EDUARDO ENGEL
FRANCISCO H. G. FERREIRA
ROBERTO RIGOBON

Editors' Summary

This volume of *Economía* has five empirical papers, which address five crucial policy issues in the region and present five very surprising results. The first two papers deal with microeconometric questions, the following two study the banking sector, and the last concentrates on the aggregate impact of oil—a macroeconomic issue.

The first paper, by Carlos Medina and Leonardo Morales, studies the effect of public utility services subsidies on Colombian households. In Colombia, as in many developing economies, public utilities (that is, electricity, piped gas, piped water, and sewerage) are subsidized for the poorest households as a way of transferring income to them. Targeting methods vary, however. Some programs define the treatment group according to household characteristics, while others focus on where the families reside (for example, by region or type of house).

Medina and Morales concentrate their analysis on a public sector subsidy in Bogotá that targets beneficiaries based on household characteristics. The authors ask the very relevant question of who benefits from the subsidy in the context of a well-functioning housing market. In other words, they examine whether the subsidies are offset by distortions in the housing market, in terms of both sale prices and rental rates. If the subsidy is fully accounted for in the price of the home, the subsidy is less effective.

Medina and Morales find, using a regression discontinuity approach, that the prices of subsidized homes increase by roughly the same amount as the net present value of the typical subsidy, after controlling for the residence properties. Questions remain about the discount rate and the distortion in public utility consumption caused by the subsidy. Even so, the fact that the price captures a sizable proportion of the subsidy should drive policymakers to seriously question the targeting system.

In the second paper, Gary Fields, Robert Duval Hernández, Samuel Freije, and Maria Laura Sánchez Puerta summarize the literature on mobility studies in Latin America. Most policies and programs in the region are evaluated

on the basis of their impact on poverty and income distribution. For instance, when assessing the cost of a financial crisis, most academics and practitioners point to the deterioration of the income distribution and the increase in the incidence of poverty as the main indicators. Fields, Duval, Freije, and Sánchez Puerta convincingly argue that this is not enough. Changes in the shape of the income distribution are important, but how individuals move within that distribution might play an even bigger role. Simply put, if moving down in the income distribution causes a higher utility loss than moving up, then shocks that redistribute income while keeping the distribution invariant are welfare reducing.

Fields, Duval, Freije, and Sánchez Puerta find, first, that Latin American income distributions are changing significantly. In fact, mobility is much greater than the conventional wisdom suggests. Second, the lowest earners have gained at least as much as middle and high earners. This implies that there is a high convergence rate between high and low earners within the countries studied. Third, the same factors affect income mobility throughout the business cycle. That is, the variables that improve income in booms are the same variables that reduce income in downturns. Finally, the mobility patterns confirm the idea that countries differ in the mechanisms by which they adjust to macroeconomic shocks. These results highlight the fact that mobility studies provide a different picture than aggregate analysis based on poverty measures or the income distributions alone.

The third paper, by Meral Karasulu, measures the degree of competition in the Chilean banking sector. This question has traditionally been addressed by measuring the degree of concentration in the sector. However, the relationship between concentration and competition is thin with regard to the banking sector. The United Kingdom, for example, has one of the most competitive banking sectors in the world, yet a handful of banks controls the market. Nevertheless, the question regarding the connection between concentration and competition remains. In light of this conventional wisdom, it is not surprising that "the concentrated structure of the Chilean banking market has raised concerns of insufficient competition in the sector."

Karasulu compares the Chilean banking sector with thirty other countries, using bank-level data covering ten years starting in 1995. She follows Panzar and Rosse, who measured the degree of competition as a function of the elasticity of revenues to the different factor prices.[1] This methodology is not concerned, therefore, with concentration or profits per se but with how revenues

1. Panzar and Rosse (1987).

and profits respond to changes in the bank's costs. The paper reports that the Chilean banking sector is concentrated and the degree of competition is smaller than in the other countries in the sample. Chilean banks also have larger profits: after controlling for the relevant macroeconomic characteristics, Karasulu finds that their margins are about 2 percentage points higher than the rest of the sample.

This paper has important implications for bank regulation. Far too much emphasis is given to market share and too little is given to the actual behavior of banks, which is measured by the elasticity of revenues to factor prices. Karasulu calls for changes in regulatory approaches to the banking sector while pointing out the need to analyze the financial sector as a whole. Future research will certainly follow her suggestions.

The fourth paper also focuses on the banking sector. Eduardo Levy Yeyati, Alejandro Micco, and Ugo Panizza examine whether the presence of state-owned banks is justified. They start from the assumption that under imperfect markets, good government intervention improves welfare—the key word being *good*. In the case of the banking sector, it is possible to argue that inefficiencies exist. For instance, credit to small firms might be too expensive, and projects that are socially profitable might not be privately financed. Problems of trust and contract enforcement may elicit excessively high collateral and interest rate conditions. Under these circumstances, government intervention should improve the market outcome. The question is how the intervention should take place, whether through subsidies, portfolio restrictions, public provision of credit, micro-lending, or the maintenance of state-owned banks.

This paper assesses whether state-owned banks have, in practice, benefited the economies in which they operate. The existing empirical literature suggests that public banks are an extremely bad idea. Levy Yeyati, Micco, and Panizza challenge this view forcefully and convincingly. First, they cast some doubts on the literature that suggests that public banks inhibit financial development and growth. They show that those regressions are not robust and that their instruments might be invalid. Second, they find that public banks do not allocate their portfolios optimally. This is to be expected, however, since the mission of the state-owned banks is to fill in the gaps left by the private sector. Furthermore, if the bank's objective is development—where social returns might differ from private returns—the portfolio allocation might be seen as inappropriate when evaluated according to private returns. Finally, the authors present some preliminary evidence on the role that public banks play in reducing the procyclicality of loans, by reducing the financial amplifier that can be so detrimental at the onset of a crisis.

From the policy perspective, Levy Yeyati, Micco, and Panizza indicate that "while there is now widespread agreement on the fact that politics plays a role in the lending decisions of public banks, this does not necessarily imply that public banks play no role in development. On the contrary, one could easily envision situations in which political influences coexist with a development mandate." This paper revives a topic that many thought dead. Future research must clearly continue addressing this question.

Finally, José De Gregorio, Oscar Landerretche, and Christopher Neilson study recent trends in the pass-through from oil prices to inflation. The exchange rate pass-through literature documents the massive drop that occurred in the last two decades. De Gregorio, Landerretche, and Neilson show that this phenomenon is also present for oil prices. Not only is the effect on prices smaller, but the recent increase in oil prices has had a negligible effect on output. In other words, the paper finds that oil has become less relevant than it was in the past.

The authors estimate a traditional Phillips curve augmented to include oil prices on the right-hand side and allowing for structural breaks. Using ordinary least squares with data covering thirty-six countries, they find that there is a statistically significant drop in the average pass-through for developed countries, while the fall is smaller for emerging economies. This raises the important issue of why the pass-through has come down. De Gregorio, Landerretche, and Neilson argue that four factors are behind the decline. First, the oil intensity of economic activity has declined worldwide in the last two decades. Clearly, if the expenditure share of oil comes down, its impact on costs is smaller, and the ultimate effect on the price level declines as well. Second, the current oil price increase is mainly a demand-driven shock rather than a supply disruption, as it was in the past. Therefore, the shock is occurring in a boom environment, which diminishes its impact on both production and prices. Third, the world inflation rate is much lower than it was during past oil shocks. This lower inflation contributes to reducing the impact of oil by allowing central banks (a high proportion of which are under inflation-targeting regimes) and the fiscal authorities (which are generally operating with a healthy fiscal account) to conduct countercyclical policies more effectively today than three decades ago. Finally, the exchange rate pass-through has declined as well, which helps reduce the overall effect of oil on the price level. Taken together, these explanations help rationalize the low effect that oil has had on prices and production.

Economía is the result of a collaborative effort of many moving parts. As usual, thanks are due to 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 discussion; and *Economía* staff helped put it all together. We thank them all for their steady and abundant effort. The articles in this issue were presented at a panel meeting held on November 1, 2006, at the Instituto Tecnológico Autónomo de México (ITAM). We are especially grateful to the program chair, Lorenza Martinez, and ITAM for hosting us and providing us with their unbounded support.