ANDRÉS VELASCO

Editor's Summary

This third issue of *Economía* contains papers presented at the Panel Meeting held on 21 April 2001 in Cambridge, Massachusetts. The Center for International Development and the David Rockefeller Center for Latin American Studies at Harvard cosponsored the meeting, and they will do so again in the spring of 2002. We are grateful to them for generous financial and logistical support.

Latin America has long been a region of great income disparities. Not all kinds of inequality are created equal, however. An unequal country in which the same people (or their children and grandchildren) are always at the highest income levels is very different from one in which mobility allows the talented and skilled to rise to the top. Which kind of inequality is Latin America's? Jere Behrman, Alejandro Gaviria, and Miguel Székely, tackle this extremely important but understudied question, which has deep implications for the way we think about development in the region. Measures of mobility may well say more about fairness and equal opportunity than do standard estimates of income disparity.

Using a hundred household surveys spanning two decades and twenty countries, they reach somewhat dispiriting conclusions. Unsurprisingly, intergenerational mobility is much higher in the United States than in Latin America. In Mexico, for instance, the probability of having a white-collar job is 3.5 times higher if one's father also had such a job; the corresponding figure for the United States is 1.5 times. There are also sizable differences in mobility across countries in the region, with Brazil and some Central American countries among those showing the least mobility.

Not all the news is bad. First, mobility (measured as the inverse of the correlation coefficient of siblings' educational attainment) need not be constant over time. It increased substantially in Latin America from the mid-1980s to the mid 1990s, but it has recently declined. Second, mobility is not God given: greater expenditures in education are associated with

substantially lower values of the correlation index, which suggests that public policies can increase intergenerational mobility.

A prominent public policy targeted at a related goal—reducing the transmission of poverty between parents and children—is embodied in Mexico's Education, Health and Nutrition Program, known by its Spanish acronym, PROGRESA. The program makes cash transfers, which are paid directly to mothers, that are contingent on regular family clinic attendance and children's school attendance. PROGRESA is being closely studied because it is both highly targeted and large (it now covers 2.6 million families in extreme poverty). Some analysts have hailed it as a model for antipoverty programs in developing countries.

Emmanuel Skoufias and Susan Parker analyze one concrete aspect of the program's impact: does it reduce child labor and increase school attendance? If so, among whom and by how much? PROGRESA was designed in a quasi-experimental fashion, involving communities that receive benefits earlier (and thus serve as treatment groups) and others that join the program later (the control group). Inferences can therefore be made with greater confidence than is typically the case in program evaluation exercises.

Empirical studies from other countries suggest that unconditional cash transfers have a marginal effect at best on school enrollment or child labor. The contingency element of PROGRESA seems to be important, since it introduces income effects (after the transfer the household is richer) and substitution effects (the relative price of schooling falls) that point in the same direction and can reinforce each other, causing an increase in the accumulation of human capital. The empirical results are encouraging: the program has been associated with significant increases in school attendance for boys and girls and reduced market work. Since the fall in the incidence of work is smaller than the increase in schooling, the adjustment seems to be coming mostly through leisure time, as well as through domestic work primarily in the case of girls.

The authors themselves stress that this apparent success of the program raises a number of questions. What about the work incentives of adults, which could decline as a result of the cash transfers? Does the increase in schooling, matched by reduced leisure and housework, unambiguously leave poor rural families better off? Are conditional cash transfers the most cost-effective way of encouraging higher school attendance? Other studies are beginning to give encouraging answers to some of these

questions. Neither incentives for adults nor cost effectiveness seem to be big problems. Nevertheless, as argued forcefully by Carola Pessino in her comments, other issues have to be addressed before we take PROGRESA as the model for programs elsewhere in the region.

It is by now commonly held that reforming the state is necessary for Latin America to achieve fast and sustained development. What that means in practice, however, is not always clear. Reducing corruption and increasing bureaucratic efficiency are obvious goals. Whether this can be achieved by adjusting public sector pay scales is the question that Ugo Panizza tackles in this volume.

Using data from seventeen Latin American countries, he concludes that on average, Latin American countries display a public sector premium; on average, the public sector premium tends to be higher for women than for men; and on average, the public sector premium is higher for workers with low education. In fact, workers with high education may suffer a public sector penalty. This more or less conforms with conventional wisdom: in a typical Latin American ministry, a departing minister is happy to take a private sector job, whereas a laid off doorman is not, even if he can find one.

Panizza then turns to the link between this wage structure and government performance. He finds that Latin America seems to be demonstrate no significant correlation between bureaucratic quality (measured by an index from the International Country Risk Guide) and the public-private wage differential, and only a weak relationship between this second variable and an index of corruption. These results suggest that paying public employees more is not the way to get them to perform better, in contrast to the findings of earlier studies. The author goes on to argue that increasing the element of meritocracy in public sector hiring does lead to better performance. This implies that low wage dispersion in the public sector may be a cause of inefficiency.

When trying to link wages and performance, it may matter whose wages are being considered. The paper at hand deals with the whole public sector. Earlier studies have focused on the earnings of top officials.[1] In neither case does the ratio of public to private compensation seem to affect performance. Another key issue is cost effectiveness: even if raising pub-

1. James Rauch and Peter Evans, 2000, "Bureaucratic Structure and Bureaucratic Performance in Less Developed Countries," *Journal of Public Economics* 75(1): 49–72.

lic wages across the board deters corruption, is that the best way to achieve that goal? Van Rijckeghem and Weder argue it is not. According to their estimates, the quasi-eradication of corruption would require average public sector wages to be two to eight times greater than average manufacturing wages.[2] Panizza reaches the same conclusion, arguing that increasing meritocracy is likely to be more efficient.

The last two papers in the volume deal with macroeconomic and finance issues. Most observers would agree that Mercosur, the customs union that joins Argentina, Brazil, Paraguay, and Uruguay, has been a trade success. From 1990 to 1997, intra-Mercosur trade barriers fell precipitously, and trade rose from U.S.$8 billion to U.S.$82 billion. As a result, intrablock trade grew from 11 percent to 22 percent of total trade for the four countries. Yet Mercosur is in political trouble. Macroeconomic disturbances, particularly abrupt changes in bilateral exchange rates, have created great strains within the customs union, causing a partial retreat from the earlier liberalizing moves.

Afonso Bevilaqua, Marcelo Catena, and Ernesto Talvi ask why this is so. The easy answer is that Brazil has a flexible exchange rate and Argentina a currency board, such that a nominal depreciation in Brazil (which happened in early 1999 and again recently) causes a sharp shift in relative prices, a contraction of demand for Argentine goods, and a slump in that country. The authors argue that this can only be part of the story. If Argentina exports oil to Brazil, Argentine producers can easily relocate that production elsewhere, with little effect on total exports. That is, in fact, what happened in the aftermath of the 1999 Brazilian devaluation. However, if Argentine exports to its northern neighbor are mostly cars, produced under a Mercosur special regime, selling those cars elsewhere is virtually impossible. Again, that was the outcome in 1999 and 2000, causing a major recession for the Argentine auto industry.

Bevilaqua, Catena, and Talvi conclude that macroeconomic vulnerability within Mercosur therefore depends not on the extent of total intrablock trade, but on the size of trade in products that are tradable within Mercosur but nontradable elsewhere. They find that in 1996 such regional

2. Caroline Van Rijckeghem and Beatrice Weder, 1997, "Corruption and the Rate of Temptation: Do Low Wages in the Civil Service Cause Corruption?" Working Paper 97/73, Washington: International Monetary Fund (IMF).

goods accounted for at least 9.5 percent of Argentine total exports. For Paraguay and Uruguay, the figures are 33.1 and 37.8 percent. Little surprise, then, that macroeconomic disturbances in the largest country—Brazil—have large repercussions elsewhere. The authors construct and calibrate a small macroeconomic model to obtain a benchmark for the size of such effects. They calculate, for instance, that a three-year, 20 percent decrease in the price of a regional good causes the trade balance of the small economy that exports this good to deteriorate by 2.8 percent of GDP. When they add supply-side effects to their benchmark calibration, they find that output in the regional goods sector declines 13.2 percent, and employment in that sector falls by 30 percent.

As Jaume Ventura argues in his comment, the welfare and policy implications of this analysis are not self-evident. If one assumes, as do the authors, that markets are complete—and in particular, that producers in the home country can ensure against volatility in the relative price of regional goods—then joining Mercosur cannot be welfare decreasing. But that is clearly a polar case. In the realistic case in which financial markets are not perfect, the costs associated with volatility could conceivably offset the gains that result from being able to trade regional goods with the other members of the block. Bevilaqua, Catena, and Talvi stop short of a full welfare analysis, but they argue informally that an arrangement such as Mercosur, with a large and unstable member, can significantly increase macroeconomic volatility for the other countries, and that volatility is likely to be costly. How to avoid this problem? The problem will diminish if the common external tariff falls over time, but this could take decades. Harmonization of macroeconomic policies in general, and of exchange rate regimes in particular, is another conceivable solution. Given the recent financial crises in Brazil and now in Argentina, however, that doesn't seem likely to happen any time soon.

Macroeconomic vulnerability is supposed to decline if a country's financial integration to the world increases. Following this logic, most Latin American countries have deregulated their capital accounts and created mechanisms for local firms to borrow and issue equity abroad. American depositary receipts (ADRs), through which local companies can raise equity capital in the United States, has been one of the most popular channels. Their proponents have argued that ADRs could also have beneficial side effects: by increasing competitive pressure on local exchanges and

regulators, they could raise standards and improve domestic rules and their enforcement, thereby making the local market more transparent, liquid, and efficient. The paper by Alberto Moel asks whether this has been so.

The answer is mostly negative. The paper finds that ADRs appear to be associated with increasing disclosure and improving accounting standards (something Moel terms openness), but they negatively affect liquidity and the listing of new companies. Such results seem to confirm the complaints by the managers of local exchanges, who fear that the migration of trading in many stocks to New York will eventually put them out of business. The paper also finds that the effect of ADR issuance on local market activity is different depending on the region concerned, with the detrimental effect being largest in Africa and Latin America.

The paper is largely empirical, and it does not venture an explanation of why this is so. The policy implications are also unclear. To the extent that local financial activity creates employment, local politicians will naturally fret if local markets shrink. Even in most large Latin American countries, the number of shares actively traded remains small. But what are the overall welfare costs of centralizing trading in a faraway place like London or New York? Does that make it more difficult for smaller local firms to raise capital? Are there informational advantages that make it optimal for some shares to be traded at home? Is there room for a two-tier market? These are all important questions for academics and policymakers alike.

In keeping with the spirit of *Economía*, the papers in this volume range far and wide across topics and subdisciplines. What they have in common is that they all contribute to throwing light on important policy issues currently under debated in Latin America.