

# The \$10 Billion Question: Which Investments Work Best?



Inter-American Development Bank  
Research Department

Volume 15  
January–April, 2008

If Latin American and Caribbean governments, philanthropic foundations, non-governmental organizations, and aid agencies had \$10 billion to solve the most urgent problems facing the region, how should the money be spent? Which programs would have the greatest impact and represent the most efficient use of limited resources? How should these programs be prioritized? To answer these questions, it would help to have a menu of good projects, prepared on the basis of all the international experiences applicable to the countries in the region.

The preparation of that menu was the task of a panel of renowned academics and practitioners who met at the *Consulta de San José*, Costa Rica in October, 2007. The *Consulta* was sponsored by the IDB's Research Department (RES), and enjoyed the support of the Copenhagen Consensus Center (a Danish organization that conducted a similar exercise at the world level some years ago) and the INCAE Business School of Costa Rica. To achieve its mission, a panel of experts analyzed a very diverse series of proposals for solving the main problems that afflict the region. The proposals were presented by international specialists who carefully evaluated the costs and benefits of those with the

greatest potential for the largest and most efficient impact.

The proposals targeted 10 challenges identified in the region, ranging from widespread poverty, social exclusion and lack of good jobs, to the poor quality and availability of education and health services, which together contribute to placing the region at the top of the world's inequality ladder. Other proposals offered solutions to combat widespread crime and violence, improve the working of political systems, including democratic institutions, and strengthen public administration and state finances. Lastly, others aimed at finding effective formulas to improve transport infrastructure, halt deforestation and preserve biodiversity. Importantly, the 10 challenges were selected through a survey of Latin American and Caribbean professionals, including policymakers, academics, business representatives, journalists, and researchers, among others, that RES conducted electronically in November, 2006. Thus, these are the problems identified by Latin Americans who live with them on a daily basis.

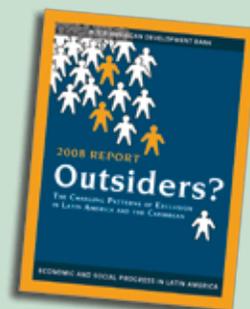
The *Consulta de San José* consisted of three days of structured presentations and debates over 44 possible solutions to the 10 selected challenges. Each solution was

Early childhood development programs would provide investors with the biggest bang for the buck in Latin America.

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based on existing empirical evidence, and the authors made an effort to estimate, wherever possible, the costs and benefits of the proposed interventions. At the end of the three days, the panel of experts issued a prioritized list of the most efficient solutions.

The panel included Nobel Laureate in Economics Finn E. Kydland, Chilean Finance Minister Andrés Velasco, former United Nations

Under-Secretary General José Antonio Ocampo, former Director of the United Nations Development Program's Poverty Group Nora Lustig, President of the Center for Global Development Nancy Birdsall, and professors Ricardo Hausmann, Jere Behreman, Orazio Attanasio, and John Coatsworth.

The verdict of this panel was to give top priority to early childhood development programs, which are interventions that improve the physical, intellectual and social development of children early in their life. Besides improving children's welfare directly, these programs create further benefits for family members, releasing women and older siblings to work

outside the home or to further their own education.

The panel also judged improving fiscal rules as a great opportunity to improve the budget process within many countries in Latin America. Consolidating the budget process through procedural rules that would set structural deficit targets, limit discretionary spending and debt levels, and increase budget transparency could help avoid insolvency and excess spending during good times.

Next on the panel's list was investment in, and maintenance of, infrastructure. Since the region underinvests in infrastructure, improving roads, seaports, water, sanitation,

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## The Top 10

The economists of the Expert Panel ranked the top 10 proposals in the following order based on what they believed to be their priority for investment.

1. Early childhood development
2. Fiscal rules
3. Investment in infrastructure, including maintenance
4. Policy and program evaluation agency
5. Conditional cash transfers
6. Universal health insurance: basic package
7. Nutrition programs for pre-school children
8. Crime prevention through environmental design
9. Replace taxes on formal employment with other taxes
10. Adopt policies and services to reduce transaction costs for trade

A full prioritized list of solutions along with all the papers and commentaries are available at <http://www.iadb.org/res/consultaSanJose/index.cfm>

This issue of *IDEA* was prepared by Eduardo Cavallo and Heather Berkman and based on the research papers of Miguel Braun, Amy Damon, Paul Glewwe, Julio González, José Luis Guasch and Tomás Serebrisky.

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*IDEA* (*Ideas for Development in the Americas*) is an economic and social policy newsletter published three times a year by the Research Department, Inter-American Development Bank. Comments are welcome and should be directed to *IDEA*'s managing editor, Rita Funaro at [Ritaf@iadb.org](mailto:Ritaf@iadb.org).

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# Children First

Investing in children is a winning strategy. Comparing the cost-benefit ratio and the viability of numerous proposals showed that the number-one investment priority in Latin America and the Caribbean should be a set of programs to improve the livelihood of children. These range from programs to monitor children's physical development, childcare services, pre-school activities and upgrading hygiene and health services, to improving the skills of mothers and fathers. With any of these programs, public and private investors should get their money's worth.

Spending on children yields high returns because they have their entire life to benefit from what is done for their health, mental development, and capacity to interact in society. The early years of life are crucial for breaking the cycle of poverty, malnutrition, poor school performance and low productive capacity that tend to be repeated generation after generation. It is scientifically demonstrated that the brain develops almost completely during the first five or six years of life, and that about half of an individual's intellectual potential is determined by the age of four. Clearly, this is the time to invest.

The nutritional status of children is normally expressed in terms of standardized weight-for-age, height-for-age and weight-for-height. Although better than the rest of the developing world, the percentage of underweight children in Latin America is still 5%. The region also has 11.8% of children who are stunted—a measure of their long-term nutritional status. In both cases, there are substantial inter-country differences, with Chile being the best and

Guatemala the worst. Micronutrient status for young children is poor in the region. Deficiencies in Vitamin A, iron and zinc run at 15%, 46% and 33% respectively. These can give rise to blindness, increased vulnerability to infections and impaired development.

**Spending on children yields high returns because they have an entire lifetime to benefit from the investment.**

Anemia is one of the most widespread health problems among children in developing countries, and it is associated with one fifth of maternal deaths. Lower adult height, partly due to poor childhood nutrition, is associated with reduced earnings: a 1% increase in height leads to a greater than 2% increase in wages.

Malnutrition in young children can be attacked from several angles including reducing the incidence of low birth weight, focusing on infant and child nutrition, promoting exclusive breastfeeding and reducing iron, vitamin A, iodine and zinc deficiencies.

Internationally, in almost no other area do spending proposals to combat these problems offer such a high and well-sustained cost-benefit ratio. There is much that can, and

is, being done. Giving young children access to randomly available nutritional supplements in rural Guatemala significantly increased school enrollment and educational achievement. Provision of Vitamin A on a semi-annual basis can reduce overall childhood mortality by 25–35%. The Colombian “Community Mothers” program, which benefits children under six, has been shown to be an effective and very low-cost way of stimulating the physical, mental and social development of kids. In very poor communities especially in rural areas, programs to distribute nutrients—such as iodine, vitamin A and iron—to women who are pregnant or have newborn babies can also have enormous benefits, up to 200 times their cost, because they are an easy way to prevent physical and mental retardation.

Evaluations of pre-school programs, which are designed to stimulate mental development and socialization at an early age, offer a cost-benefit ratio of eight to one. Children who enter school early perform better academically and have a better chance of generating income as adults. This is the economic benefit. These children are also more likely to feel personally and socially fulfilled throughout their lives.

In addition to directly improving children's welfare, these programs generate benefits for other family members. Women and older brothers and sisters can work outside the home or receive an education. Supporting early childhood development provides as many immediate as long-term benefits for children and their families while it plants the seeds for a healthier, more productive society.

# Ensuring Fiscal Solvency

Latin America has historically been a fiscal basket case. Poor management of government fiscal policy has had a harmful effect on growth, poverty and income distribution. Overall, economic and financial crises have cost the region up to 7% in GDP growth per decade since the 1970s. On the flip side, some things have improved in recent years. Since the mid-1990s, inflation has been kept under control and debt ratios have fallen. But the risk of crises due to fiscal insolvency still threatens many countries due to vulnerabilities that remain. Therefore, the expert panel at the Consulta de San José decided that a top priority in the region is to reform fiscal institutions in order to improve solvency and secure legitimate resources for financing valuable spending programs.

Since the 1970s, there have been debt and balance of payments crises and periods of hyperinflation. The public spending and tax systems are still inefficient and regressive and procyclical fiscal policy increases macroeconomic volatility still further. Fiscal reforms and higher growth have improved the situation significantly in recent years, but it is not clear that a structural change has yet occurred. As shown in Figure 1, the structural budget balance for the region in recent years paints a less rosy scenario than the observed fiscal balance, and a reversal of fortunes could quickly lead to poor fiscal outcomes.

An economic downturn could impair the ability of many governments to efficiently manage their debts and spending. The key fiscal challenge is to make better use of the windfalls recently gained thanks to economic good times, and to ensure

Figure 1. Observed and Structural Budget Balance, (quarterly data, % of GDP)



that government policy works with—not against—the economic conditions of the moment.

Improving fiscal rules is a great opportunity to improve fiscal sustainability within many countries in Latin America and the Caribbean. Consolidating the budget process through procedural rules would set structural deficit targets and limit discretionary spending and debt levels. It would also increase transparency, which would help avoid excessive spending in good times and major fiscal contractions during recessions. At a low cost, this could potentially increase countries' growth rates substantially.

Fiscal responsibility laws would go a long way towards improving

government management of public finances. Regulating for factors such as independent revenue estimates and limits to the level of deficits, spending and debt is very desirable. Brazil is the regional showcase for the successful adoption of these principles. Such laws limit the common pool of resources that agents can access and also limit the principal-agent problem by increasing transparency and accountability. These laws usually bundle together several of the desirable characteristics of budget procedures. They limit the ability of legislatures and line ministries to increase spending, and include transparency clauses to improve access

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to fiscal information by the public, thereby limiting the opportunities for corruption.

Fiscal rules that limit the scope for discretionary fiscal policies matter. An index combining the degree of hierarchy and transparency of the process and the existence of numerical limits on fiscal outcomes found that the fiscal balance in countries in the top quartile of the distribution was 2.3% of GDP better than the balance in countries in the bottom quartile. Combining this result with estimates for the effect of fiscal balance on economic growth suggests that annual growth could be boosted by 0.3% to 0.6% by moving countries from the lowest to the highest quartile. While these num-

**Addressing perennial fiscal vulnerabilities is a prerequisite for launching many desirable spending programs.**

bers are debatable, it is clear from the region's experience with fiscal management in the past that the lack

of fiscal rules and other appropriate institutions have been an impediment to sound economic policies.

Without strong fiscal institutions that enable sound management of public finances, the region will be hard pressed to escape the boom and bust economic cycles that have been so typical of previous decades. Even more importantly, without solid public finances capable of guaranteeing fiscal solvency, many of the worthy spending programs proposed in the Consulta de San José are just pie in the sky. For this reason, in the view of the experts, addressing perennial fiscal vulnerabilities is a prerequisite for launching many desirable spending programs that address important challenges in other areas.

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electricity and telecommunication would considerably stimulate growth. Furthermore, the panel found very promising the idea of establishing independent policy and program evaluation agencies that would provide evaluation and cost-benefit analysis to monitor social conditions and government programs over time. The agencies could share comparative information on effective policies among different countries to maximize the potential for more effective programs.

The panel identified a number of other very promising proposals as meriting further research. These proposals included research into the prevention of domestic violence, improving the quality of education, promoting rural infrastructure, improving financial services for the poor, and increasing the efficiency of health services delivery.

Certainly this exercise has its limitations. The most glaring is that since the proposed solutions had to be accompanied by cost-ben-

efit analyses, they were limited to interventions that have already been tested somewhere and for which there is some quantitative program evaluation. Still, the exercise was useful because prioritization, while certainly unpleasant, is unavoidable with scarce resources. While the prioritized lists are in no way a blueprint for reform, this issue of IDEA looks at the kind of programs that, in the judgment of a group of talented economists, give a greater bang for the buck.

# More and Better Spending on Infrastructure

Access to basic infrastructure services—roads, ports, electricity, water and sanitation—still remains a key challenge in the fight against poverty and the search for sustainable development in the region. While some benefits of good infrastructure are self-evident, others are less obvious. For example, the poorest people in rural Latin America live almost twice as far from the nearest paved road as their more prosperous compatriots, putting basic services and jobs virtually out of their reach. And what good is an export-led growth strategy if logistical costs are so high that companies can't get their goods to market?

Given the impact of this challenge on the region, the expert panel of the *Consulta de San Jose* assigned its third highest priority to increasing investment in, and maintenance of infrastructure. In a region that underinvests in infrastructure, improving roads, seaports, water, sanitation, electricity and telecommunication would considerably stimulate growth. Boosting infrastructure and improving maintenance should yield a very high return on investment, while also providing and enhancing access to markets and thus generating more prosperity.

A number of studies have shown that improving infrastructure has a positive impact on output, particularly for developing countries. As might be expected, the greatest returns are in the early stages of development, when the existing infrastructure is poor.

Infrastructure problems ultimately have a major impact on

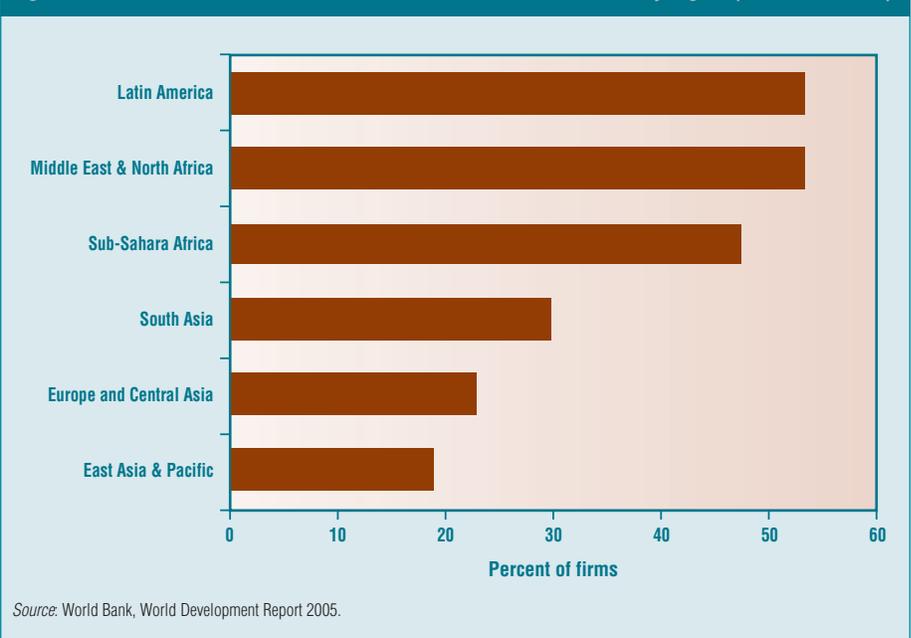
competitiveness—and companies know that. In Latin America, more than half of firms surveyed consider infrastructure to be a major or severe obstacle to running and growing a business, a much higher level than in Europe or Asia. (See Figure 2) Logistical costs in Latin America range from 18% to 34% of product value, while the OECD benchmark is about 9%.

Countries in the region currently spend on average only 2% of GDP on infrastructure, but it is estimated that 3–6% is needed to keep pace with countries such as China or Korea. The costs of this have to be borne primarily by users (with a safety net for some) and secondarily by taxpayers.

Not only must more money be spent, but it must be spent more wisely, avoiding costly prestige or “white-elephant” projects. Investments should be focused on increasing productivity and competitiveness and there is no reason why this should conflict with social goals. Implementing social tariffs will take care of social issues. The most important concern when it comes to infrastructure investment in Latin America is project selection. Selecting projects with the greatest impact is critical; thus, it is crucial that countries set up institutions capable of doing adequate planning, cost-benefit analysis and ongoing monitoring and evaluation.

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Figure 2. Businesses that Consider Infrastructure a Serious Problem, by region (Percent of firms)



# Through the Eyes of Youth

**A**ge makes a difference. The perspective of a student is certainly different than that of a seasoned economist and may offer a new vision of an old problem. The Consulta de San José sought to tap this other point of view with a Youth Forum. Away from the ivory tower, outside the cubicle, and beyond closed doors, a group of more than 30 enthusiastic Latin American and Caribbean graduate students representing over 20 countries came together to debate potential solutions to the main development challenges facing the region. Cherry-picked for their outstanding academic and professional backgrounds, these young professionals voiced their own opinions as to how to best invest scarce resources to advance their economies and their societies.

The Youth Forum operated parallel to the Consulta de San José Expert Panel, and the students were tasked with prioritizing a range of solutions to pressing regional problems based on cost-benefit analyses presented by the various authors. Students traveled to San José from top universities in Argentina and Colombia, as well as smaller yet important academic centers in Jamaica and Honduras, making for a diverse group of top-notch young people with a rich, multifaceted background. Not surprisingly, the final ranking of the Youth Forum did, in fact, differ from the results of the Expert Panel. The top 10 ranked solutions were:

1. Nutrition programs for preschool students
2. Nutrition programs for poor children
3. Conditional cash transfer programs for education
4. Increase access to healthcare
5. Improve efficiency and equity of public spending and taxes
6. Conditional cash transfer programs to combat poverty
7. Efficiently spend at least 3-6% of GDP on infrastructure
8. Increase the level of political party and party system institutionalization
9. Improve performance and cut corruption in regulation, taxation, and government procurement
10. Adopt policies and services to facilitate trade

## Students favored investments with a large and lasting impact on human capital.

A number of key themes surfaced during the discussions and voting. First, the students were particularly concerned with the need to focus on human capital. They clearly favored investments in areas that would have the largest and most lasting impact on human capital in the region. The students gave priority to education and poverty solutions, particularly those that targeted young children. More broadly, questions posed to the authors centered on how solutions in labor markets, fiscal policy and infrastructure, for example, would

affect and develop human capital directly.

The students also emphasized those solutions targeting youth, especially children aged 0 to 5. They believed that these solutions would be the most effective in breaking the cycle of poverty. Education and poverty solutions for pre-school children and infants, in particular, were ranked high.

The Youth Forum participants frequently noted that the solutions proposed by the papers offered a very limited set of options to consider, due to the emphasis on clearly measured cost-benefit analyses. They were concerned about leaving out practical and important solutions with great potential for impact simply because there was not enough statistical data to carry out a proper cost-benefit analysis. Many students commented on other solutions that might be more effective, have more of an impact, or be more feasible for the region. They lamented that focusing on solutions with reliable cost-benefit estimates implied recommending only those approaches that have been tried before, rather than new ideas that could potentially have a greater impact.

The Youth Forum participants expressed great interest in finding solutions that would have a meaningful impact both in the short and long-term. Although investing a certain amount of resources in a particular solution would give a high ratio of related benefits, the substantive effect on solving the pressing problems of the region may be lacking. The group tended to favor proposals with logical connections and reasonable expectations of

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Two projects funded by the World Bank illustrate how proper evaluation should be done. The first relates to rehabilitation and maintenance of two sectors of road in Bolivia. The project would reduce transport costs in a number of ways: by reducing vehicle operation, accident and travel time costs, removing physical constraints to travel both within the country and to Argentina and Chile and allowing more reliable and safer transport services to be run. For a total cost of \$23.4 million, benefits of \$45 million would accrue and the net present value is calculated as \$21.7 million (at a 12% discount rate). A sensitivity analysis showed the project was still perfectly viable if costs rose by 20% and benefits were 20% lower; it reached breakeven only for much more pessimistic assumptions.

The second project was for maintenance of Mexico's federal highways. This would reduce costs by lowering vehicle operating and travel time, and also keep the road network in good condition in an efficient and sustainable way. Benefits of \$612 million were calculated for a total cost of \$77 million. When an initial survey was done in 2001, 57% of roads were classified as being in good or fair condition; by 2004 successful implementation of the maintenance program had increased this to 75%.

As illustrated by these examples, investment in infrastructure should also deal with maintenance issues. Without proper maintenance of the existing stocks, depreciation costs increase considerably, thus raising gross investment needs to levels that

are not easy to finance in a sustainable manner.

Latin America and the Caribbean face the enormous challenge of upgrading its infrastructure. This means investing more and better, which is a costly proposition. But the payoff is potentially very big. Examples of projects undertaken with appropriate planning, execution and evaluation show that investment in infrastructure helps to unleash the forces of productivity growth, and to fight poverty, particularly in rural areas where the problem is often magnified.

In Latin America, more than half of firms surveyed consider infrastructure to be a major or severe obstacle to running and growing a business.

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real impact for Latin American and Caribbean populations. Additionally, the students not only wanted to understand the impact the solutions would have, but how they would be implemented. They asked very practical questions about who would pay the costs for implementation, and how political obstacles might be overcome. They also pressured the authors to translate their solutions and ideas into specific policies that could be implemented. They expressed an interest in wanting to take meaningful action now.

Finally, the Youth Forum participants demonstrated a keen ability to link the solutions offered in each

topic area and find the most effective combination of outcomes. They questioned how solutions from one area would affect others—in particular, synergistic effects—and they were both quick and creative in making connections between them. Most notable were their recommendations for nutritional programs that impact both education and poverty reduction goals.

The Youth Forum was valuable from the student participants' point of view as well as from the policy-makers' vantage point. With Latin America's relatively young population, the perspective of its rising stars is of utmost importance.



## New Publications

### RESEARCH DEPARTMENT WORKING PAPERS

#### Who Needs Strong Leaders? (WP-628)

*Alberto Chong and  
Mark Gradstein*

This paper's model suggests that a strong leader, sometimes with little legislative oversight, may nevertheless benefit from public support. The argument is that this support is induced as an attempt by the poor to counter the subversion of public protection of property rights by the rich, and to achieve this goal they are often willing to pay the price of the leader's diversion of tax revenues for private use. Examining individual attitudes toward strong leadership, the paper finds that support for strong leadership is inversely related to individual income and to countrywide income inequality.

#### Does a Mature AIDS Epidemic Threaten Growth? (WP-630)

*José Cuesta*

This paper models the impact on economic growth of HIV/AIDS when the epidemic is in a mature phase, in contrast with previous studies focused on periods of expansion, as in African countries. Simulations for Honduras, the epicenter of the epidemic in Central America, show that AIDS is not likely to threaten economic growth through either labor or capital accumulation channels; impacts are estimated between 0.007 and 0.27 percentage points of GDP growth annually for the period 2001-10. Likewise, increasing spending on prevention, public treatment subsidies and treatment access will not jeopardize economic growth prospects. Critical factors that slash economic growth in Africa (such as human capital reductions and shifts in

relative skills) are not strong in Honduras.

#### Using Pseudo-Panels to Measure Income Mobility in Latin America (WP-625)

*José Cuesta,  
Hugo Ñopo and  
Giorgina Pizzolitto*

This paper presents a comparative overview of mobility patterns in 14 Latin American countries between 1992 and 2003. The paper provides a set of estimators for the traditional notion of income mobility as well as for mobility around extreme and moderate poverty lines. The estimates suggest very high levels of time-dependent unconditional immobility for the region. However, the introduction of socioeconomic and personal factors reduces the estimate of income immobility by around 30%. There are also large variations in country-specific income mobility. Age, gender and, to a lesser degree, education of the household head and dwelling characteristics were found to play significant roles in changes in poverty incidence.

#### The State of Sexual and Reproductive Health in Latin America and the Caribbean: A Global Vision (WP-632)

*Carmen Elisa Flórez and  
Victoria Eugenia Soto*

This paper reviews the state of sexual and reproductive health in several countries in Latin America and the Caribbean using the Demographic and Health Surveys to select countries according to their stage in the demographic transition. The results indicate advances in some areas, the most favorable being in countries with low fertility and among higher social classes. However, there are still important challenges, especially in countries

whose transition has lagged. The evidence suggests that lack of information and access to reproductive services as well as social and cultural barriers, limits the exercise of a full reproductive life of women in high fertility countries and among underprivileged groups.

#### Corporate Governance and Firm Valuation in Colombia (WP-568)

*Luis H. Gutiérrez and  
Carlos Pombo*

This paper studies the separation of ownership and control of 108 listed companies in Colombia from 1996 to 2002, finding that voting rights are greater than cash flow rights because of indirect ownership across firms. The paper also examines the association of various ownership and control measures and separation ratios with a firm's value and performance for the same sample of companies that traded their stock from 1998 to 2002. Large blockholders were found to exert a positive influence upon a firm's valuation and performance. The paper further reports results from a 2004 survey that suggests that Colombian firms have been slow to improve their corporate governance practices.

#### Booms and Busts in Latin America: The Role of External Factors (WP-631)

*Alejandro Izquierdo,  
Randall Romero and  
Ernesto Talvi*

This paper analyzes the relevance of external factors in average quarterly GDP growth for 1990-2006 in the seven largest Latin American countries (LAC7). It is found that external factors account for a significant share of variance in LAC7 GDP growth, and

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## New Publications

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that external shocks produce significant responses. Likewise, much of recent LAC7 growth can be explained by an external factor “tailwind.” The relevance of these findings for policy is emphasized. Growth performance, the strength or weakness of macroeconomic fundamentals and the impact of domestic macro and micro policies on growth can only be properly appraised by first filtering out the effects of external factors.

### On Emerging Economy Sovereign Spreads and Ratings (WP-629)

*Juan Martínez and Andrew Powell*

This paper analyzes alternative models for emerging sovereign ratings. Although a small number of economic fundamentals explain ratings reasonably well, variations in those economic fundamentals are themselves explained by a few world factors. On the other hand, global financial variables associated with risk aversion are additionally required to explain the significant spread compression at the end of 2006. The evidence is that ratings matter. Finally, the paper finds that global indicators of risk aversion have become less important for emerging market spreads and that the effect of sub-prime news is less than the effect of “average news” on emerging economy credit default swap spreads.

### The Economic Effects of Employment Protection: Evidence from International Industry-Level Data (WP-592)

*Alejandro Micco and Carmen Pagés-Serra*

This paper examines the economic effects of employment protection legislation in a sample of developed

and developing countries. Analysis indicates that more stringent legislation slows down job turnover significantly, and that this effect is more pronounced in sectors that are intrinsically more volatile. The paper also finds that employment and value added decline in the most affected sectors, and employment and output effects are driven by a decline in the net entry of firms. In contrast, average employment per plant is not significantly affected.

### Fear and Market Failure: Global Imbalances and “Self-Insurance” (WP-593)

*Marcus Miller and Lei Zhang*

This paper proposes an integrated framework to analyze jointly two key issues: the emergence of global imbalances and the precautionary motive for accumulating reserves. Standard models of general equilibrium would predict modest current account surpluses in emerging markets if they face higher risk than the US. But, with pronounced loss aversion in emerging markets, their precautionary savings can generate substantial “global imbalances,” especially if there is not enough global “insurance.” In principle, lower real interest rates will ensure that aggregate demand equals supply at a global level. While a precautionary savings glut appears to be temporary, a correction triggered by a “Sudden Stop” in capital flows to the US might lead to a “hard landing.”

### No Education, No Good Jobs? Evidence on the Relationship between Education and Labor Market Segmentation (WP-627)

*Carmen Pagés-Serra and Marco Stampini*

This paper assesses labor market segmentation across formal and informal salaried jobs and self-employment in three Latin American and three transition countries. It looks separately at the markets for skilled and unskilled labor, inquiring if segmentation is an exclusive feature of the latter. The paper finds evidence of a formal wage premium relative to informal salaried jobs in the three Latin American countries, but not in transition economies. It also finds evidence of extensive mobility across these two types of jobs in all countries. These patterns suggest a preference for formal over informal salaried jobs in all countries. In contrast, there is little mobility between self-employment and formal salaried jobs, suggesting the existence of barriers to this type of mobility or workers’ aversion to do so. Lastly, for both wage differentials and mobility, the markets for skilled and unskilled labor are similarly affected by segmentation.

### The Missing Point in CAFTA (WP-610)

*José Antonio Reyes*

Although the Central American Free Trade Agreement (CAFTA) with the US is intended to provide benefits for exporters and importers, the region’s high port costs are likely to undercut these benefits. High costs, along with concerns regarding infrastructure, security, efficiency, and productivity, can diminish CAFTA’s potential benefits. Central America must therefore enact legal reforms to privatize port operations, as the private sector possesses the resources necessary to invest in those ports and make them competitive.

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## New Publications

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### RESEARCH NETWORK WORKING PAPERS

#### Female-Headed Households and Homeownership in Latin America (R-547)

*Nestor Gandelman*

The gender of the household head has often been treated as an exogenous determinant of homeownership. This paper argues that several determinants of homeownership also affect household headship and that failing to explicitly account for this endogeneity leads to inconsistent results. Using individual level data for Chile, Honduras and Nicaragua, the paper shows that although on average women are less likely to be homeowners, women who head households (single, separated or divorced) are more likely to attain homeownership. Thus, household level analysis should control for the endogeneity of household headship in order to properly address the gender effect on housing tenure. Estimating a bivariate probit model, the paper finds evidence that female-headed families have a lower probability of owning their home in Latin American countries. Without the endogeneity control this result was not present in eight countries.

#### Gender Differentials in Judicial Proceedings: Field Evidence from Housing-Related Cases in Uruguay (R-546)

*Eduardo Gandelman,  
Nestor Gandelman and  
Julie Rothschild*

Using micro data on judicial proceedings in Uruguay, this paper presents evidence that female defendants receive more favorable treatment in courts than male defendants. This is due to longer foreclosure proceedings and higher probabilities of being grant-

ed extensions in evictions and dispositions for female defendants.

#### What Emigration Leaves Behind: The Situation of Emigrants and their Families in Ecuador (R-542)

*Giorgina Piani,  
Máximo Rossi and Ximena Soruco*

This study seeks to identify, measure and analyze possible discriminatory behaviors in southern Ecuador. There are three main findings. First, emigration is perceived as a social problem. Second, emigrant families are seen as economically “irrational” because they do not invest remittances in productive and sustainable activities; they are also portrayed as “irresponsible” because they leave their families in search of better living conditions. Third, emigrants’ children do worse in school than their peers and live outside the society at large. Observed discrimination follows a cultural pattern: persons closer to the dominant culture are proportionately more likely to discriminate against emigrants and their families, and women are more discriminatory than men.

### OUTSIDE PUBLICATIONS

#### Is it Possible to Speak English Without Thinking American? On Globalization and the Determinants of Cultural Assimilation

*Alberto Chong and  
José Galdo.*  
*Economics Letters. Available on-line  
24 January 2008.*

Based on research in linguistics and psychology, this paper uses language speech as a reflection of acculturation. It uses individual and city-level data from the Lake Ontario area in Canada to study the determinants of cultural assimilation. The focus is on educa-

tion, age, income, and some globalization-related factors such as immigration, television viewing, borders, and residence history of the individuals. The paper finds that actual contact does matter as a determinant of cultural homogenization. Virtual contact appears to be irrelevant.

#### Beliefs vs. Actions. The Mystery of Discrimination in Latin America

*Alberto Chong and  
Hugo Ñopo.*  
*Economía, Vol. 8, No.2 (Issue 16)*

Perception surveys confirm that there is discrimination in Latin America. However, such surveys cannot pinpoint the extent and mechanisms behind discrimination. Using a new methodology based on harmonized household surveys, this paper confirms the presence of wage gaps that cannot be explained by individuals’ human capital characteristics, but does not necessarily provide proof of discrimination. In fact, recent experimental evidence suggests few discriminatory practices in the region. This apparent contradiction is consistent with an explanation about stereotyping that vanishes when information flows operate well.

#### An Extension of the Blinder-Oaxaca Decomposition to a Continuum of Comparison Groups.

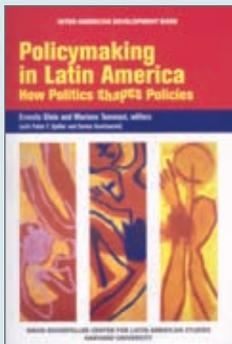
*Hugo Ñopo.*  
*Economics Letters,*  
*Available online 15 February 2008.*

This paper proposes an extension of the Blinder-Oaxaca decomposition from two to a continuum of comparison groups. The proposed decomposition is then estimated for the case of racial wage differences in urban Peru, exploiting a novel data set that allows the capturing of mestizaje (racial mixtures).



## Network News

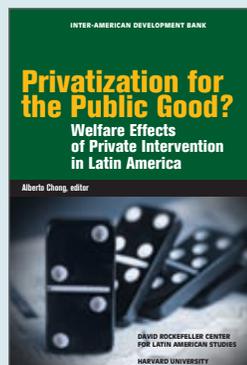
These two books are products of  
Latin American Research Network projects.



**Policymaking in Latin America:  
How Politics Shapes Policies**  
*Ernesto Stein and Mariano Tommasi, Editors  
(with Pablo Spiller and Carlos Scartascini)*  
Harvard University and Inter-American  
Development Bank. 2008.  
*Research Network Project: Political  
Institutions, Policymaking Processes and  
Policy Outcomes*

What determines the capacity of countries to design, approve, and implement effective public policies? To address this question, this book builds on the results of case studies of political institutions, policymaking processes, and policy outcomes in eight Latin American countries. The result is a volume that benefits from both micro detail on the intricacies of policymaking in individual countries and a broad cross-country interdisciplinary analysis of policymaking processes in the region. It shifts the focus of analysis from policies themselves to the process behind these policies.

**Privatization for the Public Good?  
Social Effects of Privatization in  
Latin America,**  
*Alberto Chong, editor; David Rockefeller  
Center for Latin American Studies,  
Harvard University and Inter-American  
Development Bank. 2008*  
*Research Network Project: Does Society  
Win or Lose as a Result of Privatization?  
Provision of Public Services and Welfare  
of the Poor*



This book provides a detailed microeconomic analysis of the impact of various privatizations in different countries in the region. Its central message is that in many cases, contrary to popular belief, society as a whole and in particular the poor have benefited from privatization. The book presents a careful analysis of the various mechanisms through which privatization has an impact on welfare, an analysis that by and large has been missing from the debate.

[www.iadb.org/res/researchnetwork](http://www.iadb.org/res/researchnetwork)

### Seminar

**All That Glitters  
May Not Be Gold:  
Assessing Latin America's  
Macroeconomic  
Performances**  
*Forty-Ninth Annual Meeting of the  
Board of Governors of the Inter-  
American Development Bank*

*Miami Beach Convention Center,  
C-125/126  
April 4, 2008  
2:30-5:30 pm*

Latin America is growing fast and fundamentals look healthier. Are these achievements here to stay? Strong commodity prices may not last forever and a US recession could have major repercussions in the region. Should countries prepare now for tomorrow's crisis? What is the top-ten list on the policy agenda? The seminar will address these issues and more.

#### Speakers:

Luis Alberto Moreno, President, IDB  
Randall Krozner,  
Governor, US Federal Reserve  
Santiago Levy, Vice-President of  
Sectors and Knowledge, IDB  
Ernesto Talvi, Executive Director,  
CERES  
Michael Gavin,  
Citadel Investment Group  
Guillermo Mondino, Lehman Brothers  
Carmen Reinhart,  
Professor of Economics,  
University of Maryland  
José Juan Ruiz, Chief Economist,  
Grupo Santander