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Ideas for

D

Development

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in the Americas

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Room for Development in Housing Markets



Inter-American Development Bank
Research Department

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Latin American and Caribbean countries are the most urban in the developing world, enjoy very high home ownership rates, and boast high average family incomes by developing world standards. However, many of the region's city inhabitants are still poorly housed. Of the 130 million urban families in the region, 5 million rely on another family for shelter, 3 million live in houses that are beyond repair, and another 34 million live in houses that lack either title, water, sewerage, adequate flooring, or sufficient space.

But the problem doesn't stop there. A home is much more than four walls and a roof; it is also the neighborhood in which it is located. Neighborhood population density that is neither too low nor too high, the amenities associated with its location, and proximity to city centers are also important components of a good house, as they enable families and society to enjoy the benefits and efficiencies of urban agglomeration—the phenomenon of people living close to one another. Access to jobs and other economic opportunities, cheap transportation, the environmental benefits that come with dense urban land use (such as lower energy consumption), and access to cultural activities, parks, sports facilities, health centers and schools all factor into the definition of a good house.

With pervasive poor housing, the stereotypical, modern Latin American and Caribbean city is a jumble of ramshackle informal settlements, or slums, surrounding

pockets of formal residential neighborhoods and business districts. But the problem is not merely cosmetic. Fundamentally, living in a good house—adequate shelter in an acceptable neighborhood—influences people's quality of life, the health and education of their children, their carbon footprint, and their vulnerability to crime and natural disasters.

The importance of adequate housing is typified by its effects on health. A bad house can become a breeding ground for disease and desolation instead of a nest of security and comfort. In cities throughout Latin America and the Caribbean, millions of households still live in overcrowded houses with dirt floors and without sanitation, water, and garbage collection. Over-

crowding facilitates the spread of contagious diseases within the household; dirt floors compound the problem as they help transmit parasitic diseases. Lack of water, electricity, and sanitation make it costly and difficult to obtain clean drinkable water, to prepare and store food safely, and to maintain good personal hygiene, compromising the health of residents and fostering the spread of communicable and food-borne diseases. Other housing problems such as poor regulation of temperature and humidity can lead to respiratory disease. If the house is in one of the many informal settlements located on floodplains or hillsides on the periphery of big cities, chances are it is also subject to the dangers of heavy

A home is much more than four walls and a roof; it is also the neighborhood in which it is located.

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traffic and pollution, industrial activity, solid waste dumps, vector breeding sites, or natural disasters. Living in a neighborhood without parks and places for outdoor recreation and leisure activities also negatively impacts mental and physical health, and may contribute to obesity.

Clearly, living in a bad house is bad for your health, especially if you are a child. Moreover, the effects of infirmity are hard to undo and likely to affect school enrollment and performance, even into adulthood. In fact, the damage from childhood diseases and malnutrition can be irreversible. Not only do children often miss school due to illness, they can permanently lose cognitive capacity from parasitic infec-

tions, many of which can be traced back to the overall unhealthy homes in which they were raised.

Housing also affects educational outcomes, both directly and indirectly. For example, lack of piped water and electricity effectively reduce the number of hours a child can study by forcing him to fetch water or limiting his work to daylight hours. Overcrowding creates distractions and thus limits the academic performance of students.

Poorly functioning housing markets and land markets may also lead to residential segregation. This, in turn, affects education through peer and neighborhood effects. Students who live in segregated low-income areas likely have peers who also live

in inadequate, overcrowded housing, and have few resources to invest in education. Having low-achieving peers decreases the academic performance of students—individually and as a group. Furthermore, schools in segregated areas lack resources to provide an adequate environment for learning, perpetuating the poverty cycle.

Poorly planned, deteriorated, and unsafe residential areas negatively impact a range of social outcomes. Such areas usually lack adequate public services, parks, or playgrounds, and have been associated with an increase in obesity rates, poor cognitive development among children, and exposure to social risks such as drug addiction, idleness, and gang activities. Indirectly, the degree of social cohesion influences crime and psychological well-being.

Housing and land markets also matter for the environment. The fuel that residents use for cooking depends on whether a house is connected to the electrical grid or to a natural gas pipeline. The layout and insulation of the dwelling impacts energy use for heating and cooling. The density and location of neighborhoods and their access to roads and public transportation networks affect energy consumption for transportation. The shape of a city and its population density represent key determinants of the energy consumption—and hence greenhouse gas emissions—of its inhabitants, particularly for transportation. Contrary to popular belief, dense urban settlements provide efficient and effective responses to climate change by reducing per capita greenhouse gas emissions, promoting economic growth, and improving standards of living. Urban sprawl, on the other hand, boosts dependence on cars as households must commute longer distances

This issue of *IDEA* was prepared by Rita Funaro and was based on the latest edition of the Inter-American Development Bank's Development in the Americas's (DIA) series titled *Room for Development: Housing Markets in Latin America and the Caribbean*, edited by César Patricio Bouillon. It draws on research conducted for the book by Viviane Azevedo, Andrés Blanco, Cynthia Boruchowicz, César Patricio Bouillon, Fernando Cuenin, Katia Herrera, Nadin Medellín, Carolina Piedrafita, and Eduardo Rojas.

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A Housing Report Card

Anyone who lives in or visits a Latin American or Caribbean city comes face to face with the housing problems that ail most neighborhoods in the region. There is nothing subtle or hidden about the ramshackle dwellings that crowd most of the region's capitals. Upon arrival, visitors to Caracas are greeted by the spectacle of tens of thousands of dilapidated houses jam-packed precariously along the hillsides that line the main road between the airport and the city. Overcrowded *conventillos* (tenement houses) still abound in the historical downtown areas of old capital cities such as Bogota and Buenos Aires. In a region notorious for its high income inequality, the con-

trast between the haves and the have-nots is striking in the housing sector. Poor inhabitants of *favelas* (Brazilian slums) in Rio de Janeiro share the same view of Ipanema Beach with wealthy households living lavishly in some of the most expensive real estate on the planet. In Lima, households living in jerry-built shacks devoid of running water or toilets watch luxury cars speed by to modern mansions in the exclusive sector of La Molina or to beach houses south of the Peruvian capital.

While this picture provides an overall impression, numbers can provide the details to help countries design appropriate housing policy. How widespread are housing problems? Recent estimates

indicate that housing problems affect more than one-third of Latin American and Caribbean families living in cities. Economic growth will likely help narrow the region's housing gaps, but not enough. By 2015, economic growth will have helped only 36 percent of the families currently living in substandard houses. Existing public housing programs will likely help only another 5 percent of families. With these projections, by 2015 about 36 percent of families—nearly 59 million people—in both urban and rural areas will still be living in inadequate houses, compared to 37 percent of households in 2009.

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for work and services and precludes the benefits of the economies of scale that can come from networked services like water, transport, and electricity.

Enjoying good health, having children succeed in school, not having to face long, arduous commutes, living free from exposure to pollutants, and being able to relax at home and not worry about crime all contribute to a good quality of life. Thus, it is logical to conclude—and supported by research—that housing quality impacts strongly on how satisfied people are with their lives.

Given the importance of housing, the Inter-American Development Bank focused the 2012 edition of its flagship publication, *Development in the Americas*, on this vital sector and asked a very basic question: Why do so many

Latin Americans live in relatively bad homes? In some cases, families cannot afford even a simple basic house. In other cases, even if they earn sufficient income to afford better housing, they cannot get a mortgage; they cannot document income, credit markets are too shallow, or mortgage credit is too expensive. In still other cases, no home is available for them to buy. Why don't private sector builders and developers offer good basic homes for these families? Is it because building such units is not as profitable as building homes for wealthier households? Or is it because high land and construction costs or regulations make them too expensive to produce in some markets? Finally, some families may not want a good home built by the private sector even if they could afford it if they think that they

can get it more cheaply by obtaining the land from an illegal developer or by taking over (invading) and building the house themselves.

This issue of *IDEA* draws from that book, *Room for Development: Housing Markets in Latin America and the Caribbean*, to examine the magnitude of the problem and review policy options for dealing with the region's shortcomings in the financial, construction, and land markets that so greatly impact housing. It takes a special look at the regional bias against rental housing and how that affects the provision of quality housing. Understanding the causes, consequences, and possible cures for the region's housing ills is crucial to ensure that all city inhabitants can enjoy the economic and social benefits that urban life has to offer.

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Measures of *housing gaps*, often called *housing deficits*, are widely employed to assess housing problems and access to basic urban services. In turn, housing gaps are usually divided into “quantitative” and “qualitative” shortages. *Quantitative shortages* measure households in dwellings unsuitable for living that cannot be repaired plus households that share units. *Qualitative shortages* include households in dwellings with insecure tenure, walls made from discarded materials (such as palm fronds or throwaway materials like cardboard), dirt floors, no access to piped water, inadequate sanitation, or overcrowding (three or more people per room).

Lack of infrastructure (especially water and sanitation) constitutes one of the main housing deficits in urban areas of the region. Around 21 million households live in dwellings lacking at least one basic service. Inadequate sanitation is the main infrastructure problem, affecting 13 percent of households (almost 17 million). Around 8 million households (6 percent) lack piped water. By contrast, coverage of electricity is almost universal.

Housing shortages vary across income quintiles, and not surprisingly, the poorer the household, the worse the shortages. This is especially true for gaps in access to infrastructure, use of inadequate building materials, or overcrowded dwellings.

While these figures refer to averages for the region, there are significant differences among countries in the structure of their housing shortages. Some must solve significant quantitative shortages while reducing qualitative shortages; others face problems mostly concerning housing quality, commonly related to lack of access to infrastructure. Table 1

breaks down urban quantitative and qualitative shortages by country.

Region-wide, the percentage of urban households facing quantitative and qualitative shortages decreased between 1995 and 2009, except for households lacking security of tenure. However, because the population has grown, the number of households facing shortages has increased in the period. Housing conditions have improved for all income groups, particularly for the lowest income quintiles.

Some of the 18 countries studied in the DIA are doing better than others in improving housing conditions in general and for the poor in particular. Most countries have made significant progress in reducing quantitative housing shortages in urban areas (see Figure 1). All countries have gaps below 12 percent, with the exception of Bolivia (30 percent) and Peru (14 percent). Nicaragua, Peru, and Guatemala have the highest aggregated qualitative gap (over 45 percent). Materials gaps

TABLE 1: Urban Housing Deficits in Latin America and the Caribbean by Country, 2009 (percent of households)

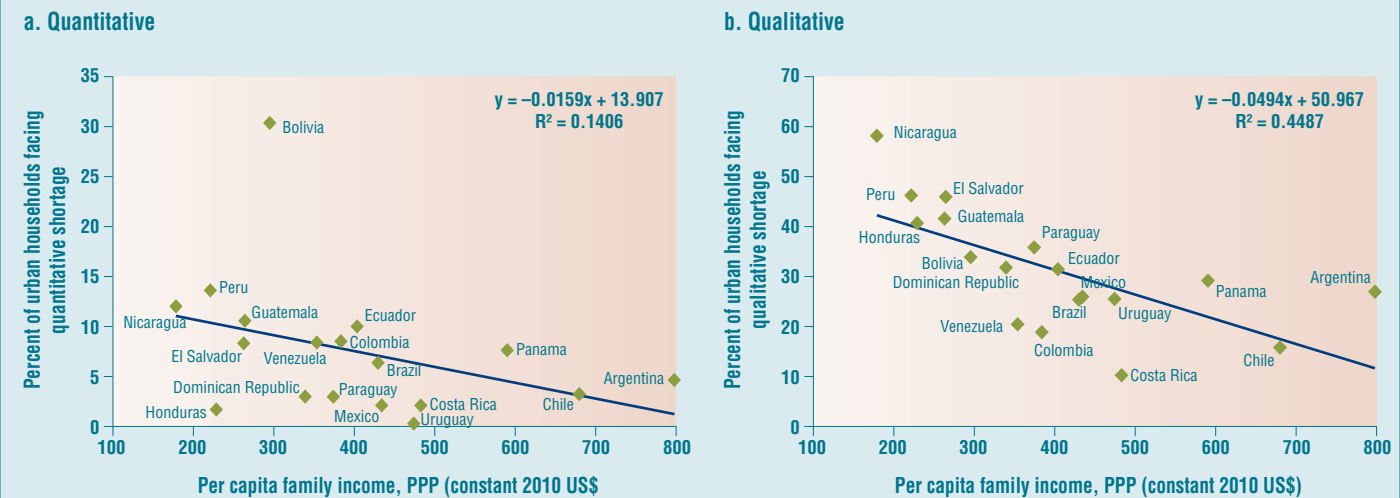
Country	Quantitative shortages	Qualitative shortages				
		Total	Materials	Overcrowding	Infrastructure	Lack of secure tenure
Argentina	5	27	9	6	13	16
Bolivia	30	34	27	23	32	11
Brazil	6	25	2	0	22	7
Chile	3	16	1	1	2	14
Colombia	9	19	7	4	9	10
Costa Rica	2	10	5	1	1	6
Dominican Republic	3	32	5	3	25	9
Ecuador	10	31	14	8	19	13
El Salvador	8	41	21	16	30	17
Guatemala	11	46	32	27	32	10
Honduras	2	41	18	14	26	12
Mexico	2	26	9	5	8	15
Nicaragua	12	58	33	28	52	10
Panama	8	29	7	6	22	13
Paraguay	3	36	13	9	25	10
Peru	14	46	34	11	29	21
Uruguay	0	25	4	3	4	22
Venezuela	8	20	13	6	5	6

Source: Room for Development based on Rojas and Medellín (2011).

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Figure 1. Housing Shortages by Country, 2009



Source: Room for Development based on Rojas and Medellín (2010).

for households in the lowest income quintile surpass 50 percent in Bolivia, Guatemala, Nicaragua, and Peru. Nicaragua has the highest infrastructure gap (51 percent); however, in the lowest quintiles of Bolivia, the Dominican Republic, Guatemala, and El Salvador, the rate exceeds 50 percent. Only 5 of the 18 countries boast an infrastructure gap for the lowest quintile below 20 percent.

With respect to security of tenure, at 21 percent, Peru suffers the highest percentage of households with insecure tenure. The highest shortages are among the bottom quintile in Argentina, Panama, and Uruguay (around 30 percent).

Both at the country and city levels, income is one of the principal determinants of housing deficits. As average income increases, the percentage of families living in bad homes should decrease, since more families can afford to buy good homes. But this pattern is distorted by the ability of families

to obtain credit, and the ability of the private sector to develop land and build houses for households of all income levels. Nicaragua, Bolivia, and Argentina have the largest deficits when compared with what would be expected by the income level of the country. On the other hand, Costa Rica shows very low shortages, given its level of income.

At the city level, cities in Bolivia suffer from the most severe quantitative shortages. Bogota enjoys one of the lowest qualitative deficits when compared to its income level thanks in large part to the efforts of its government to create partnerships and implement incentives and policies to promote land development and housing construction for most income levels in the city.

The variation among countries and cities suggests that different countries need different solutions for their housing problems. There is no “one-size-fits-all” solution to the urban housing problems of the region; countries should base their housing policies and programs on

detailed and well-documented diagnoses of their housing situations, thereby avoiding the temptation to imitate policies and programs that have worked in other countries but that may not work as well in their own.

Moreover, the government’s use of housing gaps, by itself, to set production goals often creates substantial problems. Housing programs should pay as much or more attention to the location and quality of projects, target the poor and leave the lower middle class to the private sector, set subsidies for poor households at a level high enough for them to really afford them, give as much choice to households as possible in the use of subsidies, and improve communities and local services. Housing programs should also be accompanied by regulation reform and by interventions to improve the functioning of the region’s land markets. These steps may be even more important than meeting production goals for physical units intended to reduce housing gaps.

To Buy or Not to Buy

Home ownership may be a good choice for many people, but it is not necessarily the best for all. Renting may offer a better option for some families for whom home ownership may not be the right fit given their needs, lifestyle, or life cycle. Unfortunately, most Latin Americans today do not have that choice, as renting is not really an option.

A well-functioning rental-housing market is a critical part of a sustainable, integral, and healthy housing system. Expanding the rental-housing market in Latin America and the Caribbean could broaden the choice of housing options for households, injecting flexibility into housing markets to respond to the full spectrum of citizens' housing needs and preferences. In addition, rental housing could provide policy alternatives for policymakers to tackle the quantitative and qualitative shortages affecting most countries.

The beneficial choice offered by rental housing is evident for middle-income households in countries like Argentina, Brazil, and Colombia, where renters tend to be younger people with fewer or no children and with higher education levels. These individuals prefer to rent a higher quality dwelling rather than own a low quality one. Yet broader choice also benefits low-income households. In central areas of Mexico City, for instance, low-income families headed by young women working in the informal sector prefer renting a room than living in informal housing on the periphery so they can save on commuting time and avoid the costs associated with building their homes themselves.

Rental housing offers numerous benefits. It can accommodate dense populations in multistory structures, thus offering the potential for higher

density urban areas. Unlike informal urbanization, this increase in density would not stem from overcrowding but from “verticalization” and capital-intensive buildings that provide adequate open spaces and social infrastructure. By utilizing urban serviced land more efficiently, rental housing could help remedy the quantitative and qualitative deficits of low income housing. Public interventions that support rental housing may also provide

A well-functioning rental housing market is a critical part of a sustainable, integral, and healthy housing system.

access to housing for lower-income households in more cost-effective ways than other types of interventions. Moreover, such housing could be centrally located in consolidated areas that have better employment and income opportunities.

One key advantage of rental housing is greater mobility for individuals and families seeking jobs. The transaction costs associated with buying and selling a property tie down homeowners; renters are essentially free to pack up and move when economic opportunity knocks. Similarly, rental housing expands access to social opportunity, particularly for poorer residents, bringing them closer to areas with better access to urban services and amenities. For this group, greater mobility

could not only mean access to jobs, but also access to better schools and safer neighborhoods.

Renting can also provide much needed shelter from financial exposure. For most homeowners, especially the poor, their housing unit is an undiversified investment. With all their eggs in one pot, families are exposed to the risks of a market downturn and thus to losing their lifetime savings. Renting, on the other hand, can provide the same housing services as home ownership without the risk, and allows households to invest in assets other than housing.

In 2007, only 24 million households—approximately 17% of total households in Latin America and the Caribbean—rented their dwellings. The significance of rental tenure, however, varies considerably by country. Renting is extensive in Colombia (31% of households) and the Dominican Republic (27%), but less common in Venezuela (10%), Peru (7%), and Nicaragua (3%). In most Latin American and Caribbean countries, the level of rental tenure ranges from 11% to 18% (see Figure 2).

In addition to being relatively small, the rental sector remains stagnant. The average level of rental tenure for urban areas in 17 countries in the region grew from 18% in 1995 to 19% in 2007: a meager increase of 1 percentage point in one decade.

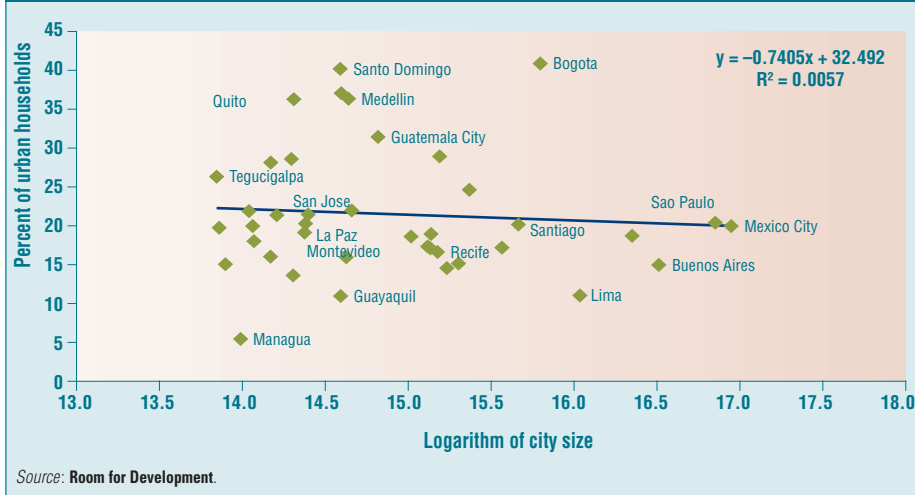
The proportion of urban households renting in substandard conditions, and in particular suffering from overcrowding and poor construction materials, roughly mirrors that of owners in all countries except Bolivia, Honduras, and Peru. By contrast, in nearly all countries the proportion of urban households suffering from lack

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Figure 2. Rental Tenure: Latin America and the Caribbean vs. Selected European Union Countries (percent of population)



of adequate access to piped water, sanitation, and electricity is higher for homeowners than for renters. This means that living conditions in the rental market are better or at least relatively similar to those in the ownership market, debunking the widespread belief that associates renting with poor quality housing.

If renting offers such a viable solution, then why is the rental market so underdeveloped? To begin with, housing policy in most Latin American and Caribbean countries emphasizes home ownership rather than the general provision of safe, salubrious, and inclusive housing. Direct housing subsidies, favorable tax treatment, and lower financing costs for owners effectively make ownership cheaper than renting.

The policy bias is based on the belief that home ownership in itself leads to better financial and social outcomes including greater life satisfaction, better physical health, more community and political engagement,

increased neighborhood stability, higher property values, and better education for children. However, the empirical evidence is not as conclusive as it is often presented in policy circles. Still, governments in the region continue to pursue universal home ownership, a strategy reflected in very high home ownership rates. Countries such as Venezuela (80%), Brazil (74%), Paraguay (75%), and Costa Rica (72%) have the highest home ownership rates in the region and some of the highest rates in the world.

The regulatory framework mediating tenant-landlord relationships is another important factor hampering the supply of rental housing. Legislation and the judiciary system tend to favor tenants' rights over landlords' rights, thus making it extremely difficult and costly for landlords to evict tenants and repossess their properties. This situation increases investment risk and deters owners and investors from investing in the private rental market.

Rent control regimes also share the blame in restricting the private rental market. Rent control sets the rate and frequency of rent increases, often linked to some measure such as the consumer price index. Tight rent control laws limit landlords' ability to generate a sufficient rate of return to remain invested in the development of this sector and reduce their incentive to invest in more rental units.

Financing is another limiting factor. In a well-functioning rental-housing market, an owner-investor should be able to contract a long-term mortgage loan to finance the construction, acquisition, or rehabilitation of a rental housing project. Longer-term loans increase the amortization period, which could lower the monthly mortgage payment considerably, reducing monthly operational expenses and increasing the profitability of a rental-housing project. In Latin America, access to long-term mortgage loans is limited. Where such loans are available, the amortization period is considerably shorter and the interest rate is considerably higher than in developed countries. The average real mortgage rate in Latin America and the Caribbean reaches 11.4%. To date, the financial system has not developed financing schemes targeting rental builders. Thus, rental investors are forced to take commercial loans or "free-investment" loans, which are short term and carry significantly higher interest rates than the special credit lines offered to traditional building companies.

Households need more choices if countries are to make a measurable dent in their housing deficits. Adding renting to their list of options will likely result in putting more people in better quality homes.

Building a Better Housing Policy

The challenge for the region's housing sector is clear: to eliminate existing quantitative and qualitative shortages while catering to the needs of newly formed households. The key question is, how to do it? Should governments intervene in the housing sector? If so, how? Is there a combination of public policies and programs that can generate better housing outcomes?

Clearly, public intervention in housing is justified. Houses are produced and traded in a complex set of interrelated markets such as land, credit, building materials, and construction. Each individual market suffers from imperfections (information, externalities, monopolies, oligopolies, and the like) that can result in disappointing social outcomes. Even when some of these flaws can be eliminated, the high levels of inequality in Latin American countries bode poorly for satisfactory results. These problems are not exclusive to housing markets, but their impact on individual and collective well-being turns housing into a merit good, prompting governments to search desperately for programs that ensure households at least a minimally acceptable abode.

Despite consensus on the need for public intervention in the housing sector, differences arise when defining its type and scope. There are two extreme positions on the matter. One advocates a strong interventionist role for government that includes regulating and actively participating in housing provision. The other favors focusing on facilitating the operation of all markets related to housing. In practice, governments do not take these 'pure' extreme positions; rather, they implement both types

of programs, which actually seem to complement each other. Since housing deficits in most countries are so large, public resources should be complemented by private interventions. On the other hand, casting the public sector in the role of facilitator is not a mandate to retreat from the housing market.

Direct provision, with its high costs, high-quality housing standards, and high subsidies, has not been effective in expanding coverage and leveraging resources from households. However, when well targeted to the poor and efficiently executed, it significantly improves access to services and reduces overcrowding, albeit at a high cost.

The ABC programs (from the abbreviation in Spanish for Savings, Bonds, and Credit) were designed to respond to the affordability issue and reduce the fiscal burden of housing policy. Presumably, public subsidies would mobilize private resources, which would cover the cost of housing solutions while lowering costs to the state. However, since the underlying market failures that affect low-income groups persist (mainly their low saving capacity and lack of access to credit), private financing remains dormant. Moreover, the private sector remains reluctant to go downstream and supply low-income housing in the region, probably due to some combination of lack of demand, profitability concerns, overly stringent regulations, and the prevailing informality in land development and construction.

Besides these general conclusions, certain issues must be addressed when putting together a tool kit to design sound public policies for housing.

- Countries need to adopt a comprehensive vision of the housing problems affecting all income groups, going beyond low-income groups to underserved lower-middle- and middle-income households as well. Each group faces different challenges, so the instruments to support must also differ. Lower-income groups—particularly those with informal sources of income—need higher subsidies to afford a house of even minimum quality; land policies and regulation to ensure the supply of serviced land for their needs; and incremental construction approaches when appropriate. The middle class needs incentives to save and help with loans to increase the affordability of housing.
- There are significant trade-offs between quality, targeting, and coverage. Higher quality not only raises the cost of houses but also makes them attractive to higher-income groups that compete with lower-income households. This obviously translates into lower coverage. Of course, quality should not be ignored to extend coverage successfully with extremely low standards. Then, families end up spending too much to live in the houses and often simply abandon them.
- Public housing policy should not be rigid, but it should remain stable in its fundamental objectives. Policy shifts to respond to economic conditions (i.e., recession) or sociopolitical concerns (i.e., special population groups like the elderly or migrants) alter the original rules and negatively affect the capacity to plan ahead.

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Longer-term stability, in turn, is fundamental for market development, especially to promote private sector participation.

- A sustainable, long-term solution to existing housing gaps requires the mobilization of private resources with programs that promote savings and facilitate access to credit to middle- and low-income households. Increases in per capita income, macroeconomic stability, and more developed financial markets will also enable more households to be assisted by the private sector.
- On the supply side, policy must encourage the production of low-income housing, promote competition among developers, and improve tools that support low-cost land development—a key issue in large cities.
- Housing policy in the region has focused almost exclusively on constructing new housing units, which has helped lower the quantitative housing deficit. However, housing policy should diversify, not just to reduce costs but also to attend to the low quality of the existing housing stock, which affects the poor the most. Toward this end, countries should adopt, continue, or expand options such as incremental housing programs, rental housing, and upgrading poor neighborhoods. For low-income households, group or community-based subsidy schemes present definitive advantages over the individually based subsidies that work for middle-income households.
- Program implementation must be improved. Currently, high execution costs stem from the need to

ensure targeting and avoid leakages. Linking eligibility to housing programs to social evaluation instruments, like the Social Protection Certificate in Chile or SISBEN in Colombia, represents a good first step to share the costs of screening applicants with other social programs. However, more needs to be done to reduce the administrative costs of housing programs and construction. More fully involving the community in supervising local elected officials may help enhance transparency and efficiency and is an additional rationale for decentralizing the execution of these programs.

- In finding a long-term, sustainable solution, the government in the short term should continue helping low-income households satisfy their housing needs, despite the high fiscal price. Even if the potential market for housing microfinance (HMF) is large, the private sector is still reluctant to fully attend to such demand. In the meantime, the government must fill in the holes and help develop

specific business models to serve low-income groups, which require longer repayment times, flexible collection schemes, technical assistance, and a staged approach to acquiring a house.

There is no silver bullet to solve the complex maze of housing sector issues in the region but there are discernible paths in the right direction. The solutions should be tailored to local needs, comprehensive, and attend to the different aspects of the problem. They should be pragmatic, rather than ideological, combining the best of the interventionist approach with market-enabling techniques to attend to the housing needs of all people. Programs should focus on generating a new housing stock along with improving the existing one, taking into consideration the quality of materials, access to urban and public services, and property rights. Policy should simultaneously focus on short-term needs, without jeopardizing long-term sustainability. To this end, it is necessary to act on the root of the problem instead of focusing just on its symptoms.

WELCOME TO RES

RES is pleased to present the newest addition to its research staff: Julián Caballero. A Colombian national, Julian joins the Research Department as a Young Professional. Julián received a PhD in International Economics from the University of California, Santa Cruz. Before joining RES, he worked for over four years as a consultant at the IDB's desk for Central American countries.

RES also welcomes Aglae Parra and Ana Lucia Saettone, who join RES' administrative team as project coordinators, and Cathleen Conkling-Shaker, who is the newest member of the department's dissemination staff.

New Publications

Available in English only unless otherwise stated.

WORKING PAPERS

Amarante, Verónica, Rodrigo Arim, and Andrés Dean

Protecting Workers against Unemployment in Uruguay (IDB-WP-267)

This paper considers the main institutional features of the Uruguayan labor market and its recent evolution and analyzes the main policies aimed at protecting workers against unemployment. Using administrative data from social security records, the paper studies the dynamics of the labor market, particularly inflows and outflows from the formal labor market, as well as the effect, in terms of earnings loss, of episodes out of the formal labor market. Finally, it presents an impact evaluation of recent changes in the unemployment insurance program.

Arbeláez, María Angélica, Roberto Steiner, Alejandro Becerra, and Daniel Wills

Housing Tenure and Housing Demand in Colombia (IDB-WP-259)

Using the 2003 and 2008 Quality of Life Surveys, this paper identifies the factors that affect housing tenure decisions in Colombia. Households with higher incomes are more likely to purchase than to rent, and the choice of formal housing is positively associated with wealth. Households eligible for social housing subsidies are more likely to purchase than to rent, and those working in the informal sector are more likely to purchase informal dwellings. Subsidies and access to mortgage credit increase demand. Finally, savings boosted demand in 2008, but not in 2003. Pent-up demand for low-income housing explains why both subsidies and credit increase demand.

Arbeláez, María Angélica, Carolina Camacho and Johanna Fajardo

Low-Income Housing Finance in Colombia (IDB-WP-256)

Using the Quality of Life Surveys conducted in Colombia in 2003 and 2008, this study finds that policy instruments aimed at easing low-income households' access to affordable housing such as subsidies and loan guarantees have played a modest role in increasing the use of mortgages as a source of funding. Despite this, subsidies have had a significant impact on both the quality of dwellings and the quality of life of the beneficiaries. Therefore, this paper suggests promoting the use of both instruments by improving their design and targeting.

Ardanaz, Martín and Carlos Scartascini

Why Don't We Tax the Rich? Inequality, Legislative Malapportionment, and Personal Income Taxation around the World (IDB-WP-282)

This paper argues that the details of political institutions help explain the low levels of personal income taxation. In particular, legislative malapportionment enables rich elites to exercise disproportionate political influence. Because overrepresented districts tend to be dominated by parties aligned with the elite, these groups can block legislative attempts to introduce progressive taxes. Using a sample of more than 50 countries (including 17 across Latin America) between 1990 and 2007, this paper finds that i) countries with historically more unequal distributions of wealth and income systematically present higher levels of legislative malapportionment;

and ii) higher levels of malapportionment are associated with lower shares of personal income taxes in GDP.

Balderrama, Fernando, Julie Litchfield and Caio Piza

Housing Demand in Brazil: Evidence from the Formal and Informal Sectors (IDB-WP-261)

This paper describes the determinants of housing demand in Brazil, with the intention of informing policy aimed at reducing the housing deficit and increasing home ownership. As price elasticity for renters is slightly higher, public policies that aim to influence the price of dwellings and/or the income of households are expected to affect renters more than owners. Given that rent is a pro-cyclical variable and that housing-price supply elasticity tends to be low, a social housing policy focused on the rental market might be an effective option, at least in the short run, to satisfy rising housing demand in Brazil.

Bermudez, Guillermo, Marcela Cristini and Ramiro Moya

Argentina's Housing Market in the 2000s (IDB-WP-262)

This study analyzes the main drivers of Argentina's housing market and relates them to the macroeconomic environment to advance an agenda for housing policy reform. Structural characteristics of the market include a highly concentrated urban population in a few large cities, the association of urban poverty with the housing deficit, and overcrowding. The mortgage market lost its appeal following the 2001–02 crisis due to widespread breaches of contract legitimized through protective legislation, insufficient long-term financing,

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and high inflation. The housing deficit could be eliminated within eight years if well-coordinated policy initiatives to develop the mortgage market and provide low-income housing were adopted under a decentralized, demand-driven, subsidized program.

*Cesa-Bianchi, Ambrogio,
Hashem M. Pesaran, Alessandro
Rebucci and TengTeng Xu*

China's Emergence in the World Economy and Business Cycles in Latin America (IDB-WP-266)

This paper investigates how changes in trade linkages between China, Latin America, and the rest of the world have altered the transmission of international business cycles to Latin America. Evidence based on a GVAR model for five large Latin American economies shows that the long-term impact of a China GDP shock on the typical Latin American economy has increased threefold since the mid-1990s while the long-term impact of a U.S. GDP shock has halved, and the transmission of shocks to Latin America and the rest of emerging Asia GDP (excluding China and India) has not changed. These changes owe more to changes in China's impact on Latin America's traditional and largest trading partners than to increased direct bilateral trade linkages boosted by the decade-long commodity price boom.

*Cristia, Julián, William Evans and
Beomsoo Kim*

Does Contracting-Out Primary Care Services Work? The Case of Rural Guatemala (IDB-WP-273)

This paper estimates the impact of a large-scale contracting-out program in Guatemala, using two waves of living standard measurement surveys that collected data before and after

the expansion of the program. Results indicate large program impacts on immunization rates for children and prenatal care provider choices. The program increases substantially the role of physicians and nurses as prenatal care providers at the expense of traditional midwives.

*Fajardo, Deisy Johanna and
Eduardo Lora*

Latin American Middle Classes: The Distance between Perception and Reality (IDB-WP-275)

This paper compares objective and subjective definitions of the middle class using data from the 2007 World Gallup Poll. Seven objective income-based definitions of social class are contrasted with a self-perceived social status measure. Mismatches between classifications are largest when the objective definition is based on median incomes. Mismatches arise because self-perceived social status is associated not just with income, but also with personal capabilities, interpersonal relations, financial and material assets, and perceptions of economic insecurity. Objective definitions of the middle class based on absolute incomes provide the fewest mismatches and the most accurate differentiation of the middle class from other classes.

*Garabato, Natalia and
Magdalena Ramada-Sarasola*

Housing Markets in Uruguay: Determinants of Housing Demand and Its Interaction with Public Policies (IDB-WP-258)

This paper analyzes the determinants of housing demand for Uruguay and the extent to which housing policies impact their target population. The paper first analyzes the determinants of housing demand. Determinants

of formality and ownership choices include both household demographic attributes and access to and use of public housing and other social programs. Policy recommendations are offered on the basis of the finding that a price- and income-inelastic, formal housing market greatly contrasts with a price- and income-elastic, informal housing market.

Lefort, Fernando and Miguel Vargas

Tacit Collusion in the Santiago Housing Market (IDB-WP-260)

This paper tests the extent of competition in the housing market in Santiago, Chile using a two-step methodology. In the first step, using a hedonic price model, the Santiago housing market is divided into sub-markets, which are analyzed separately. The second step is the tacit collusion test itself, which compares the industry markup with the business cycle in each sub-market using panel data regression models. Evidence of collusion is found in certain sub-markets.

Lora, Eduardo and Andrew Powell

A New Way of Monitoring the Quality of Urban Life (IDB-WP-272)

This paper proposes a methodology to resolve the problems that result from using both objective and subjective information in evaluating urban quality of life. The paper suggests techniques to identify and rank issues of potential importance for urban dwellers. To combine objective and subjective information in a coherent manner and focus on the most relevant dimensions of the quality of life in a city or neighborhood, the paper attempts to exploit the complementary nature of two approaches: the "hedonic" approach, which employs market prices for housing, and the "life

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satisfaction" approach, which addresses subjective well-being. Results using both approaches in selected Latin American cities are discussed and compared.

Lundberg, Eduardo, Bruno Martins and Tony Takeda

Housing Finance in Brazil: Institutional Improvements and Recent Developments (IDB-WP-269)

This paper investigates the recent evolution of the housing market in Brazil, focusing on whether the current expansion in mortgage lending reflects institutional and economic improvements favoring economic stability and compliance with contractual obligations or merely the higher level of housing loans imposed by the government on financial institutions. Different explanations are found for private and public institutions.

Majnoni, Giovanni and Andrew Powell **On Endogenous Risk, the Amplification Effects of Financial Systems and Macro Prudential Policies (IDB-WP-276)**

This paper proposes an analytical framework that combines exogenous and endogenous risks, the latter stemming from frictions in financial markets. Arguing that endogenous risks may be systemic and costly, the paper employs a database of emerging market corporate bond spreads and finds evidence that endogenous risks are present and have amplified the effects of financial crises. Larger financial systems exacerbate the impact of crises, and weaker financial systems particularly exacerbate the impact of banking crises. The results suggest that policymakers should monitor time-varying systemic risks using both price

and quantity signals and act in good times to mitigate potentially amplifying effects during times of stress.

Monge-González, Ricardo

The Impact of Internet Banking on the Performance of Micro and Small Enterprises in Costa Rica: A Randomized Controlled Experiment (IDB-WP-242)

This paper uses a randomized controlled experiment in Costa Rica to determine whether Internet banking (IB) use by Banco Nacional de Desarrollo's micro- and small enterprise (MSE) clients impacts their performance, as measured in terms of productivity, sales, and cost reduction. Results from the intervention group surveys indicate that MSEs use the Internet little in their daily operations because of limited access to computers and the relatively low penetration of Internet services in employees' activities. In addition, firms know little about the uses of the Internet as a business development tool. These results contrast with the benefits reported by a small group of firms. Those benefits include reduced costs, higher sales, and better contact with customers.

Outes-León, Ingo, Catherine Porter and Alan Sánchez

Early Nutrition and Cognition in Peru (IDB-WP-241)

This paper examines the causal link between early childhood nutrition and cognition in a sample of pre-school-aged Peruvian children. Food price changes and household shocks during a child's critical developmental period are used as instruments. The analysis shows significant, positive returns to early childhood nutritional investments. An increase in the Height-for-Age z-score of one standard deviation

translates into increases in the Peabody Picture Vocabulary Test (PPVT) score of 17–21% of a standard deviation. The period of analysis includes the recent global food-price crisis that also affected Peru between 2006 and 2008. Thus, this quantifies the nutritional and subsequent cognitive costs of food prices on the sample which could be magnified in later years.

TECHNICAL NOTES

Abreu-Lastra, Raúl, Marco López-Silva, Agustín Paulin-Hutmacher and Alberto Saracho-Martínez

Housing Finance in Mexico: Current State and Future Sustainability (IDB-TN-287)

This paper analyzes a large database provided by INFONAVIT, Mexico's principal mortgage issuer, which contains information on borrowers' repayment behavior. It finds that borrowers who received subsidies do not show higher default rates than borrowers who received no financial assistance. Borrowers receiving subsidies actually take longer to show their first default than borrowers not receiving subsidies. Therefore, current subsidy programs do not seem to have negative financial implications for participating mortgage institutions.

Auguste, Sebastián, Ricardo N. Bebczuk and Ramiro Moya

The Demand for Mortgages under Macro Volatility: The Argentine Case (IDB-TN-284)

This paper analyzes mortgage loan demand in Argentina using a new survey in the Buenos Aires Metropolitan Area. It finds that recurring macro volatility and violation of financial proper-

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ty rights have increased demand for real estate as an investment, which in turn boosts housing prices and makes it more difficult for households to meet minimum income requirements for obtaining a mortgage. Affordability thus seems to offer a better explanation than standard supply-side constraints for the small size of the mortgage market in Argentina. Overall, the shallow mortgage market has not posed a major impediment to home ownership in Argentina; the small (and shrinking) mortgage market has more to do with lack of demand than credit supply constraints.

*Garabato, Natalia and
Magdalena Ramada-Sarasola*

Are Uruguayan Housing Policies Reaching the Poor? An Assessment of Housing Deficit, Housing Informality and Usage of Housing Programs in Uruguay (IDB-TN-278)

This document surveys the Uruguayan housing market, first describing the main housing programs and policies, then comparing their design with households' characteristics and needs. It additionally measures Uruguay's housing deficit using the basis deficit as well as quantitative and qualitative deficits and provides a definition of housing informality that captures most irregular housing situations, thus delineating the size and attributes of the informal housing market. Considering both the housing deficit and informality permits an understanding of which population segments have the most urgent housing needs and whether they are currently eligible to participate in housing programs. Finally, the study considers how many households eligible for housing programs actually make use of them.

Kugler, Adriana

Is There an Anti-Labor Bias of Taxes? A Survey of the Evidence from Latin America and around the World (IDB-TN-299)

This paper surveys the macro and micro empirical evidence on the effects of different types of labor taxes (in particular, payroll and income taxes) on firm performance and worker behavior.

Miller, Sebastian and Bok-Keun Yu

Climate Change Funds and Implications for LAC Countries and the IDB (IDB-TN-289)

This paper surveys climate change funds related to Latin American and Caribbean countries and attempts to derive some implications through performance analyses of these funds. These analyses show that the following matters should be addressed: increases in the IDB's participation as an agent in the projects for the region, enlargement of the scale of co-financing in the IDB-brokered cases as well as in the region, and reinforcement of the linkage between the SECCI funds and international climate change funds. Further research as to why the level of co-financing in LAC countries is lower than in other regions would also be of interest.

OUTSIDE PUBLICATIONS

*Ardanaz, Martín, Carlos Scartascini
and Mariano Tommasi*

“Political Institutions, Policymaking, and Economic Policy in Latin America” in Ocampo, J. and Ros, J. (eds.), *The Oxford Handbook of Latin American Economics*. Oxford: Oxford University Press. 2011.

This paper surveys selected themes

in the political economy of policymaking in Latin America, with an emphasis on recent research focusing on actual decision making and implementation processes, and on the political institutions and state and social actors involved in those processes. In particular, the paper addresses how political rules work for or against intertemporal cooperation among political actors. The document shows that the extent to which polities obtain the key policy features that seem to determine development depends on the workings of political institutions, which define who, how, and where the policymaking game is played.

*Bastos, Paulo and
Natalia P. Monteiro*

Managers and Wage Policies

Journal of Economics & Management Strategy 20(4), 957-984, 2011.

Do individual top managers matter for wages and wage policies? Are there general differences in “style” among managers with respect to worker compensation? To shed light on these questions, this article exploits a large panel dataset to match workers, firms, and managers, and follow the movements of the latter across different firms over time. While accounting for the effect of worker and firm heterogeneity, the authors estimate the role of top manager fixed effects in determining wages and wage policies. The estimates suggest that (i) top managers have a significant influence on wages and wage policies; (ii) different managerial “styles” exist; and (iii) managers' (observable) attributes matter for worker compensation.

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Look Who's Talking

This section of the newsletter spotlights presentations or events sponsored by RES in recent months.

Will the World Relapse into Crisis? Can the Region Remain Immune? September 23, 2011

At a September seminar, experts including Raghuram Rajan, Carmen Reinhart, and Stephen Cecchetti discussed possible scenarios for the European crisis. As this very fluid situation continues, the predictions of a group of regional experts on its effect on Latin America are of great interest.

Guillermo Calvo

During financial crises, the dominant demand-side factor for emerging markets is exports. Compared to other crises, recovery in the sub-prime crisis is difficult because: i) emerging markets are the only outlet for exports from advanced countries; ii) increased government expenditure is low compared to WWII; and iii) credit is not increasing. If the U.S. cannot count on exports or government expenditure, investors will have to explore innovative activities in the midst of a financial crisis. Consequently, U.S. interest rates will be low for a long time and investors will continue to search for yield. Latin America should focus on lowering financial vulnerabilities, especially on credit lines (which may evaporate) as Greece risks default.

Advanced economies now find themselves in an unprecedented and difficult situation (due to the additional political and financial com-

plications) where producers are having great difficulty finding a way to impact the market at a macro level; Latin America, however, continues to grow and precisely because of that, it must proceed with caution to avoid the same trap.

Paulo Leme

Uncertainty in European financial markets and policy has led to the belief that Latin America is about to face difficult times due to the large European presence in the region. It is essential for Latin America to have a completely different perspective when dealing with the global crisis: typically it is very reactive in terms of policy and much can be done in terms of better macro-management and proactive policies that negatively impact growth.

Europe is a very large lender and investor to Latin America and due to its foreign exposure, trade lines and credit are at risk, which will all negatively impact growth and export volume. The European bank presence is very large in the region, but quite varied depending on the respective country, a factor that could further reduce credit. The overall result in terms of trade balances will now shift to deficits for many countries. Latin America is not headed towards a recession; rather it is in the midst of a long, painful deleveraging process. Efforts should not just center on crisis management, as there is still a lot that Latin America can do in terms of long-term growth and productive activity.

Liliana Rojas-Suárez

How resilient are Latin American countries to a new global shock? Focusing on solely financial systems, the mechanisms of contagion are dependent on: i) the degree of financial integration; and ii) the presence of foreign banks. Financial integration and the presence of foreign banks amplify the effect of a large foreign financial shock resulting in a liquidity squeeze, huge capital losses, and most importantly, a contraction in real credit growth.

According to previous research analyzing 2007 macroeconomic indicators—the capacity of a country to react to a shock in fiscal and monetary terms—suggested that Latin America was resilient to foreign shocks. Updating the analysis, are countries in the region still resilient to a shock? The research suggests that countries are still recovering from the past crisis and are not as resilient as they were in 2008–9. These countries are still normalizing their monetary policy, and if a shock (at the same magnitude or greater than that of 2008) were to materialize, it is unlikely that Latin American countries would be able to react the way they did in the past crisis.

Eduardo Engel presented his new book: Public-Private Partnerships: When and How November 2, 2011

Eduardo Engel, Yale University Professor, discussed at an IDB seminar

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topics from a forthcoming book written with Ronald Fischer and Alexander Galetovic: *Public-Private Partnerships: When and How*. Public-private partnerships (PPPs) increased in popularity as a means for providing infrastructure services during the last 25 years. These partnerships are especially popular in Latin America and now, with the many problems facing advanced economies, PPPs are potentially attractive for the U.S. and Europe. Considering an array of infrastructure experiences and outcomes, the book seeks to answer central questions: i) what are the main lessons to take away from past PPPs? ii) when is a PPP the best option? and iii) how should they be implemented?

Public infrastructure is best thought of as a long-lasting and irreversible investment used to provide a public service. These types of projects are typically airports, schools, water systems, highways, etc. PPPs finance this investment through an arrangement in which the government contracts a private firm to provide or improve a public infrastructure asset and to maintain and operate it for a long period of time in exchange for revenues during the life of the contract. Revenues are generated directly through government transfers, or by user fees that are charged for use of the infrastructure. At the end of the contract, the asset is returned to government control.

Highways, specifically (though the forthcoming publication will also focus on other projects), are the main type of infrastructure utilized for PPPs. Like many forms of public infrastructure, highways present a large, upfront, sunk investment

for a long-lasting asset. These projects are exceedingly expensive even before the added costs due to delays, overruns and pricing issues associated with government contracts. However, demand is highly uncertain as there is no guarantee that the public's use of infrastructure will match expectations—many times due to poor government planning—and adequate pricing often eludes planners. Furthermore, high maintenance costs plague highways as upkeep is frequently neglected and quality diminishes, resulting in large-scale repairs, which can be as much as three times more expensive than routine maintenance.

With the substantial costs and uncertainty, what can be gained from PPPs? Policymakers often claim that PPPs relieve strained budgets, freeing up public funds. This is clearly untrue with any payment made via government transfers—the project will ultimately be financed through tax revenues. Also, if the infrastructure is financed through user fees, governments may initially save money, but they forgo the revenues that contractors collect. PPPs can, nevertheless, bring about significant efficiency gains as they introduce competition and bundling into the marketplace; PPPs are closer to privatization. Firms competing for government contracts have more incentives for appropriate maintenance (bundling a range of services into proposed contracts) which, in turn, guarantees they will charge appropriate user fees.

In practice, the experience of PPPs has been varied. One major problem is poor accountability and regulation; planning, adjudicating, monitoring, and regulating the con-

cession of contracts are typically done by the same agency. Additionally, PPPs allow for off-budget spending as the projects last so long, leaving future administrations to bear much of the costs. This becomes more problematic as renegotiations throughout the project often lead to high profits for firms (at the expense of governments) that do not face any outside competition. Ultimately, governments' circumvention of budgetary control can result in a poor choice of projects and firms as this process favors a firm's ability to lobby rather than the quality of the services it provides.

Given all of the problems associated with PPPs, how should they be executed and when should they be used? Key in this process is improving the governance of renegotiations through adequate and independent monitoring at all stages. This limits the possibility for contract changes, and ensures that contracts will be based on the service provided and on their efficiency. One way of achieving this is through flexible term contracts, particularly present-value-of-revenues contracts (PVRs), which limit costly renegotiations as firms bid on a contract based upon the present value of toll revenues. PVRs shift the focus to the costs of the project and reduce the risk premium as tolls are also adjustable to fit demand. The advantages of PPPs are country- and infrastructure-specific, but a basic requirement is that the projects carry negligible expropriation risk. In the case of highways, because the service is contractible, PPPs can lead to better maintenance, efficiency gains and more efficient pricing.

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Cova, Petro, Akito Matsumoto, Massimiliano Pisani and Alessandro Rebucci

News Shocks and Asset Price Volatility in General Equilibrium

Journal of Economic Dynamics and Control 35(12): 2132–49. 2011.

This paper studies equity price volatility in general equilibrium with news shocks about future productivity and monetary policy. As West (1988) shows, in a partial-equilibrium present-discounted value model, news about future cash flow reduces asset price volatility. The article shows that introducing news shocks in a canonical, dynamic, stochastic general equilibrium model may not reduce asset price volatility under plausible parameter assumptions. This is because, in general equilibrium, the asset cash flow itself may be affected by the news shocks. In addition, neglecting to account for policy news shocks can potentially bias empirical estimates of the impact of monetary policy shocks on asset prices.

librium model may not reduce asset price volatility under plausible parameter assumptions. This is because, in general equilibrium, the asset cash flow itself may be affected by the news shocks. In addition, neglecting to account for policy news shocks can potentially bias empirical estimates of the impact of monetary policy shocks on asset prices.

Hallerberg, Mark and Carlos Scartascini.

Economic Crisis and Fiscal Reforms in Latin America.

International Journal of Public Budget 76: 71–104. 2011.

This paper explores the connection

between economic crises and fiscal institutional reforms in Latin America. It reviews the literature and provides five hypotheses about why, and under what circumstances, crises would promote reforms. The empirical evidence shows that debt crises make reforms more likely but banking crises alone reduce pressure for fiscal institutional reforms. Political institutions are also important. If the electoral system encourages the personal vote, the country is more likely to reform. This evidence may become useful for predicting the likelihood of reforms in the developed world.



Network News

www.iadb.org/res/researchnetwork

The following proposals were selected to participate in the research project **Agriculture and Adaptation to Climate Change: The Role of Insurance and Technology Dissemination in Risk Management**

Agricultural Insurance and Climate Change: The Case of Colombia

- FEDESARROLLO

Insurance and Adaptation to Climate Risk: Soybean and Dairy Production in Argentina, Paraguay, and Uruguay

- Alejandro Galetto
- Guillermo Podesta
- Laura Gastaldi
- Marcos Gallacher

Effectiveness of Weather Derivatives as a Cross-Hedging Instrument against Climate Change: The Cases of Reservoir Water Allocation Management in Guanajuato, Mexico and Lambayeque, Peru

- Leonardo Sánchez Aragón

Agriculture and Adaptation to Climate Change: The Role of Insurance and Technology Dissemination in Brazilian Risk Management

- Fundação Instituto de Pesquisas Econômicas (FIPE)