

Editor's Summary

This volume of *Economía* consists of four papers. The first discusses why Latin American governments have such a low capacity to execute proper public policy. The second studies the lending channel in Brazil using a high-frequency, extremely detailed, and novel data set. The last two papers study commodity prices and their impact.

The first paper is Mauricio Cárdenas's Presidential Address, entitled "State Capacity in Latin America." The state's capacity refers to the ability of governments to enforce and respect contracts, to collect taxes and execute expenditures, to honor their commitments, and so forth. In his paper, Cárdenas studies why governments in Latin America have exceptionally low levels of state capacity. The paper starts with a proper definition of state capacity and then proceeds to document the very low levels that are characteristic of Latin America. Indeed, Latin America underperforms even within the smaller comparison group of colonized countries. Cárdenas finds three important results. First, he argues that political and economic inequalities are two important determinants. Using a panel, he finds that countries in which inequality is large have fewer incentives to invest in their own bureaucracies, and they therefore underperform. Second, his evidence supports the hypothesis that internal wars (such as civil wars and other forms of internal conflict) deteriorate the quality of the state, while external wars have no impact. Finally, he finds that democracy tends to improve the quality of state capacity. In his view, the detrimental effects of internal conflict and of political and economic inequalities in Latin America outweigh the positive impact of democracy. This paper is a must read for those interested in institution building and development.

The second paper, authored by Christiano A. Coelho, João M. P. De Mello, and Márcio G. P. Garcia, is entitled "Identifying the Bank Lending Channel in Brazil through Data Frequency." In this paper, the authors estimate the strength of the lending channel in Brazil and outline its characteristics. The workings of the lending channel have been a concern of the literature for more than two decades in developed nations, in particular in the United States. The

main problem of the literature is that the identification problem in the estimation has not been resolved. In other words, if the interest rate increases, does lending contract because the interest rate is higher (the standard channel of transmission) or because the banks find it very expensive to lend (the lending channel)? The best evidence available in the literature focuses on bank characteristics—big versus small, rural versus urban—to distinguish the effect. This empirical strategy presumes that bank characteristics and behaviors are exogenous to the cost of lending and the types of clients the banks face. These two assumptions are clearly weak. In the end, the identification is dubious, and the measurement of the lending channel is weak at best.

This paper is completely different from earlier efforts. The authors use very high frequency bank-level data on loans to isolate supply shocks driven by monetary policy. As explained by the authors, “Our method bypasses both concerns with Kashyap and Stein’s identification strategy. We have daily bank-level data on interest rate and quantity. The high frequency of the data allows us to isolate supply from demand shocks. The key identifying assumption is that supply reacts faster than demand to monetary shocks.” From an empirical point of view, this is the standard Cholesky decomposition used so frequently in macroeconomic vector autoregressions (VARs). The underlying assumption is that “demand for credit depends on investment and consumption decisions that do not react immediately to changes in monetary policy,” while “banks’ costs of funds increase immediately (on the following working day) in response to an increase in the basic interest rate.” This identification strategy takes advantage of the very good quality of the data to which the authors have access and convincingly tackles a very important question in the literature.

The paper presents two main results. First, the authors find a very strong lending channel in Brazil. “Credit volume and interest rate respond strongly to monetary policy changes in the direction one would expect if we were estimating a supply response.” In contrast, the literature finds a very small effect. Second, they investigate whether the bank structure affects the strength of the channel. They find that larger banks react more strongly to monetary policy than smaller banks. This is in sharp contrast with the literature, and it actually explains why the estimates might be so small. This is a very good paper, on a very good data set, answering an extremely important question.

The third paper, written by John Parsons and entitled “Black Gold and Fool’s Gold: Speculation in the Oil Futures Market,” studies whether or not, and by how much, the oil price increases experienced between 2003 and 2008 could be the result of a bubble. This is an extremely important question that is

being explored in almost every forum in the world, and Parsons is one of the leading authorities on this subject. Nothing could be more revealing than the paper's first sentences: "On its face, nothing looks more like a classic bubble than the accelerating inflation of the oil price between 2003 and mid-2008, followed by a sudden collapse in late 2008. Starting from \$30 per barrel, the price climbed fitfully but persistently to \$100 per barrel at the end of 2007 and then shot up above \$140 by July 2008, only to collapse below \$40 by the end of 2008. Clearly the price spiked dramatically, but was it a bubble?" In other words, how much of the price increase was due to changes in the demand and supply, and how much to speculation? I will not provide the punch line of the paper, but invite the reader to peruse both the main paper and Ramón Espinasa's discussion. They formally and thoroughly study the demand and supply sides of the oil business, as well as the inflows to oil-related financial assets. This paper is certainly not the last word on the topic, but it provides an extremely interesting and careful view of the problem.

The fourth paper, entitled "Understanding the Impact of High Food Prices in Latin America," is authored by Miguel Robles and Máximo Torero. The 2000s were perhaps one of the most fruitful periods in Latin America. Growth was abundant, and overarching reforms were implemented almost everywhere. Income inequality started to fall (as has been documented in several papers published in previous volumes of *Economía*), and democracies were cemented during the same period. Nevertheless, poverty, malnutrition, and lagging agricultural growth continued to present serious challenges. As stated in the paper, "more than 60 percent of the region's poor live in rural areas, where slow economic growth, unequal distribution of assets, inadequate public investment and public services, and vulnerability to natural and economic shocks are major policy issues." This paper studies the impact of the 2007–08 food crises in Latin America. At the outset, the impact should depend on the net purchase positions of the poor. For instance, high food prices cause a positive terms-of-trade shock if the poor are net exporters of food, but they have a negative effect if the poor are net importers (or consumers) of food. The paper points out that the very high food prices exacerbated the contrast between rural and urban areas, irrespective of their net effect. It is the case in Latin America that the effect of the increase in food prices was negative. As the paper points out, "the share of the households that were net consumers before the crisis was 68.2 percent in El Salvador, 83.3 percent in Guatemala, 88.8 percent in Honduras, and 90.2 percent in Nicaragua. As a result, a rural household in El Salvador in 2008, for example, was able to buy only 56 percent of what it used to buy eighteen months before with the same amount of

money.” This is a dramatically negative effect. Finally, the paper also evaluates formally how international prices are propagated to the rural areas, and it identifies how the rural areas are hurt in this process.

This paper is relevant not only for policy design, but also as a preparation of what is to come. It is clear that after the world financial crisis is over, the high demand for food will drive prices up. Prices may not rise as high as in 2007, but they will certainly be much higher than today. Governments in Latin America will need to understand the possible negative effects of these price increases in order to ameliorate the impact on the poorest segments of the population.

Economía is the result of a collaborative effort, and as usual, thanks are due to the many people who made that process successful. Associate editors worked hard to guide papers to publication, members of the panel contributed valuable insights and spirited discussions, and *Economía* staff, in particular Myriam Bahiman, helped put it all together. Without Myriam’s steady and abundant effort, this volume would not have come to fruition. Most of the papers published here were presented during the Fourteenth Annual LACEA Meeting in Buenos Aires. We thank Torcuato Di Tella and the conference organizers for their support and continuous commitment toward the journal.