RAQUEL BERNAL
UGO PANIZZA
ROBERTO RIGOBÓN
RODRIGO SOARES

Editors' Summary

This issue of *Economía* consists of a keynote speech and three papers. The keynote speech, which focuses on the art of modern central banking, was delivered by José De Gregorio at the 2011 LACEA-LAMES Conference hosted by the Universidad Adolfo Ibáñez in Santiago, Chile. The first paper studies the Mexican banking system over the period 1997–2007, with a special focus on the effects of foreign bank entry; the second paper provides new evidence on the political business cycle in the Organization for Economic Cooperation and Development (OECD) and Latin American countries; and the third paper analyzes whether the expansion of the Panama Canal will affect the country's poverty and inequality levels.

There are many reasons why the annual LACEA conference is one of the most exciting events on an economist's calendar. One of the key factors is that while the conference organizers are resolute about maintaining the highest academic standards, the papers presented at the conference are never pure ivory-tower pieces. They are always rooted in real-world problems, with a strong policy focus. Publishing rigorous but policy-relevant papers is, of course, also the mission of *Economía*.

Economists like José De Gregorio are central to the success of LACEA and *Economía* in promoting a rigorous policy-oriented discussion on the main issues that concern the region and the world's economy. José has a sterling academic background and publication record, but he was never an ivory-tower economist and has never been afraid to get involved in policymaking. After serving his country as the Minister of Economy, Mining, and Energy, José joined the Board of the Central Bank of Chile in 2001, was nominated vice governor in 2003, and became the Bank's Governor in 2007, a position that he held until the end of 2011. José has always been close to LACEA and *Economía*. He was the main organizer of the Fourth Annual LACEA Conference, which took place in Santiago in October 1999; he has published two papers in past issues of *Economía*; and he is now part of the Association's executive committee. As editors, we are

therefore excited to publish José's keynote speech summarizing what he learned while leading one of the region's most successful central banks.

De Gregorio's speech starts with a flash review of the history of inflation targeting, with a special emphasis on its practical applications in emerging market countries. It then discusses the role of central banks during financial crises and makes the point that while many central banks in advanced economies did not pay enough attention to financial stability, emerging market countries have always placed guaranteeing financial stability at the core of their central banks' mandate. This focus on financial stability has contributed to the resilience of many emerging market countries during the crisis. In discussing the links between monetary policy and financial stability, de Gregorio dismisses the idea that the crisis was caused by lax monetary policy in the United States. However, while he emphasizes that asset bubbles do not necessarily lead to financial crises, he also recognizes that the so-called Greenspan put may have led to excessive risk taking and thus contributed to the crisis. Among the instruments for guaranteeing financial stability, de Gregorio spotlights the importance of macroprudential regulation, procyclical capital buffers (dynamic provisioning), and the need to monitor currency mismatches and the use of derivative products. With regard to the interactions between monetary policy and financial stability, he starts from the Tinbergen principle requiring as many instruments as policy targets. He then argues that in a perfect world, the interest rate should be used to manage monetary policy and to achieve the inflation target, while macroprudential tools should be used to guarantee financial stability. However, we do not live in a perfect world, and there are important interactions among different policy instruments. According to de Gregorio, one of the main challenges of modern central banking is to coordinate these instruments and to ensure that rather than negating each other's actions, each policy instrument reinforces the effects of the others. To this purpose, de Gregorio concludes his speech by asking for more research on the complex interactions among different monetary and regulatory policy instruments.

In "Foreign Entry and the Mexican Banking System, 1997–2007," Stephen Haber and Aldo Musacchio study the impact of foreign bank entry on the pricing and availability of credit in Mexico. They start with the observation that in 1997, Mexico changed the laws governing the foreign ownership of banks, which led to a fivefold increase in foreign ownership (from 16 percent in 1997 to 76 percent in 2002). This provides a natural

experiment that can be used to assess the effect of foreign bank entry on domestic credit conditions. Based on a panel of bank-level data, the authors find evidence that foreign bank entry decreases the availability of credit, and they speculate that the inverse relationship between foreign ownership and the extension of credit might be a product of Mexico's weak property rights. Haber and Musacchio also find that a switch from domestic to foreign ownership is associated with a reduction of nonperforming loans and an increase in interest rate spreads, but that foreign greenfield banks are not distinguishable from domestic banks. They argue that these results are probably driven by the fact that foreign investors bought domestic banks that had been making loans with low interest rates to parties that had a low probability of repayment.

In her discussion, Liliana Rojas-Suarez makes the point that papers like that of Haber and Musacchio are essential for answering important policy questions on the regulation of foreign banks. In particular, she cites Guillermo Ortiz, former Governor of the Central Bank of Mexico, who argues that foreign banks do not extend enough credit in Mexico because they are overcapitalized and pay high dividends. On the basis of these observations, Ortiz calls for tighter controls on the operations of foreign banks. While Rojas-Suarez agrees that Haber and Musacchio's results are in line with Ortiz's views, she does not fully agree with his policy proposals and asks, among other things, for tighter cooperation in bank supervision between home and host countries. Rojas-Suarez also suggests that some of Haber and Musacchio's results could be explained by changes in Mexico's supervisory regime in 2003–07. This is an interesting idea that deserves more research.

The expansion of the Panama Canal is a massive investment project, estimated to cost nearly 30 percent of Panama's gross domestic product (GDP) over a seven-year period from 2007 to 2014. In "Distributional Effects of the Panama Canal Expansion," Maurizio Bussolo, Rafael E. de Hoyos, and Denis Medvedev evaluate the potential distributional effects of the expansion of the Panama Canal by linking a dynamic computational general equilibrium (CGE) model of Panama with a microsimulation framework based on a recent Panamanian household survey. While the approach used in the paper is not well suited for estimating the growth effects of the expansion of the canal, it can keep track of the intersectoral linkages in Panama's economy and map how the macroeconomic effects of the canal's expansion affect household welfare. The authors find that

large capital inflows during the construction and operation phases will lead to a real appreciation of the currency and a loss of competitiveness of noncanal sectors. According to their estimations, income distribution will deteriorate, as income gains will be concentrated at the top of the income distribution and higher domestic prices will hurt the poor. The authors also suggest that by increasing the demand for educated nonfarm formal workers, the enlargement of the canal will lead to growing wage disparities and widening income inequality. These negative effects on income inequality could be attenuated by using some of the fiscal revenues generated by the canal expansion to fund a targeted cash transfer program such as *Red de Oportunidades*. In particular, the authors conduct a simulation showing that such a policy could almost eliminate extreme poverty and reduce the moderate poverty headcount by 50 percent.

In his discussion, Francisco Ferreira praises the authors for their efforts to model the general equilibrium consequences of such a massive investment project. He also points out, however, that the paper's results are based on a series of assumptions that need to be validated, and he suggests that it would have been useful to evaluate the paper's simulations using the data available at the time of publication. With these caveats in mind, Ferreira argues that the paper's estimations seem plausible, and he agrees with the authors' conclusions that a large share of the fiscal revenues generated by the canal expansion should be used to fund anti-poverty programs.

In "Temporal Aggregation in Political Budget Cycles," Jorge M. Streb, Daniel Lema, and Pablo Garofalo point out that a main drawback of the existing literature on political budget cycles is their reliance on annual observations, which do not allow for a precise identification of the election year (an election that takes place in December will have a different effect than an election that take places in January). Previous work tries to address this issue by using previous-year data for elections that take place before July and current-year data for elections that take place in the second half of the year. Streb, Lema, and Garofalo argue that this approach is problematic if, instead of being concentrated in the election year, pre-electoral effects are spread out over a longer period or if the pre-election fiscal stimulus is reversed after elections. To address this issue, the authors build a cross-country panel with annual and quarterly fiscal data from nineteen Latin American and twenty OECD countries over the 1980–2005 period and use this novel data set to test for the presence of a political business cycle in these two regions. Their results contradict the previous literature that

finds evidence of a political business cycle in developing countries, but much weaker evidence in the OECD countries. In particular, Streb, Lema, and Garofalo find evidence, in both Latin America and the OECD, of a large fiscal expansion in the four quarters that precede an election. The fiscal expansion sometimes continues in the first post-electoral quarter, but in the next three post-electoral quarters, there is a compensating fiscal contraction in Latin America but not in the OECD countries. This suggests that the political business cycle contributes to debt buildup in the advanced economies but not in Latin America.

In her discussion, Marcela Eslava commends the authors for going beyond the standard practice of analyzing the political business cycle using annual data and highlights the many rewards of using higher frequency data. However, Eslava also suggests that some of the authors' conclusions should be taken with caution. For instance, she points out that the authors' finding of a political business cycle in both developing and advanced economies is unlikely to be due only to the use of quarterly data. In fact, the paper's results differ from the previous literature even when the paper uses annual data. More work is thus needed to explore what drives this difference in results. Eslava also maintains that the authors should be more careful in comparing point estimates across regions with different levels of fiscal surplus and institutional characteristics.

Economía is the result of a collaborative effort, and we would like to thank our authors for choosing *Economía* as an outlet for their research, the discussants and associated editors for putting in a lot of time and effort to bring the papers to publication, and members of the panel for contributing to a lively debate. As usual, our managing editor, Roberto Bernal, was the person who made things happen, and this volume is one of the many outcomes of his steady, hard work. The papers published in this issue were presented at seminars held at LACEA Annual Conferences and in meetings hosted by the Inter-American Development Bank and the World Bank in Washington, D.C. We are grateful to these two institutions for allowing us to use their facilities, helping to coordinate the logistic of our meetings, and continuously supporting *Economía* and, more generally, economic research in Latin America and the Caribbean.