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Editors' Summary

Economía always seeks to publish articles that apply rigorous thinking and credible empirical methods to the analysis of issues that are directly relevant to policy in Latin America today. This is particularly clear in this thirteenth issue of the journal. The five papers belong to different fields within economics, but their common thread is a direct bearing on pressing public policy issues in the region. One paper sheds new light on the mechanisms through which trade liberalization affects wage premiums. Two analyze the consequences of reform in the provision of social services: changes in the funding of health care in Colombia in one case, and the expansion of Oportunidades to urban Mexico in the other. The last two papers investigate the consequences of Latin America's reliance on foreign savings for the continent's borrowing costs, and for the conduct of fiscal policy.

An influential theoretical perspective on why trade liberalization often (but not always) is found to contribute to increases in wage premiums in Latin America is that it helps spur skill-biased technological change that raises firms' demand for skilled labor. One mechanism for the diffusion of new technologies that may be complementary to skilled labor is the reduction in tariffs on technologically intensive inputs, like computers and machinery. It is generally difficult, however, to empirically disentangle this effect from a variety of confounding factors, such as changes in the skill composition of labor supply or changes in output tariffs.

In the first paper in this issue, Bruno Giovanetti and Naércio Menezes-Filho do just that. Working with three skill groups of workers (unskilled, semiskilled, and skilled), they first document some basic stylized facts for Brazil's labor market in 1980–98: the supply of semiskilled labor increased faster than that of the other two categories; wage differentials rose between skilled and semiskilled workers, but fell between semiskilled and unskilled workers. Since the behavior of the wage gaps is consistent with the changes

in labor supply, the authors ask whether labor demand played any role in the observed changes in the wage distribution.

The authors combine a matched employer-employee data set for the formal sector with firm-level output and industry-level tariff data to ask whether trade liberalization contributed to increases in the demand for skilled labor, via skill-biased technological transfer. The results do provide some support for the theory: skilled workers and capital appear to be complements in Brazilian manufacturing, and input tariffs are negatively correlated with the share of skilled workers in employment, even when the authors control for output tariffs. The same result is not robustly obtained for semiskilled workers. This indicates that greater openness in Brazil—and perhaps in other Latin American countries—did contribute to an increase in the demand for skilled workers, and thus to higher wage premiums, by reducing the cost of inputs that embody new, skill-intensive technology.

This effect takes place primarily within firms. The between-firm component of the change in the share of skilled workers is negative, as firms that use skilled labor most intensively decrease their participation in total employment. This is consistent with the Stolper-Samuelson theorem: as protection for skill-intensive goods falls, production and employment retrench in that sector. All of the pieces of the puzzle appear to fit together. The paper presents evidence that trade liberalization contributes to higher wage-premiums through skill-biased technological transfer, but this effect is offset through the Stolper-Samuelson mechanism. Although Giovanetti and Menezes-Filho do not discuss the net effect for wage inequality, other work suggests that the latter effect dominates in Brazil.

In a context of technological and policy changes such as these, human capital investment and social protection policies become increasingly urgent. Improving services for the poor, in particular, has long been an important challenge for Latin American governments. Many economists argue that demand-side incentives may help further this goal, since service providers are then faced with similar incentives to those that would prevail in a competitive market. Alejandro Gaviria, Carlos Medina, and Carolina Mejía provide a cautionary note on this expectation. Their paper evaluates the health reform that took place in Colombia in the 1990s and concludes that the transition from supply- to demand-based funding posed political challenges that the designers of the reform overlooked. This explains why the introduction of voucher financing was not accompanied by the expected reduction in supply-side funding, resulting in a doubling of government expenditure on health. More generally, the paper provides a rich and nuanced descrip-

tion of how this reform worked in practice, with interesting lessons beyond the supply- versus demand-side subsidies debate.

The third paper in this issue offers another cautionary note on demand-side social policy. Samuel Freije, Rosangela Bando, and Fernanda Arce investigate the likely effects of various changes in the design of Mexico's flagship social program, Oportunidades (previously known as Progresa). While acknowledging that the program's main objective is to reduce future poverty by enhancing investment in the human capital of the poor, the authors focus on the program's impacts on current poverty through the direct effect of its cash transfers.

The questions of interest, which were initially raised by the policymakers in charge of the program, concern various hypothetical changes in benefit levels and beneficiary coverage, so ex post impact evaluations cannot provide all the answers. The authors therefore use a counterfactual microsimulation of the program, relying on a simple model of labor supply for both children and adults, to estimate the changes in household income that would arise in both rural and urban areas of Mexico under three counterfactual scenarios. (Interestingly, they find that the effects of the transfer on labor supply are small, so a simple accounting simulation generates a good approximation of the results of the behavioral model.) The analysis of the first scenario, which involves the abolition of the program, reveals that Oportunidades accounts for almost a third of the 17 percent poverty reduction observed in rural Mexico between 1998 and 2002. The program's estimated contribution to poverty reduction in urban areas is much smaller, however, reflecting either the incipient nature of the urban expansion of the program or targeting problems in urban areas (or both). Whereas beneficiary selection in rural areas was based first on geographical targeting and then on welfare scores constructed for a household census in the treatment villages, the urban program only screened among applicants.

The remaining two scenarios suggest that the targeting of the urban component of Oportunidades may be faulty. Doubling program transfers (and keeping the identity and number of beneficiaries unchanged) in both areas would further reduce poverty by seven percentage points in rural areas, but have almost no effect in urban areas. Doubling the number of beneficiaries in urban areas on the basis of the current (estimated) targeting criteria would not make much of a dent in poverty, either. In addition to detecting a potentially important shortcoming in the design of the urban expansion of one of Latin America's best known social programs, Freije, Bando, and Arce illustrate how ex ante policy assessments based on simulation exercises using household survey

data sets can be validated against ex post evaluation results, thereby providing useful tools for policymakers considering program reforms.

On the macroeconomic front, policymakers, practitioners, and academics have long noticed that Latin American sovereign debt yields comove tremendously with high-yield bonds in the United States. This comovement could reflect a correlation of default risks, because the same liquidity shocks affect both markets, or it could stem from the fact that both markets are subject to changes in the degree of risk aversion on the part of market participants (that is, investors' risk appetite). The fourth paper, by Alicia García Herrero and Alvaro Ortiz, evaluates the contribution of these factors to the observed degree of comovement.

The authors' main empirical challenge is measuring and disentangling global versus idiosyncratic default. Since it is impossible to separate liquidity and risk appetite, the paper considers them together. The identification strategy is to assume that country fundamentals explain default risks and that the residuals are independent across countries. A factor decomposition is feasible under these assumptions. García Herrero and Ortiz estimate the common component (or global factor) across all Latin American yields and then evaluate how the global factor is affected by the risk-free rate and economic growth in the United States. They find that a sizeable share of the comovement is explained by the global factor (roughly a quarter of the variance two to three years ahead), estimated either as the corporate rate in the United States or using alternative measures.

From the policy perspective, the fact that Latin American sovereign yields are so dependent on foreign risk preferences implies that the current calm and stability might be shaken up in the future—not because fundamentals deteriorate, but because investor conditions change. The authors conclude that further research on policies that help isolate the country's yields from global factors would be an important step toward macroeconomic stability in the region.

The strong dependence of Latin American debt yields on conditions abroad is also a central issue in our final paper, which asks whether debt sustainability concerns might account, at least in part, for the procyclicality of fiscal policy in the region. Neoclassical theory holds that it is optimal to implement a countercyclical fiscal policy if taxes are distortionary or if government expenditures substitute for private consumption. This common view is reflected in the usual prescription that fiscal policy should stabilize and smooth short-run fluctuations. The theoretical recommendation, however, contrasts dramatically with what we observe in reality.

The empirical evidence repeatedly shows that fiscal policy is procyclical, especially in emerging markets. The literature explores several reasons for this. First, there may be reverse causality in those correlations, in the sense that fiscal policy innovations are driving the cycle, as opposed to fluctuations in output affecting the automatic response of the fiscal authority. In other words, the theoretical prediction is about how taxes and expenditures should react to output fluctuations, not how taxes and expenditures affect activity.

The second most important reason behind the procyclicality of fiscal policy is how the degree of financial access changes through the cycle. For instance, if countries face stringent financial conditions during recessions, they may not be able to implement the desired procyclicality. In this paper, Alberola and Montero study two questions: how procyclical is fiscal policy in the region, and how important are credit market conditions? To answer the first question, and to deal with the low quality of the data in Latin America, they use new filtering techniques to improve the estimates of the output gap. They find that fiscal policy is indeed procyclical when the output gap is properly measured. The second step is to study how the procyclicality is affected by credit worthiness (or the credit perception of the country). The idea is that countries that are more financially vulnerable will be less able to implement a countercyclical policy during recessions. They proxy creditworthiness with a measure of debt vulnerability. They find strong evidence that credit constraints play a significant role in the absence of countercyclical fiscal policy.

Two of the papers included in this issue were presented at the panel meeting in Paris, France, in October 2005; the other three were discussed at the panel meeting held in Cartagena de Indias, Colombia, in May 2006. As usual, associate editors of Economía, members of the 2006 panel, outside discussants, and referees have all done a superb job. Thanks are due to them all.