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Ideas for

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Development

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in the Americas

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The Skills Gap: Teens in the Workforce



Inter-American Development Bank
Research Department

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Countries throughout Latin America and the Caribbean have made dramatic progress over the last few decades in expanding access to education. Today the share of the region's elementary school-age children who actually attend classes stands at 95%, essentially the same as the average for the developed world. The corresponding share for secondary school is lower, at 73% (compared with 91% in the developed countries), yet even that represents a marked improvement just since the 1990s, when only 65% attended. Many countries have also closed much of the gap in terms of years of schooling for the average adult: the figures for the highest-achieving countries are within a year or two of the developed-world average.

These are real achievements and reflect a substantial increase in the resources devoted to education in the region. There is disturbing evidence, however, that these ambitious investments are not producing the expected payoffs. For one thing, dropout rates remain high: only a little more than half of today's 15- to 19-year-olds in Latin America have completed ninth grade, and only about 40% of 20- to 24-year-olds are high school graduates. In all, some 50 million young adults in the region lack a high school diploma.

Moreover, there are signs that the labor market returns to secondary-school education are on the decline in the region. These

There is a mismatch between the skills that the region's young people are acquiring and those that today's employers demand.

returns are conventionally measured in terms of a wage premium, or the increment in the wages paid to workers, on average, for each year or level of additional education they possess. The wage premium that Latin American secondary-school graduates command relative to their counterparts with only elementary schooling has fallen, while the premium for those with college or other postsecondary education has risen (figure 1). Other measures of returns show similar patterns.

Falling returns to secondary-school education are not unique to Latin America. They have also been a topic of intense interest in the United States, for example, where the phenomenon is thought to relate to computerization: computers typically complement the skills of the college educated, making them more productive, while having little impact on the least educated. It is mainly workers in the middle range—typically those with a high school education and no more, performing skilled but routine (and therefore automatable) tasks—who see their jobs being replaced by computers.

The same is likely occurring in Latin America, but other factors may be at work as well. One of these may be precisely the expansion of access that is the region's great achievement in education. All else equal, the resulting increase in the supply of high school-educated workers should put downward pressure on

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The Skills Gap: Teens in the Workforce

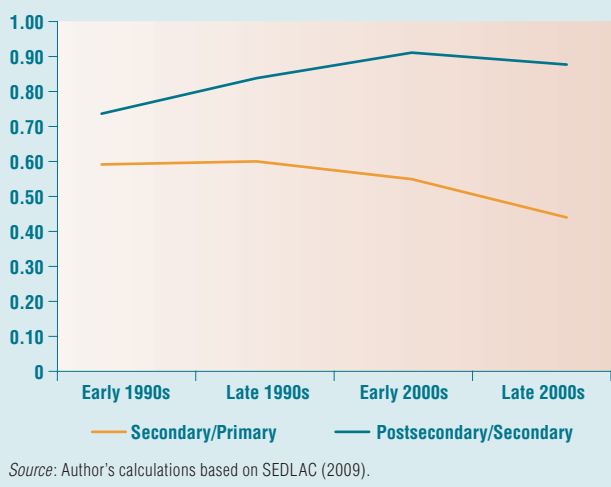
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wages and employment for this group.

A more unsettling possibility is that the region's increasing *quantity* of educational output is not being matched by increasing *quality*. There are two senses in which this might be so. Latin American students may be completing more years of school, yet failing to master the knowledge and skills they were expected to learn there. Or they could be acquiring that knowledge and those skills, only to find that those are not the knowledge and skills they need for success in the workplace. In other words, there may be a serious disconnect between supply and demand—between what employers are seeking in terms of knowledge and skills, and what young people are actually learning in the region's schools.

The program for International Student Assessment (PISA) provides evidence supporting the first proposition—that too few of Latin America's young people are learning basic academic skills. Every three years, PISA administers a standardized examination to 15-year-olds in dozens of countries worldwide to measure not just rote learning of facts from a curriculum, but rather the ability to apply the knowledge and skills learned in school—in reading, mathematics, and science—to problems that mimic those encountered in the real world. Nine countries in Latin America and the Caribbean took part in the 2009 version of the PISA examination. Although their scores showed improvement from previous years, the region as a whole tested in the bottom third of all participating nations, and well below the median.

Figure 1. Wage Premiums by Educational Group in Latin America and the Caribbean (Adult Workers)



About half of the region's 15-year-olds scored below the minimally competent level in reading, and almost two-thirds came up short in mathematics, compared with only about 20% of those from developed countries.

These are discouraging findings. But what if there is also a mismatch between the skills that the region's young people are acquiring and those that today's employers demand? It is well known that many employers value not only cognitive skills, acquired through academic learning, but also an array of "softer" skills and attributes related to behavior and personal characteristics, such as a sense of personal responsibility, perseverance, and teamwork. Yet solid evidence on the role of these skills and their prevalence in the working population have been scant, even in the developed world, because only recently have skills other than the traditional academic ones been systematically measured. The accumulated evidence suggests that these "noncognitive" or "socioemotional" skills are critical for success in the working world.

One other thing that is known about socioemotional skills is that an individual's environment plays a relatively larger role in their acquisition than is the case for cognitive skills. In other words, where success in acquiring intellectual skills (intelligence) is largely a matter of genetic factors and stimulus during early childhood, socioemotional skills are more easily molded. In addition, whereas that innate capacity to acquire cognitive (intellectual) skills is largely fixed in early childhood, the critical period for learning socioemotional skills extends into the teen years and possibly beyond.

This is good news for Latin America, because it means that a window of opportunity remains open for the region's secondary schools to instill, shape, and consolidate these vital skills in the growing share of the population that they serve. In a part of the world where most young people do not continue their education beyond high school, secondary schools thus have an essential role to play in preparing today's youth for the transition to the workplace.

In the meantime, however, much more needs to be understood about the acquisition of both cognitive and noncognitive skills by Latin American and Caribbean youth, and about which of these skills are most sought after by the region's employers. To this end, researchers from the Education and Research Departments at the Inter-American Development Bank have undertaken a series of studies, whose results are reported in a new book, *Desconectados: habilidades, educación y empleo en América Latina*. The focus of the study

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Does Education Pay Off?

Do individuals with more education have measurably more skills than individuals with less education and are they rewarded commensurately in the workplace? In other words, is pursuing an education worth it? At first blush, the answer to this question may seem intuitive. However, while it is well known that persons with more education enjoy greater success in the workplace, it is less clear precisely what it is about education that produces this advantage.

The answer to this question appears to lie in looking beyond traditional academic skills. Cognitive skills (more precisely, intellectual capacity, a concept not identical to, but correlated with, IQ) are certainly important. But so, too, are socioemotional skills: social skills (leadership capacity, ability to work with others), metacognitive skills (the ability to organize and plan cognitive tasks), and self-efficacy (the ability to perceive oneself as a capable, effective student or worker).

A study conducted in 2008 among a sample of 4,497 Chileans and 1,800 Argentines between the ages of 25 and 30 tested these various skills and came up with some notable results. Argentina and Chile have similar incomes per capita and similar educational systems, but the latter also differ in ways that make the comparison interesting. Although the focus of the study was on secondary education, the sample included individuals across the whole spectrum of educational attainment to provide a frame of reference for measuring the contribution of secondary school to skill acquisition and workplace success. Just under 10% of the sample in both countries had attended elementary school alone; at the other extreme, about 45% in each country had at least begun their postsecond-

ary education, at either a university or a technical or professional school. The remainder, a little less than half the total sample, had attended (but not necessarily completed) high school but had gone no further.

Several noteworthy findings emerged from the study. To begin with, there was little correlation between cognitive skill and any of the three socioemotional skills examined: strong cognitive performance did not predict strength in the noncognitive domain, and vice versa. However, the three socioemotional skills did show a high correlation with each other. This is perhaps unsurprising given that all three differ from cognitive skills in being less dependent on genetic endowment and more malleable well into adolescence.

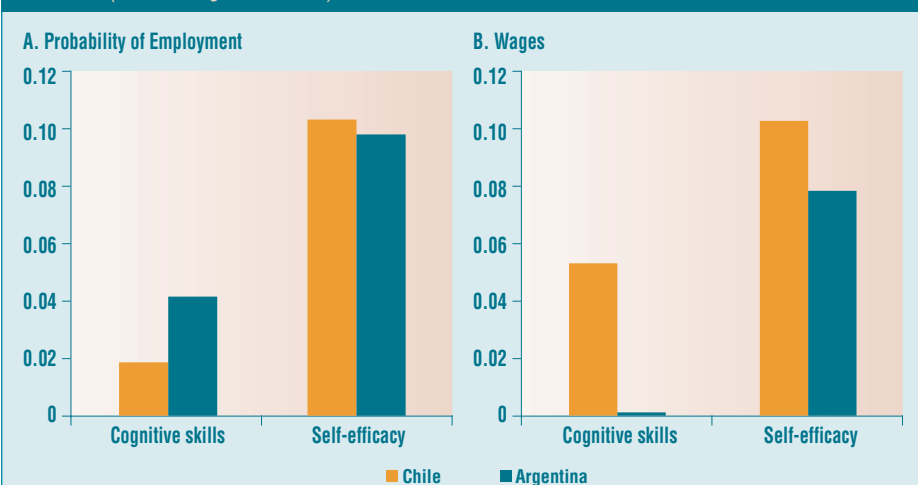
In general, more education was indeed associated with more skill of every type: individuals with tertiary (university or technical-professional) education tended to outperform those

with only secondary-school education, who in turn outperformed those who had attended only elementary school. (The one possible exception to this finding was that those who had attended a university scored slightly lower on self-efficacy than those educated at technical or professional schools.) This suggests that additional schooling does make a positive contribution to one's skill endowment, and not just in the cognitive domain—education builds noncognitive skills as well. However, a self-selection effect may also be at work whereby those with more skill are the ones who succeed in achieving higher levels of education.

Interestingly, although cognitive skills were positively associated with several measures of workplace success, the association of socioemotional skills with success was even stronger (figure 2). This was true whether the measure of success was wages, labor

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Figure 2. Association between Selected Skills and Employment Outcomes
(Workers aged 25 to 30)



Source: Authors' calculations based on STS survey results (2008a e 2010b).

Note: The estimates were obtained with a Probit model of employment and log wages as dependent variables, respectively. Explanatory variables include age, gender, father's education, mother's education, family income, skills levels (without controlling for level of education of the individual). In both cases, individuals who were in school at the time of the survey were excluded from these regressions.

The School-to-Work Transition

Every young person who aims to earn his or her living must at some point make the transition from the familiar world of school to the world of work. The transition is often difficult, even for the relative few who have planned for the move by studying for what they believe will be a marketable occupation. Young people entering the workforce from secondary school typically pass through a series of temporary jobs, often in different occupations—and in Latin America, often in the informal sector—before finding a good and stable match. Many endure a year or more of joblessness before securing their first job. Many discover that the well-paying career they have dreamed of requires that they return to school to enhance their skills.

Yet despite its importance in the life of every worker, surprisingly little is known from a social sciences perspective about the school-to-work transition, and the gap in this knowledge is even greater in Latin America than elsewhere. What are the factors, both individual and environmental, associated with success in the transition? What skills do employers look for in the young people they hire for entry-level jobs? And are they finding them?

In 2010, a survey of roughly 1,200 firms in Argentina, Brazil, and Chile in industries that were known to hire workers directly out of high school for jobs related to their primary activity sought answers to these questions. The survey covered firms of various sizes in five selected industries—automobile manufacturing, food processing, hotels, finance, and retail trade—that togeth-

er employ a third to roughly half of all young workers, depending on the country. Both unionized and nonunionized firms were represented, as were both firms that serve only the local or the national market and firms with international reach.

The surveyed employers were asked about the kinds of jobs they offered and what they paid, the skills those jobs required, the difficulty encountered in finding applicants with those skills, and what the firms did when workers with the needed skills could not be found. In so doing, the survey attempted to address the demand side of the school-to-work transition, thus complementing the supply-side investigation—the acquisition of skills through education.

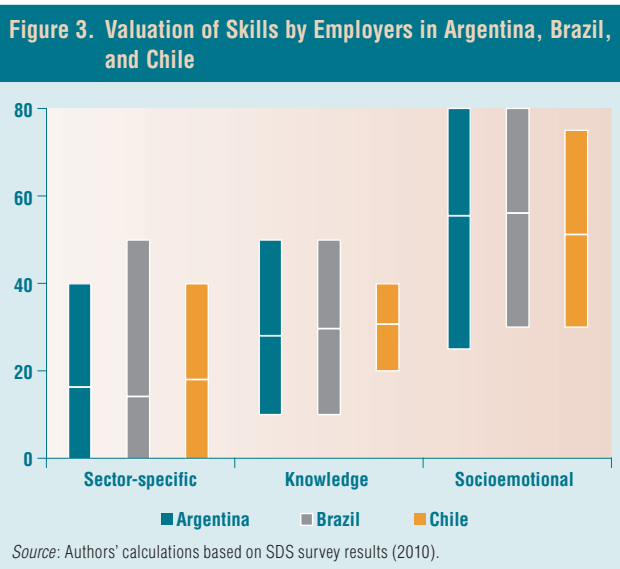
The survey found, first, that good opportunities do exist for Latin American workers with only a secondary-school education. Entry-level wages at the surveyed firms averaged around twice the official minimum (but with substantial differences across firms), and average and maximum salaries

were substantially higher than entry wages (but much more dispersed), indicating that career advancement is a real possibility. Competition for those good jobs was intense, however, and the average duration of these entry-level jobs was less than half that for more highly qualified workers. The survey also found that about half of the firms had raised their skill requirements within the last five years—a trend that may reflect the impact of computerization.

Employers were asked about the relative importance of three different categories of skill: cognitive or knowledge skills (reading, writing, and basic math, but also reasoning and critical thinking), socioemotional skills (attitude toward work, commitment and responsibility, client-centeredness, and ability to work within a team), and skills specific to their firm. In all three countries, socioemotional skills were rated more important than cognitive skills, with firm-specific skills, perhaps surprisingly, in third place (figure 3). This ranking was observed consistently across firms of different

size and across industries, except that automotive firms placed a higher value on firm-specific skills than did firms in other industries.

Only 12 percent of the surveyed firms reported having no difficulty finding the skills they needed among their applicants entering the workforce from high school. Socioemotional skills were the most difficult to find: here the share of firms reporting difficulty ranged from 16% in Chile to 30% in Brazil. Within the cognitive skills group, the more abstract, high-



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er-level skills such as critical thinking were also reported scarce. Firms that placed a higher value on the relatively scarce socioemotional skills also paid higher wages to those who possessed them. However, no such correlation was observed between cognitive skill endowment and salary.

Finally, there was substantial homogeneity among firms in how they responded to skills shortages in the labor market: a majority reported that their practice in such circumstances was to go ahead and hire the best candidates available and train them, rather than wait for applicants who fulfilled their skill requirements to present themselves. However, firms tended to be more likely to offer training for firm-specific skills than for socioemotional or cognitive skills—the reverse of the order as ranked by importance or scarcity. Most likely, a firm has a stronger incentive to train employees in skills that only that firm can use: once trained, a worker is free to sell that skill to the highest bidder; thus, the benefits of training in more widely applicable skills are likely to be captured by a firm's competitors.

Taken together, the survey's findings are evidence of a real disconnect in the region between the skills that young secondary-school-educated workers bring to the labor market and those that employers require. In all three countries surveyed, good-paying jobs with career potential exist for young people with only a high school education, yet the vast majority of employers are having difficulty finding workers with the basic skills needed to fill those jobs—skills that should have been learned in high school. Moreover, this skills gap imposes real costs on both sides: for the employers in the form of higher search costs, addition-

al training, and higher turnover, and for the young applicants in the form of longer spells without work.

If labor markets were perfectly competitive, such a disconnect would never arise (or would not last long). Firms encountering a shortage of skilled workers would raise the wage they offer for the skills demanded, and potential hires would respond by acquiring those skills (if they do not already have them); the available jobs would then be filled, and the market would clear. Evidently, this is not how labor markets work in Latin America, or elsewhere for that matter, and the reasons why are not difficult to perceive. For one thing, potential workers cannot simply acquire new skills at will—schooling is costly (in terms of the opportunity cost of not working, even if the tuition is free), the costs cannot always be financed, and each individual's learning potential is limited by his or her aptitude.

Surely the greatest obstacle to the efficient matching of skilled workers with skill-demanding jobs, however, is lack of information—on both sides

of the employment transaction. Young high school students often simply do not know what skills are most in demand in today's workplace, and would-be employers have difficulty evaluating the potential—especially in terms of the socioemotional skills they value most—of the young people who fill out their applications. The result is the disconnect revealed by the research: students exit the educational system, often with too few skills or the wrong ones, and enter the bewildering maze that is the modern labor market. There they typically endure months to years of dissatisfying work, interspersed with periods of unemployment, and only after much searching do they find—if they are lucky—the right job match for their talents, skills, and interests.

Increasing the flow of information between school and the workplace thus seems the key to resolving the disconnect. Yet as so often happens, this information has the character of a public good that everyone would benefit from, yet no one has the incentive to provide.

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is squarely on secondary education. Again, this focus was chosen not just because of the growing importance of secondary schools in the region's educational system, but also because the relevance of the education being provided there is very much open to question. It is this segment of the population that is perhaps most in danger of being “disconnected” from the world of productive work, of having spent years

developing skills that do not meet employers' needs—or worse, acquiring few useful skills at all. If, as the cliché has it, the future of Latin America is in its young people, what is happening—or not happening—in those schools will largely determine that future. This edition of *IDEA* draws on the findings reported in this new book and what they imply for public policy in education throughout the region.

Bridging the Skills Gap

A disconnect exists between the demand for and the supply of skills in the Latin American labor market. Simply put, the skills that the existing educational system is producing are not the skills that employers in the region are looking for. Why is this deep divide present? In part, the parties involved in the educational system at all levels—students, parents, teachers, principals, and education policy-makers—lack information about the kinds of skills, socioemotional as well as cognitive, demanded in today's labor market. Worse yet, this underproduction of sought-after skills derives at least in part from a lack of incentives on the part of educators to give priority to their nurturance.

Actually, the reasons for today's skills mismatch may lie in the history of the region's educational systems. The original Latin American model of secondary education was rooted in the European model, which traditionally offered two separate tracks toward a diploma: a liberal, generalist, humanistic curriculum designed to prepare its graduates for university study, and vocational education for those who would enter the workforce directly out of high school. Around the beginning of the twentieth century, however, this system came to be viewed as perpetuating longstanding inequalities that undermined social coherence and stability. The two-track system was therefore largely set aside in favor of one that promoted the generalist approach to secondary education for all, and an open door for all to higher education.

Today, that admirably egalitarian and idealistic model is confronting a hard reality: whether because of financial, institutional or cultural limitations, or for lack of interest, ability or need, not every young Latin Ameri-

can is destined for an academic college education. As a consequence, an enormous number of the region's youth are emerging from the system with at best an incomplete command of the college-preparatory curriculum they have been taught, and little acquaintance whatsoever with the skills needed for the jobs that must be filled.

The problem has in fact long been recognized, and a number of ad hoc efforts have been undertaken throughout the region to bridge the gap between secondary school and the world of work. These include Chile's dual education program Chile Califica, Colombia's Servicio Nacional de Aprendizaje, Mexico's Colegio Nacional de Educación Técnica (Conalep), and Jamaica's National Youth Service Corps Programme. Locally structured internship programs are also becoming more widespread across the region.

However, much more needs to be done, especially from a systemwide perspective, beginning with training the educators throughout the system. In a nutshell, efforts must focus on two areas: first, on expanding and improving flows of information among all parties, both within the educational system and outside it, and; second, strengthening incentives within the system to ensure that the information thus transmitted is appropriately acted upon.

A critical step toward generating and disseminating information from within the educational domain outward is a system of national evaluations using standardized testing to measure basic academic skills. The system established in the United States under the No Child Left Behind legislation has demonstrated the effectiveness of such evaluations, and Brazil has enjoyed success with similar initiatives. Countries in the region should also

participate in international comparative evaluations, as some are doing already. In the longer run, however, more is needed, including a process of evaluation that covers the broader set of skills identified in the research, and a process for tracking the labor market outcomes of those who have made the school-to-work transition, to help determine whether real progress has been achieved. Finally, much information already exists or could be compiled within the schools that could be usefully made public, from rates of absenteeism and the incidence of disciplinary problems to average grades and average hours of classroom time per semester or year.

Enhanced flows of information about what is going on within schools and in the education system as a whole would be beneficial in several ways. Parents who are better informed about the educational options available, and about the quality of different schools, would be empowered to make better choices for their children and have a basis for demanding improvements in the schools. Better-informed teachers and administrators would learn where improvements are needed and could direct their limited resources more effectively. Employers, too, would benefit both through better-informed hiring decisions and a better understanding of what skill gaps remain for them to fill through training. Employers themselves could contribute to the improved flow of information by providing data on labor market outcomes as mentioned above, as well as by sharing with the schools information about their evolving need for skills and about available jobs.

But information alone is insufficient; incentives to act on that information are also needed. Research

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has shown that when secondary-school students are given information regarding the various occupational alternatives available, and that information includes information about pay, this knowledge influences their decisions about whether to continue school and what to study. This suggests that secondary-school students are mindful of their imminent transition to the world of work and capable of responding to incentives. But it is teachers and administrators who set the skill standards that the students must meet, who then impart those skills, and who finally verify that the skills have been acquired and the standards met. They, too, therefore, must face adequate incentives to use the improved flows of information, from within the schools and from beyond their walls, to strengthen curricula and their own teaching and testing practices.

Increasingly, the practice of setting educators' pay strictly according to their credentials—degrees earned, years of teaching experience, and the like—has proven ineffective at motivating good teaching, and this practice is being discarded in favor of pay based on documentable results. The incentives are in some cases offered to individual teachers, as in a program in India's Andhra Pradesh state, and in others at the level of the school, as in Israel. Besides giving existing teachers a direct incentive to improve their performance, results-based pay should also encourage young people with a talent for teaching to enter the profession.

One concern with results-based incentives is that they may promote “teaching to the test”—that is, they may induce teachers simply to drill students in material known to be on the test while discarding other, equally

important content. Similarly, teachers may feel compelled to “coach” their students in test-taking strategies rather than teach them in ways that lead to genuine understanding and mastery. These are valid concerns—the personalized nature of education makes designing an “ideal contract” for teachers difficult. Empirical research has shown, not surprisingly, that results-based incentives work best when the teacher has meaningful control over the learning process, the rewards re-

game is perceived as enduring, and the size of the reward is enticing. Another probable factor in success is the extent to which teachers have access to opportunities to improve their own classroom skills.

Bridging the skills gap is not an easy task but one that will reap rewards for job seekers and employers alike. Moreover, ensuring people are prepared for the jobs at hand will undoubtedly grease the wheels of the economy as a whole.

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force participation, or the likelihood of being employed. Within the group of socioemotional skills, self-efficacy showed the strongest relationship with workplace outcomes, indicating that individuals who value their own abilities more highly are more likely to perform well in their work careers.

Technical and professional schools are apparently the best at preparing students for the workplace. People who had graduated from (as opposed to merely attended) technical and professional schools displayed higher levels of the socioemotional skills than did other groups. Since these are the skills that seem to be most highly valued by employers, this finding raises the question of what is behind this association. If these schools are better than others at building these valuable skills, what are they doing right, and what can other schools learn from them?

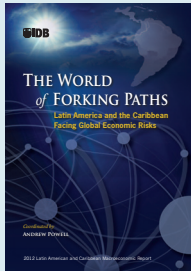
It is important to stress, though, that the association of greater skill of a given type with a given level or type of

education is not necessarily causal. At the tertiary level, at least, it could well be that the effect is one of self-selection as much as of creation: individuals may need to possess some threshold level of skill simply to be considered for acceptance, for the individual to believe that pursuing a given course of study will be worth the effort, and to actually succeed at a higher level. Here is where self-efficacy, in particular, comes into play: it is reasonable to suppose that those who have a positive view of their own abilities will be more likely to undertake more challenging educational ventures. Studies cannot yet distinguish between these effects. Doing so will require longitudinal data, following the same individuals over many years, and since this type of inquiry is still in its infancy, such data are not yet available. What seems clear, however, is that even though high school graduates may have higher levels of skills, these skills do not match the ones that firms demand.

New Publications

Available in English only unless otherwise stated.

MONOGRAPHS:



Powell, Andrew
The World of Forking Paths: Latin America and the Caribbean Facing Global Economic Risks (IDB-MG-126)

This report details the divergent paths that the world economy may take and their potential effects on Latin America and the Caribbean. Scenarios are constructed employing a modeling exercise that captures the trade, financial and other linkages between the region and the rest of the world. While vulnerabilities remain and external shocks have been and remain critical, the region enjoys many strengths and has developed a growing arsenal of policy tools. What is the balance of vulnerabilities versus strengths? How can countries address the existing vulnerabilities? How can they perfect their policy tools and minimize the effect of external crises?

WORKING PAPERS:

Artana, Daniel, Sebastián Auguste, Marcela Cristini, Cynthia Moskovitz and Ivana Templado

Sub-National Revenue Mobilization in Latin American and Caribbean Countries: The Case of Argentina (IDB-WP-297)

This paper analyzes sub-national revenues in Argentina, including the most important taxes collected by federal, provincial, and local governments. It considers the determinants of sub-national revenues and the impact of the 2001–02 crisis. It finds that automatic transfers improve collections of the cascade sales tax and the prop-

erty tax by enlarging the disposable income of the private and public sectors of the provinces favored by the regional redistribution of income, while discretionary transfers reduce own-source revenue effort and encourage public investment. The paper concludes by analyzing options to improve sub-national revenue mobilization and offering specific proposals, particularly in regard to improving the cascade provincial sales tax.

Barros, Ricardo, Mirela de Carvalho, Samuel Franco, Rosane Mendonça and Andrezza Rosalem

A Short-Term Cost-Effectiveness Evaluation of Better-Quality Daycare Centers (IDB-WP-239)

Studies of the effects of preschool programs on child development in developing countries have found scant impact. This study was conducted to reconcile the importance of daycare for child development with the empirical estimates of small effects. Using a random sample of 500 children from 100 daycare centers in Rio de Janeiro (Brazil), the study relates child development to daycare center quality. A hedonic cost function permits an evaluation of the cost-effectiveness of better-quality daycare centers. The study finds that the developmental age of children attending high-quality centers is greater than that of children attending low-quality ones. It also finds that quality improvement can be measured in a number of ways, with different cost implications or impacts on child development.

Bobba, Matteo and Jeremie Gignoux

Policy-Induced Social Interactions and Schooling Decisions (IDB-WP-278)

This paper considers a conditional cash-transfer program targeting poor

households in small, rural villages and studies the effects of the geographic proximity between villages on individual enrollment decisions. The paper finds that the additional effect stemming from the density of neighboring recipients amounts to roughly one-third of the direct effect of program receipt. Importantly, these spatial externalities are concentrated among children from beneficiary households. This suggests that the intervention has enhanced educational aspirations by triggering social interactions among the targeted population.

Bonvecchi, Alejandro and Carlos Scartascini

The Presidency and the Executive Branch in Latin America: What We Know and What We Need to Know (IDB-WP-283)

The presidential politics literature depicts presidents either as all-powerful actors or figureheads and seeks to explain outcomes accordingly. The president and the executive branch are nonetheless usually treated as black boxes, particularly in developing countries, even though the presidency has evolved into an extremely complex branch of government. While these developments have been studied in the United States, far less is known in other countries, particularly in Latin America, where presidential systems have been considered the source of all good and evil. To help close the knowledge gap and explore differences in policymaking characteristics not only between Latin America and the U.S. but also across Latin American countries, this paper summarizes the vast literature on the organization and resources of the Executive Branch in the Americas and sets a research agenda for the study of Latin American presidencies.

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New Publications

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Canavire-Bacarreza, Gustavo, Jorge Martínez-Vázquez, Cristián Sepúlveda

Sub-National Revenue Mobilization in Peru (IDB-WP-299)

This paper analyzes the problem of sub-national revenue mobilization in Peru and proposes policy reforms to improve collections while maintaining a sound revenue structure. In particular, the paper analyzes the current revenues of regional and municipal governments and identifies the main priorities for reform. Among the most important problems are the acute inequalities and inefficiencies associated with revenue sharing from extractive industries. These revenues represent a significant share of sub-national budgets and currently they are distributed without consideration of the relative expenditure needs or fiscal capacity of sub-national units. In order to address this problem, the paper proposes incorporating a measure of fiscal capacity into the formula of FONCOMUN, the municipal equalization transfer program. Other reforms explored include reassigning revenue sources between municipal provincial and district governments and assigning new taxes to regional governments.

Cristia, Julián, Santiago Cueto, Pablo Ibararán, Ana Santiago, Eugenio Severin

Technology and Child Development: Evidence from the One Laptop per Child Program (IDB-WP-304)

Although many countries are aggressively implementing the One Laptop per Child (OLPC) program, there is little empirical evidence on its effects. This paper presents the impact of the first large-scale, randomized evaluation of the OLPC program, using data collected after 15 months of implementation in 319 primary schools in rural Peru. The results indicate that the program increased the ratio of computers per student from 0.12 to 1.18 in treat-

ment schools. This expansion in access translated into substantial increases in use both at school and at home. No evidence is found of effects on enrollment and test scores in Math and Language. However, some positive effects are found in general cognitive skills as measured by Raven's Progressive Matrices, a verbal fluency test and a Coding test.

Fernández, Jorge and Sebastián Miller

When Should Developing Countries Announce Their Climate Policy? (IDB-WP-281)

This paper provides a rationale for developing countries to announce future credible commitments to reduce GHG emissions even if these are not to materialize in the short run, and for domestic reasons only. A simple framework shows that it may be costly for an economy to transition from high to low emissions; if climate policy eventually will be enacted, then it may be better for countries to commit earlier and therefore eliminate the uncertainty for the private sector to invest appropriately in clean technologies. In particular, conditions are shown under which the private investor prefers a pre-announced climate policy, and how this policy affects investment decisions and the deployment of clean technologies.

González Rozada, Martín, Lucas Ronconi and Hernán Ruffo

Protecting Workers against Unemployment in Latin America and the Caribbean: Evidence from Argentina (IDB-WP-268)

This paper takes advantage of several reforms that provide time and cross-sectional variation to identify the effects of unemployment insurance and severance payments on the duration of unemployment and on the separation probability in Argentina. Administrative data permit analysis of duration of unemployment with detailed information about transfers and their duration, while

household surveys permit the study of separation probability and transitions to informal jobs, which are not observed in administrative data. It is found that unemployment duration increases significantly when unemployment insurance transfers are higher or are provided for a longer period; the effects of severance pay on unemployment duration are less robust. On the other hand, higher severance pay is found to reduce separation probability, while unemployment insurance transfers have a positive, but small, effect on separations.

Hernani, Werner, Maria Villegas and Ernesto Yáñez

Unemployment in Bolivia: Risks and Labor Market Policies (IDB-WP-271)

This paper attempts to evaluate the effectiveness of Bolivia's labor market institutions, particularly the Plan Nacional de Empleo de Emergencia (PLANE). It is found that unemployment as conventionally defined may not be the most important problem in Bolivia's labor market, as the non-salaried market is always an alternative. While unemployment duration and scarring consequences are relatively low, labor market regulations and labor market programs do not help increase the size of the formal market because of Bolivia's rigid labor markets and labor policies based mainly on temporary employment programs. Such programs, however, may have helped to smooth consumption. Given the country's high level of informality, protection policies are second best to active policies specifically designed to increase the productivity/employability of vulnerable populations.

Lora, Eduardo

Health Perceptions in Latin America (IDB-WP-290)

This is the first study that uniformly analyzes health perceptions in all of

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Latin America and tests in a systematic way their relation to economic conditions at the country, income group and individual levels. The study uses three types of health self-assessment questions: i) health satisfaction; ii) health status on a scale of 0–10; and iii) the EuroQol 5D instrument (EQ-5D), which asks about mobility, self-care, usual activities, pain/discomfort, and anxiety/depression. The empirical analysis supports the hypothesis that cultural differences between countries prevent cross-national comparisons of health perceptions, but it does not find support for the widely held view that the same applies within countries, presumably because the poor are more tolerant of their health problems.

Machado, Fabiana

Does Inequality Breed Altruism or Selfishness? Gauging Individuals' Predispositions towards Redistributive Schemes (IDB-WP-285)

While decreasing inequality is generally considered desirable, and there is a growing understanding of which policies do and do not promote equality, much less is known regarding why these policies are adopted in different times and places. To explain this variation, the constituencies for different policies under various conditions must be identified. This paper explores that question using Brazilian public opinion data on preferences regarding taxation, conditional cash transfers, pension schemes, and educations. It is found that disagreement across socioeconomic groups arises on how government should address inequality rather than whether it should do so. While poorer respondents support cash transfers more than the rich, the rich are more likely than the poor to support expenditures on public education. Contrary to what is commonly assumed, inequality seems to

breed altruism among the rich regarding the quintessential poverty reduction scheme of conditional cash transfers.

Maier, Antonia, Marcus Miller and Andrew Powell

Prudent Banks and Creative Mimics: Can We Tell the Difference? (IDB-WP-284)

The recent financial crisis has forced a rethink of banking regulation and supervision and the role of financial innovation. This paper develops a model in which prudent banks may signal their type through high capital ratios. Capital regulation may ensure separation in equilibrium, but deposit insurance will tend to increase the level of capital required. If supervision detects risky behavior *ex ante* then it is complementary to capital regulation. However, financial innovation may erode supervisors' ability to detect risk and capital levels should then be higher. Regulators, however, may not be aware their capacities have been undermined. The paper argues for a four-prong policy response with higher bank capital ratios, enhanced supervision, limits to the use of complex financial instruments and CoCo bonds. The results may support the institutional arrangements proposed recently in the United Kingdom.

Scartascini, Carlos and Mariano Tommasi

Institutionalization of Political Institutions and Their Impact on Public Policy (IDB-WP-287)

This paper argues that institutionalization is an equilibrium phenomenon and is associated with better policies and better results in terms of economic development. In support of this argument, a theoretical model extends the space of feasible actions for political actors, including the possibility of investing in both institutionalized and non-institutionalized arenas. Thus, visualizing the process of institutional-

ization can be endogenous to the functioning of political institutions. In addition to this conceptual model, quantitative results show that low levels of institutionalization tend to weaken the results arising from the literature of more traditional political economy. That is, low institutionalization in the context of traditional political institutions, particularly those *jure* measures may not be relevant in explaining policy outcomes. Still, this work opens up more questions than it answers and leaves lines of research proposals that can help provide answers to them.

TECHNICAL NOTES:

Auguste, Sebastián, Ramiro Moya and Sandra Sookram

Housing Finance Policy under Dutch Disease Pressure: The Mortgage Market in Trinidad and Tobago (IDB-TN-302)

This work analyzes housing finance in Trinidad and Tobago during the last 20 years. An economic bonanza led by the energy sector influenced this period. Housing prices skyrocketed, but the demand for mortgage loans was low. The results suggest that this is explained by affordability problems in the dynamics of the new post-shock equilibrium, as housing prices increased more rapidly than wages. Public housing finance also played a role, but in recent times it has been more prudently managed than during the previous boom of the 1970s.

Bonilla, María Isabel, Mario Cuevas and Sigfrido Lee

The Missing Foundations of Housing Finance: Incomplete Markets, Fragmented Policies and Emerging Solutions in Guatemala (IDB-TN-286)

This paper applies an analytical framework that identifies the types of market

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failures responsible for the underdevelopment of the housing finance system. The working hypothesis is that there is a correlation between the nature and scope of market failures, and the kind of public interventions actually implemented. Evidence seems to disprove the policy adequacy hypothesis. Nevertheless, it is encouraging that solutions have begun to emerge as economic agents learn to overcome market failures; these experiences are reinterpreted as “natural experiments” showing what could happen if market failures could be fixed on a large scale through appropriate government policy. Building on this framework, the paper proposes guidelines for the design and implementation of housing finance policy in Guatemala.

Palomino Bonilla, Miguel and Rudy Wong Barrantes

Housing Finance in Peru: What Is Holding It Back? (IDB-TN-288)

Housing for most Peruvians is improving but is still grossly inadequate. Nonetheless, public housing finance policies mainly involve programs that subsidize middle-income families and banks that lend to them. Research indicates that financing will not be the main obstacle to improving housing conditions in Peru and that public sector efforts would be better aimed at dealing with significant externalities and institutional restrictions. Thus, public sector efforts and funds could temporarily support the development of: i) cheaper construction techniques and materials, ii) lower-cost credit technologies for low-income housing, and iii) greater availability of adequately enabled land for large-scale, low-income housing projects.

Rivera, Luis, Julio Rosales and Francisco Sancho

Housing Finance in Central America: What Is Holding It Back? (IDB-TN-285)

This paper surveys housing finance in Costa Rica, El Salvador, and Panama. The development of a secondary mortgage-backed securities market in Costa Rica is very limited despite a broad legal framework, while in El Salvador it is nonexistent and in Panama has not grown due to high liquidity. In Costa Rica's subsidy policy, core institutions responsible for housing policy act as facilitators of private agents. This contrasts with the dispersion of policy and institutional efforts identified in Panama and El Salvador. Government subsidies are especially directed to households where more than 90% of the housing deficit is concentrated. A solution based on public budgets is not sustainable, requiring an active role of the private housing-finance sector. Increasing the purchasing capacity of families and reducing the cost of financing are necessary conditions to reduce housing deficits.

OUTSIDE PUBLICATIONS

Becerra, Oscar, Eduardo Cavallo and Carlos Scartascini

The Politics of Financial Development: The Role of Interest Groups and Government Capabilities

Journal of Banking and Finance, Vol. 36, No. 3: 626–643. 2012.

Although financial development is good for long-term growth, not all countries pursue policies that render full financial development. This paper constructs a theoretical model showing that the intensity of opposition to financial development by incumbents depends on both their degree of credit dependency and the role of governments in credit markets. Empirical evidence for this claim

is provided, and the results suggest that lower opposition to financial development leads to an effective increase in credit markets' development only in those countries with high government capabilities. Moreover, improvements in government capabilities impact significantly on credit market development only in those countries where credit dependency is high (thus, opposition is low). This paper therefore provides a unified account of credit market development that includes two of its main determinants, traditionally considered in isolation.

Cesa-Bianchi, Ambrosio, M. Haskem Pesaran, Alessandro Rebucci and Teng Teng Xu

China's Emergence in the World Economy and Business Cycles in Latin America

Economía, Volume 12, Number 2 (Spring 2012). (Brookings Institution Press)

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 Chinese 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. The transmission of shocks to Latin America and the rest of emerging Asia (excluding China and India) has not changed. These changes owe more to changes in China's impact on the region's traditional and largest trading partners (namely, the euro area and the United States) than to increased direct bilateral trade linkages between China and Latin America, associated with the decade-long commodity price boom. These findings have important implications for both Latin America and the international business cycle.



Network News

DC Comparative Politics Seminar Series:

UNBUNDLING DEMOCRACY by Roger Betancourt (University of Maryland)

Date: June 22, 2012

Time: 12:00–2:00 p.m.

Place: IDB Headquarters: 1300 New York Ave., NW, Washington, DC

RSVP: <http://events.iadb.org/calendar/eventDetail.aspx?lang=en&id=2804>

Development Challenges in Latin America and the Caribbean

Date: June 14–15, 2012

Place: 1300 New York Ave., NW, Washington, DC

Time: 9:30 a.m.–5:00 p.m.

RSVP: <http://events.iadb.org/calendar/eventDetail.aspx?lang=en&id=8867>

Research Projects

The following proposals were selected to participate in the research project **Fiscal Policy for Sustainable and More Equitable Growth in Latin America and the Caribbean**:

- Normative Fiscal Policy and Economic Growth: Some Quantitative Implications for Latin America and the Caribbean – *Universidad Torcuato Di Tella, Argentina*
- Fiscal Burden, Volatility and Growth – *Universidad Católica de Chile*
- Fiscal Policy for Sustainable and More Equitable Growth in Mexico – *Centro de Investigaciones y Docencia Económicas (CIDE) de México*
- Fiscal Policy for Sustainable and More Equitable Growth in Argentina – *Instituto de Estudios de la Realidad Argentina y Latinoamericana (IERAL) de la Fundación Mediterránea*
- The Role of Taxation and Public Expenditures in Economic Growth and Income Inequality in Latin America: Evidence from a Large Panel of Countries – *Georgia State University*

This issue of IDEA was prepared by Rita Funaro and Michael Treadway and was based on the book *Desconectados: habilidades, educación y empleo en América Latina (Disconnected: Skills, Education and Employment in Latin America)* by Marina Bassi, Matías Busso, Sergio Urzúa, and Jaime Vargas.

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