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Editors' Summary

It has long been understood that economic growth and development are not achieved by brute-force factor accumulation alone. The pursuit of a development path that combines both greater efficiency and social fairness has been high on the agenda for many governments in Latin America during the last decade (if not longer). A preoccupation with equity and efficiency, and the best ways to combine them, also permeates the five papers in this Spring issue of *Economía*.

A possible trade-off between greater efficiency and equal opportunity is central to the debate on school vouchers, for instance. Whereas economists since Milton Friedman have argued that school choice would align provider incentives with the interests of consumers and thus lead to increases in educational quality, a more recent literature points to the possibility that school choice might exacerbate stratification by socioeconomic status across schools. In "School Choice, Stratification, and Information on School Performance: Lessons from Chile," Patrick J. McEwan, Miguel Urquiola, and Emiliana Vegas contribute to this literature in two ways. First, using highly disaggregated, district-level data for Chile and a regression-discontinuity design, they find evidence that the entry of private schools into the education market is not associated with significant increases in test scores but is associated with increases in social stratification. This conclusion is consistent with previous results from the literature, suggesting that greater school choice leads to increased sorting, with no commensurate improvements in average achievement.

Second, McEwan, Urquiola, and Vegas consider the implications of sampling variance (and even of "population variance" over time) for policy schemes that reward or punish schools on the basis of changes in average test scores. Policymakers have focused on these so-called value added (that is, first-differenced) measures of test scores, since test score levels are highly correlated with family socioeconomic status, as a result of the stratification previously discussed. Changes in scores also reflect sampling variation, however,

including variation among the specific groups of students starting school in any given year, as well as genuine changes in the quality of the services provided by the schools. Although this issue is unlikely to be a serious problem for large municipalities, it can generate substantial rerankings for individual schools and even for smaller districts, as the authors confirm through a number of statistical tests. These findings suggest that the Chilean debates on school choice, on the ideal design for voucher schemes, and on the precise manner in which data on student achievement can be used to reward or punish schools have contributed to advances in the educational agenda in Latin America but have not yet reached a final conclusion.

The concern with combining equity and efficiency also underlies the "conditional cash transfer revolution" that has transformed social policy in Latin America over the last ten years. The first of these programs began somewhat timidly in Brazil and Mexico in the mid-1990s, yet by 2007 some 80 million individuals across the continent had received government assistance through some form of conditional cash transfer. In "Cash Transfers, Conditions, and School Enrollment in Ecuador," Norbert Schady and Maria Caridad Araujo evaluate the impacts of Ecuador's cash transfer program, known as the *Bono de Desarrollo Humano* (BDH), on school enrollment. A novel aspect of the paper is that it uses differences between the initial program design and the subsequent implementation to assess the relative importance of the conditions (as opposed to the cash itself) in explaining the effects of the program. Given the costs of monitoring and enforcing conditions, this assessment is of considerable policy interest.

Schady and Araujo exploit several idiosyncrasies in the program's design and implementation. First, assignment into treatment and control groups was random in the initial phase of the project. In practice, however, actual treatment did not perfectly coincide with the random assignment. Second, data were collected both before and after the program was implemented, from both treatment and control groups. Third, the program was designed and announced as a conditional transfer program, in which households would receive the transfer conditional on children's school enrollment and attendance, but the condition was not actually enforced in practice, due to administrative constraints.

To overcome the problems associated with selection into the program, Schady and Araujo present before-and-after comparisons and use random assignment as a plausible instrument for program participation. Their results indicate that the program was associated with a large increase in school enrollment. The effect was especially high compared with effects in similar studies

in other Latin American countries. Most of the effect seems to be concentrated in transition grades (five or eight years of schooling), when dropout rates are especially high.

The authors then assess the role of the condition in explaining program effects by comparing households that indicated at follow-up that they believed that sending children to school was a requirement of the program (the conditioned households) with households that reported they did not have this perception (the unconditioned households). Although exposure to information about the program cannot be assumed to have been randomly assigned, the results seem to be robust to a variety of specifications, including a comprehensive set of controls, data trimming, and zeroing out of fixed differences between the two groups. The results indicate that most of the program effects seem to be driven by households that believed that there was a school enrollment condition attached to program participation. Interestingly, these reduced-form results are not inconsistent with predictions deriving from structural models of household decisionmaking in the presence of conditioned cash transfers.

There are few better examples of economic behavior that are both inefficient and unfair than discrimination in the labor market, defined as differential hiring or remuneration of workers with identical productivity, on the basis of characteristics such as race or gender. In "The Mystery of Discrimination in Latin America," Alberto Chong and Hugo Ñopo provide a rich overview of the evidence on the prevalence of this behavior in Latin American labor markets. The main theme is that the evidence from different sources paints a number of different pictures. In opinion surveys like Latinobarómetro, Latin Americans overwhelmingly report that discrimination is rampant in their countries. However, delving a little deeper reveals that interviewees and researchers appear to have different interpretations of the term *discrimination*. Interviewees often identify groups such as the poor or the uneducated as the main victims of discrimination.

The authors then turn to the econometric evidence on wage gaps from labor force and household surveys, using a propensity-score matching variant of the Oaxaca-Blinder wage gap decompositions (by ethnicity and gender). An interesting feature of these decompositions is that in addition to the returns and characteristics components, the matching approach yields a term that measures the extent to which the supports of the two groups (on their observed characteristics) overlap. Although this analysis confirms the presence of large wage gaps that cannot be accounted for by acquired human capital characteristics, the

authors are careful not to interpret those gaps as providing categorical evidence of discrimination, since many relevant worker characteristics (which may be correlated with race or gender) are not observable through household surveys.

The paper reports on a third (altogether different) type of evidence bearing on discrimination, which arises from experimental attempts to "observe the unobservables." These attempts include randomized field trials in which identical résumés with different genders or class-revealing surnames were sent to prospective employers in Santiago; an experimental study monitoring the Peruvian government's job intermediation service in Lima; and games designed to study stereotypes, played in both Argentina and Peru. Surprisingly, these less conventional approaches suggest a much smaller role for discrimination than is evidenced in the opinion surveys and econometric analyses. Economic agents in Latin America thus seem to act according to economic or monetary incentives rather than on the basis of a propensity to discriminate purely on the basis of preferences. There is some evidence that the population shares beliefs about the potential performance of certain groups, but information and economic incentives trump the propensity to discriminate on the basis of those beliefs. The end result is an unresolved puzzle, in which opinion surveys imply that Latin Americans discriminate often, standard wage-gap decompositions suggest large unexplained wage gaps, and experimental studies point to the possibility that most of those stem from differences in unobserved characteristics. The authors do not claim to have solved the puzzle. By merely laying it out, however, they have contributed to much-needed further research on the true nature of discrimination in Latin America.

Increased efficiency and incentives for productivity growth are often argued to follow from greater trade openness and access to export markets. In the last two decades, however, Latin America has faced increasingly tough competition from other low-cost producers in the developing world, especially China. In "How Sensitive Are Latin American Exports to Chinese Competition in the U.S. Market?" Ernesto López-Córdova, Alejandro Micco, and Danielken Molina use U.S. import data (at the six-digit level) to investigate just how serious that competition has been in trade with the region's main single trading partner. The paper begins by estimating the elasticity of substitution of U.S. imports using detailed trade data over the 1990–2003 period and a two-stage least squares framework. The elasticity estimates for aggregate imports are in line with those of other recent studies. The authors also provide elasticity estimates at the sectoral level, which they use to assess the extent to which Latin American and Chinese goods compete in the U.S. market and to provide forecasts of how alternative policy scenarios could affect Latin American exports to the United States.

López-Córdova, Micco, and Molina simulate three main counterfactual scenarios: a currency revaluation in China, the elimination of U.S. tariffs on Latin American exports under a hemispheric free trade agreement, and the elimination of quotas on apparel and textile exports under the Multi-Fiber Agreement (MFA). They find that a 20 percent appreciation of the renminbi would reduce Chinese exports to the United States by a fifth. Aggregate U.S. imports would decline by 1.7 percent in response to that terms-of-trade shock, and all other regions would have some gain in export share, with Latin America gaining about 0.5 percentage point. Hemispheric free trade would increase Latin America's exports to the United States by around 3 percent. The removal of MFA quotas would lead to a sharp increase in Chinese sales to the United States (40 percent), while Latin America would see its share of the U.S. market decline by around 2 percent (2.5 percentage points). China's gains would come mainly at the expense of other regions.

Privatization has also been promoted as a reform that could engender greater efficiency across many parts of Latin America. The experience of the last decade, however, indicates that the effects of privatization can differ measurably, depending in large part on the quality of the regulatory environment within which the privatized companies operate. This is particularly important in sectors such as electricity, where prices have knock-on effects throughout the economy as well as direct effects on consumer welfare. In the final paper in this issue, "Cost Reductions, Cost Padding, and Stock Market Prices: The Chilean Experience with Price-Cap Regulation," Rafael Di Tella and Alexander Dyck provide an ingenious empirical test for the possibility that firms manipulate their costs to game price regulators. This has long been a concern in the theoretical literature on regulation and on price-cap regulation of monopolies, in particular. The paper reviews the experience of Chile's electricity system, where a price-cap system was introduced in the 1980s. While this form of regulation has become popular as a way of putting price pressure on firms, it may be subject to manipulation through the declaration of higher costs during the review period. This is precisely what Di Tella and Dyck find. Cost reduction appears to be U-shaped, with strong initial cost reduction every four years, coinciding with regulatory reviews. A possible explanation is that firms strategically declare (or actually incur) high costs until the regulator fixes the price, and they only then implement any feasible cost reductions.

To test this interpretation, the authors use stock market data to construct a measure of cumulative abnormal returns for regulated firms around their quarterly announcements, together with a measure of naïve cost expectations that excludes any indication of the occurrence of review periods. In general, cost

reports in excess of naïve cost expectations have a negative effect on returns. The exception is cost surprises that occur during review periods, which increase abnormal returns. This is consistent with the hypothesis that strategic firms are successfully gaming the regulators. More generally, the results suggest that stock market information may be useful for complementing current regulatory procedures.

Some final acknowledgements are in order. This sixteenth issue of *Economía* contains two papers that were presented at the panel meeting held May 11–12, 2007, at Yale University's Macmillan Center in New Haven, Connecticut. It also contains three papers discussed at the panel meeting held at Universidad de los Andes in Bogotá, Colombia, on October 3, 2007. As always, thanks are due to all those involved in ensuring the success of those meetings, especially the associate editors of *Economía*, the members of the panel, and the managing editor, Catherine Mathieu-Canuto. The issue benefited enormously from their hard work.