This issue of *ESPE* contains seven articles. In the first, Carolina Arteaga studies human capital positive externalities that could help to explain differences in development, worldwide. In order to do this, she estimates human capital supply and demand functions for a roster of 60 countries, and finds that there are increasing returns to scale and increasing marginal returns that can lead to higher returns on human capital in economies where this factor is abundant, and discouraging its accumulation in countries where it is scarce.

Next, Pietro Bonaldi, Andrés González and Diego Rodríguez empirically determine the combination of nominal and real rigidities which are necessary to replicate the dynamics of aggregate variables in the Colombian economy. The authors, using Bayesian methods, estimate several dynamic stochastic general equilibrium models (DSGE), thus allowing them to easily compare different models by means of marginal densities. The results indicate that the model’s empirical fit is determined, first of all, by wage rigidity, followed in turn by rigidity of domestic prices, adjustment costs to investment, type of indexation in the economy and rigidity of import prices.

In the third article, Edgar Demetrio Tovar examines whether financial globalization has had positive effects on financial
development. He makes use of new indicators on financial globalization and financial development that are more in tune to the theoretical framework; he also provides innovative treatment for the inclusion of institutional variables. The author uses a dynamic model with panel data for 47 developed, emerging and developing countries. His results indicate that financial globalization fosters a financial system that improves functions of corporate governance and pool savings, but impairs the functions of providing information and diversifying risk.

In the following paper, Juan Jose Echavarria, Enrique Lopez, Norberto Rodriguez and Sergio Ocampo use the structural VAR-X methodology to explain rising unemployment in Colombia —from levels close to 7% in early 1995 to 19% in early 2000— and its permanence at two digit levels during the following decade. The authors find that this situation can be attributed to an unfortunate combination of shocks and poorly designed labor market institutions unable to confront them, added to the fact of an increase in the labor force since the early 1990s, which was brought on by demographic expansion and the 1998-2000 crisis. During the same period, they find that demand fell sharply due to a sudden stop of capital inflows, as well as to pro-cyclical monetary and fiscal policies and that the productivity dynamics has been very slow, mainly in the first decade of this century.

In the fifth article, Esteban Gómez, Andrés Murcia y Nancy Zamudio build a simple and effective macro-prudential tool for policymakers. They integrate the joint behavior of the main financial variables in Colombia into a single Financial Conditions Index (FCI), by means of the principal component analysis on the correlation matrix of these variables. The authors evaluate the predictive capacity of the index in forecasting GDP growth at different time horizons and find that it performs better both as a leading indicator of real activity than do other individual financial variables and as an autoregressive model for GDP growth. They also conclude that the index can be used as an early-warning indicator, and could, therefore, be a useful tool for financial stability and macro-prudential supervision.
In the sixth article, Andrés González, Lavan Mahadeva, Juan David Prada and Diego Rodríguez lay out the microeconomic foundations for a dynamic stochastic general equilibrium model designed to forecast and to advise monetary policy authorities in Colombia. The model, Policy Analysis Tool Applied to Colombian Needs (PATACON), is a New Keynesian model constructed on top of a neo-classical growth model in which economic agents optimize the use of their resources over time. The source of growth is exogenous and depends on technological change and the rate of population growth. Furthermore, this model has been augmented to match the data with features such as sticky nominal wages and prices, as well as with real rigidities such as consumption habits, investment adjustment costs, variable capital utilization and endogenous capital depreciation.

Lastly, Andrés González, Lavan Mahadeva, Diego Rodríguez and Luis Eduardo Rojas argue that theory-consistent models are only able to provide both decent predictions and useful explanations if they take into account the real world data set. These models have to rely on data which, as rich in information as they may be, are uncertain, unbalanced and sometimes make forecasts from external sources about the future path of other variables. Hence, the authors propose the combination of different types of useful, but awkward data sets, with a linearized forward-looking DSGE model through a Kalman Filter fixed-interval smoother to thus improve the utility of these models as policy tools and enhance their application to a model for Colombia.