ANDRÉS VELASCO

Editor's Summary

This inaugural issue of *Economía*, the journal of the Latin American and Caribbean Economic Association (LACEA), comes at a most propitious time. The countries of Latin America and the Caribbean launched dramatic changes in economic policy in the last decade, decisively moving toward open market systems. The region has become a major testing ground for new policies in the areas of inflation stabilization, fiscal reform, trade and financial liberalization, privatization, regulation of newly privatized enterprises, targeted social policies, and the transition from pay-as-you-go to individually capitalized social security systems. As some of these first-stage reforms are consolidated, several countries are moving into a second stage of institutional changes, tackling long-overdue improvements in the delivery of health, education, and judicial services.

These reforms have gone hand in hand with a remarkable increase in the quality of the policy debate in the region. A new generation of highly trained economists, many of them graduates of top academic programs in North America and Europe, has reached important positions in government. At the same time, the quality of economics research and teaching has improved drastically not only in traditional public universities, but also in a range of private universities, institutes, and think tanks that have been founded in the last two decades.

Yet most policy discussions remain focused at the country level. There are few forums at which economists and policymakers from the region can come together to share research results and country experiences on policy issues. And there are even fewer outlets in which these policy lessons can be put into writing, subjected to strict academic standards, and made accessible to a broad audience, both within and beyond the region.

Economía will be a policy journal, that is, one in which new theories or techniques are applied to policy questions, and not simply presented for their own sake. It will commission papers on issues that are both at the forefront of the policy agenda and of broad interest to countries throughout the region. In addition, it will seek the highest standards of theoretical and statistical rigor, but will only publish papers that are written in a style and language that makes them accessible to policymakers.

I am confident that the papers in this inaugural issue not only satisfy these criteria, but also set a high standard for contributions to come. These papers were presented at the first *Economía* Panel Meeting, which took place at New York University on 12–13 May 2000. Such panels will meet twice a year—once in Latin America, in conjunction with the LACEA annual meeting, and once in the United States. The David Rockefeller Center for Latin American Studies at Harvard University will host the meetings in the spring of 2001 and 2002.

The five papers in this volume address issues that are very much on the public agenda today in Latin America. Two—namely, the paper by Fischer and Serra on the regulation of electric utilities and the one by Heckman and Pagés-Serra on the costs of labor market rigidities—are concerned directly with so-called second-generation reforms. The remaining three—by Lustig on the impact of financial crises on the poor, by Caballero on the causes and consequences of macroeconomic volatility, and by Fajnzylber, Lederman, and Loayza on the determinants of crime—address second-generation issues that have become salient in recent years.

Crises and the Poor: Socially Responsible Macroeconomics is a revised version of the Presidential Address that Nora Lustig gave at the Fourth Annual Meeting of LACEA, held in Santiago in October 1999. That poverty rises as a result of economic crises such as those experienced by Latin America in the 1980s and again after the tequila and Asian shocks should come as no surprise. What has received less emphasis, she argues, is that such crises can lock poor people—and their children—in long-term poverty traps. Because such crises are an aggregate shock and because poor people are often outside formal credit markets and social insurance systems, most smoothing mechanisms do not work for them. Crises therefore cause the poor to disinvest and reduce their assets, including their human capital. This can have deleterious effects that long outlive the shock. Such hysteresis, Lustig argues, is a central reason why publicly funded safety nets should be part of an efficient and socially responsible policy response to macroeconomic crises.

Ricardo Caballero also addresses the issue of macroeconomic volatility, but from a different perspective. In *Macroeconomic Volatility in Latin America: A Conceptual Framework and Three Case Studies*, he attempts to identify the structural weaknesses that leave Latin American economies so vulnerable to external shocks, even when liberalization and stabilization have been successful. He argues that two main common factors lie behind structural volatility: weak international financial links and a limited development of domestic financial markets, particularly for small and medium-size firms. The paper uses case studies of Argentina, Chile, and Mexico to analyze how these factors interact with and can be magnified by other country-specific vulnerabilities, such as fiscal imbalances, rigid labor markets, and fragile banking systems. He concludes that crisis management can be thought of as international liquidity management: monetary, fiscal, and debt policies should be geared toward increasing the liquidity of domestic firms. Crisis-avoidance policies should be designed with the same objective in mind: strengthening international financial links and deepening local credit markets so that real shocks do not become liquidity crises, with predictably nasty consequences for employment and output.

In *The Cost of Job Security Regulation: Evidence from Latin American Labor Markets*, James Heckman and Carmen Pagés-Serra tackle an ever-controversial issue, yet they come up with startlingly unambiguous results. Policies to promote job security, such as severance payments and other termination costs, are common in Latin America. What are their costs, if any? The paper both summarizes existing data and provides new evidence, consisting of a cardinal measure of firing costs that summarizes the entire tenure-severance pay profile across countries. Heckman and Pagés-Serra conclude that regulations promoting job security reduce covered workers' exit rates out of employment. The evidence also suggests, however, that demand curves are downward sloping, that regulation reduces aggregate employment, and that the greatest adverse impact of regulation is on youth and groups marginal to the workforce. Insiders and entrenched workers gain from regulation, but outsiders suffer. As a consequence, job security regulations both reduce employment and promote inequality across workers.

Now that the privatization of utilities is quite advanced in most countries of the region, attention is increasingly focused on the crucial issue of regulation. In *Regulating the Electricity Sector in Latin America*, Ronald Fischer and Pablo Serra survey the experience in that key sector since the early 1980s. Countries have experimented with a wide variety of systems, ranging from early administered systems to recent systems that allow a wider scope to the market. A process of learning by watching has taken place, with latecomers attempting to avoid the mistakes of early reformers. Fischer and Serra argue that the privatization-cum-regulation of Latin American electricity sectors has been, in general terms, successful: privatized firms have sharply increased their efficiency and coverage. These productivity gains, however, have been passed on to consumers only in those cases where there is competition. Their conclusion: the Latin American experience confirms the idea that competition is the ideal regulator. When privatizing, designing a system that will ensure the broadest possible scope for competition should be the top priority.

In Latin America today, few issues take up more headlines than crime and violence. This is an economic issue in at least two senses: factors such as poverty and unequal distribution plausibly affect the level of crime, and this in turn affects a country's overall economic performance. In *Crime and Victimization: An Economic Perspective*, Pablo Fajnzylber, Daniel Lederman, and Norman Loayza focus on the first of these two senses. Using cross-country data, they analyze the determinants of homicides and robberies. The growth rate of GDP, the degree of income inequality as measured by the Gini index, and the respective lagged crime rates are significant and robust determinants of these crime rates. This last result is troubling, for it suggests that crime is self-perpetuating. Proxies for deterrence (specifically, the number of police personnel per 100,000 inhabitants and the presence of the death penalty in the country) and for the size of the illegal drug trade also help explain homicide rates (with the expected sign), but they have conflicting effects on the robbery rates. The paper then reviews recent case studies from Latin American cities that rely on survey data to assess the empirical determinants of the probability of victimization. Two individual characteristics are significant in all cases—being male and being unemployed. Some household characteristics (such as being headed by a single parent) and community characteristics (such as average educational attainment) also seem to matter, but those results are more mixed.

The economic problems facing Latin America are serious, but they are not intractable. In recent years, countries have made important gains in several directions. With attention increasingly turning to a set of obstacles, the terrain ahead is largely uncharted. Producing new research and arriving at fresh policy lessons is more important than ever. The papers in this issue make an important contribution to those tasks.