models, which were estimated through the ordinary least squares method (OLS).

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Measuring the Performance of Chile's Tax Administration

The purpose of this article is to develop an effectiveness indicator (El) for Chile's tax administration. We assume that the goal of the Chilean Internal Revenue Service (SII) is to maximize tax revenue while minimizing compliance costs. Sample taxpayer surveys and statistical information both show that SII service standard – a proxy for compliance costs – improved in the 1990s. Compliance rates, which are used as El by the SII itself, also improved significantly. Regression analysis, however, suggests that this improvement can largely be explained by the strong economic growth experienced during the period. We argue that an appropriate El for the goal of revenue maximization is the actual compliance rate divided by maximum achievable compliance given the values of variables that are beyond SII control.

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Does the Stopler-Samuelson Theorem Explain the Movement in Wages? The Linkage between Trade and Wages in Latin American Countries

How does trade liberalization affect the wage gap between skilled workers and unskilled workers? The Heckscher-Ohlin (HO) trade model gives a prediction about the relation between wages and prices. However, its simple Stolper-Samuelson (SS) and Specific-Factors (SF) versions make opposite predictions about the correlation between prices and wages of certain types of workers (specific factors in industries) when they are not used extensively. The analysis in this paper provides evidence that may allow one to distinguish empirically between these two versions of the HO model, using wage data from household surveys in several Latin American countries—Bolivia, Mexico, and Venezuela. Two different specifications for the specific factor are examined: educated workers and experienced workers. In summary, the results favor SS, when educated workers are defined as the specific factor for these Latin American countries from the late 1980s to the mid 1990s.

How Do Social Security and Income Affect the Living Arrangements of the Elderly? Evidence from Reforms in Mexico and Uruguay

It has been shown that the social security system and other sorts of government transfers have helped poor elderly people, such as widows, to live alone in the U.S. This paper investigates whether government financial support contributed to the increase in the probability of the vulnerable elderly living alone in Latin American countries as well. Specifically, the countries that in the 1980s experienced government reforms favorable to the vulnerable elderly, Mexico and Uruguay, are examined. It is concluded that the improvement of educational attainment was mainly responsible for helping the elderly poor to live alone in rural areas in Mexico and not the government system. On the other hand, in Uruguay, for unmarried elderly females, the increase in social security income explains most of the increase in the probability of living alone.

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Memory and Persistence of Unemployment in Uruguay

In the last few years, the economic literature has experienced an intense debate concerning the permanent or transitory nature of economic fluctuations. This work examines the persistence in Montevideo unemployment by estimating fractionally integrated ARIMA models, which constitute an approximation to Wold representation, which permits a more detailed examination of the components at low frequencies. Evidence of memory or persistence is found, though this long memory need not be associated with a unit root.

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Stability in Nominal Variables and the Business Cycle: The Case of Mexico

This article documents some of the business cycle regularities of the Mexican economy over the last sixty years and analyzes its relationship with nominal stability. The analysis is conducted from an empirical perspective with particular emphasis in the long-run performance of the economy. From the decade of the forties to the seventies, the economy experienced sustained economic growth and stability in nominal variables. However, over the last two decades, the economy experienced lower economic growth and nominal instability. This period of nominal instability coincides with important changes in the regularities of the business cycle. The evidence shows that during the nominal stability period, business cycle regularities in Mexico are similar to those of the business cycles in industrialized countries and the Mexican cycle seems to follow that in the United States. However, during the nominal instability period, there are some important differences with the business cycle regularities in industrialized countries; and the relationship with the United States cycle is difficult to identify. In addition, the evidence also shows that the business cycle regularities in Mexico are similar to those in other Latin-American countries that have experienced periods of nominal instability.

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Terms of Trade and Economic Cycles: 1950-1998

This paper studies the relationship between the terms of trade and the level of output, in order to estimate the magnitude of a terms-of-trade shock on economic growth. Given the statistical limitations of official series, alternative methodologies are used in order to build more robust series. The current terms of trade series are calculated with the Paasche index using 1990 as the base year. This series has two limitations. First, the Paasche formula uses as weights those of the current-period basket. In this way, the comparisons could reflect not only price variations but also changes in the weights, thus generating a negative bias. The second limitation is that a base year becomes inadequate as the structure of export changes. Thus, although the index could appropriately represent the evolution of the terms of trade in periods close to the base year, it is not suitable for the analysis of longer periods. Real GDP is calculated by using a Laspeyres index of fixed quantities at constant prices of the year 1979. It does not allow consideration of the effects of important changes in both the relative prices and quantities produced. Additionally, the hyperinflationary episode of the late eighties could have introduced distortions in the estimation of GDP and its nominal structure and, therefore, in its real variations. In order to analyze the relationship between the terms of trade and economic activity, different methods of cycle-tendency decomposition were applied. The rate of growth, moving-averages, the Baxter and King and the Hodrick-Prescott filters were used to quantify the short-term effect of terms-of-trade shocks on output growth.

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Core Inflation in Peru

The Consumer Price Index (IPC), which is customarily used to measure inflation, includes permanent and transitory components. In a context in which the Central Bank's unique objective is price stability, an indicator that only considers the permanent component is required. This paper discusses a broad concept of core inflation that considers its permanent or long-run component, which is associated with the fundamental economic variables. The index of core inflation for Peru is calculated by using several statistics and econometric methods. By focusing on the characteristics a good indicator should have, the best measurement of the core inflation for Peru is then selected.

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Business Cycles, Policies and Fiscal Rules

This paper shows that Peru's fiscal policy has been procyclical and volatile, magnifying business cycle fluctuations and increasing macroeconomic uncertainty. In order to reinforce fiscal discipline, the paper proposes the adoption of fiscal rules, in particular the cyclically neutral budget rule. Additionally, the introduction of multi-annual expenditure schedules and the creation of reserve funds are recommended.

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The Impact of the Euro on Latin America

The introduction of the euro will affect foreign exchange and financial markets and economic activities around the world. Most analysts have focused on the impact on participating countries and their neighbors. What risks and opportunities does the euro represent for Latin America and the Caribbean? On January 1, 1999, a new era of European economic and monetary union (EMU) began when 11 of the 15 member countries of the European Union (EU) replaced their national currencies with a single currency, the euro. Will the introduction of the euro have real economic effects, or will it be primarily an accounting phenomenon? As far as the countries of Latin America and the Caribbean are concerned, the euro will probably affect their trade with Europe only slightly but have a somewhat greater impact on their financial markets and debt-management policies over the short and medium terms.

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Development in the New World Economy

This paper examines globalization as the paradigm that will serve as the means of economic growth for all economies. The work emphasizes that for economic policies to be successful, they must adequately address welfare concerns by reaching out to all social groups. Also, structural reform is much more than an economic policy or an economic strategy. The reforms must be all-inclusive ultimately making all individuals market participants.

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Private Sector Participation: A Theoretical Justification of the Brazilian Position

The Brazilian position on the issue of private sector participation in the efforts to forestall and resolve emerging markets crises is that there should be an approach of contacting and convincing a large number, but not the totality, of private creditors. They should be convinced that the international public sector loans will allow a transition to stability that is over-financed in case they voluntarily join in by maintaining their exposure to the country, at the spreads they choose, and with the counterparts they wish to have as clients. We model private sector participation by means of a game. We show that the traditional argument that there is a coordination problem among the private creditors does not exist in a model without Knightian uncertainty, because there is a unique Pareto dominant Nash equilibrium that involves participation. By introducing Knightian uncertainty aversion, is high enough, then there is a unique Nash equilibrium under uncertainty, which involves nonparticipation. Finally, we show that if there is a large enough number of private creditors who decrease their uncertainty aversion, then again private participation becomes the unique Pareto dominant Nash equilibrium under Knightian uncertainty. If we interpret the approach of contacting and convincing the private creditors as decreasing their uncertainty aversion, then this last result is a justification of the Brazilian position. In fact the private creditors would voluntarily choose to maintain their exposures, because private sector participation is the unique Pareto dominant Nash equilibrium under uncertainty of the game.

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