FRONTERA NORTE
NÚM. ESPECIAL: POBREZA, 1994

The Challenge of Decimating Poverty in Latin America by 2010

*Albert Berry**

ABSTRACT

It is probably too early to draw any definite conclusions on the effect of structural adjustment in the distribution of income, and the evolution of poverty in Latin America. This paper, however, represents an attempt to assess income distribution trends and the evolution of poverty in seven Latin American countries during the 1980's. The evidence presented here points at a correlation between processes of rapid change in the countries' trade regimes, and a tendency toward the concentration of income. At the same time, this article emphasizes how countries with a gradual process of trade reform have shown an improvement in their distribution of income.

RESUMEN

Probablemente sea aún muy pronto para llegar a cualquier conclusión definitiva sobre el efecto de los ajustes estructurales a la distribución de ingresos y su efecto sobre la evolución de la pobreza en América Latina; sin embargo, este trabajo intenta evaluar las tendencias arriba mencionadas en siete países lationamericanos durante la década de los ochenta. La evidencia que aquí se presenta apunta hacia una correlación entre los procesos de cambio acelerado en los regímenes de comercio de tales países y una tendencia hacia la concentración de los ingresos. A la vez, este artículo subraya que los países con un proceso gradual de reformas comerciales han mostrado un mejoramiento en su distribución del ingreso.

**Albert Berry*. Professor of Economics, Departament of Economics, University of Toronto. Se le puede enviar correspondencia a: 150 George Street, Toronto, Canadá, M5S1A1, Tel.: (416) 97 849 78.

1. Introduction

LATIN America has long been justifiably noted for the extreme inequality of incomes and opportunities characteristic of nearly all countries of the region. Cross-country comparisons single it out; many analysts have contributed to its explanation; and political economists ask what can be done about it. The urgency of dealing with this region's unnecessary poverty -- unnecessary because average incomes are generally high enough to imply that there would be little poverty if the income share of the bottom few deciles were not so low -- has naturally been heightened by the economic crisis of the 1980s and the frequently sharp declines in per capita income observed in these countries. Some observers are concerned with the possibility that the series of economic reforms currently at various stages of implementation (depending on the country) -- trade liberalization, financial and labor market reforms, and privatization -- will push real wages down and further accentuate poverty, at least in the short and perhaps the medium run. Others believe that what really matters is to "get the region moving again," and that enough of the fruits of growth will then trickle down to the poorer members of society to resolve the poverty problem. The backdrop to this discussion/debate includes a lack of consensus on what has been happening to income distribution and poverty during the 1980s.

This paper reviews evidence on recent income distribution trends in the countries of the region and the factors that may have contributed to those trends. It discusses the possible implications of present policy changes, and it suggests that substantial improvements might occur over the next fifteen years or so with a bit of luck and some good management. That element of optimism is based on three points:

(1) Many countries of the region may have been close to the end of their "labor surplus" phase by the time the debt crisis put an end to the earlier growth process. Assuming that they have not slipped back too far from that turning point during the years of stagnation, it might not take many years of healthy growth for them to enter the tight labor market situation at which low-skill wages begin to rise quickly.

(2) There has been no general trend towards increasing inequality during the crisis years, though worsening is apparent in three countries -- Chile, Argentina, and Mexico -- and could have occurred in some others where inadequacy of the data leaves ambiguity.

(3) Rapid educational advance -- together with astute policy making in the education area, on certain labor market questions, on poverty redressal techniques, and on a few other aspects of social and economic policy -- may help to create the conditions for a significant decline in inequality over a fifteen-year period.

While there are thus grounds for optimism, based partly on what has happened in a few countries of the region, the positive outcome alluded to certainly cannot be taken for granted. It goes almost without saying that the scenario at the other end of the spectrum of possibilities is far from rosy: many unprecedented changes are occurring, and liberalizing economic reforms are taking the region into uncharted waters and into a transition that could involve a lengthy period during which much labor will be marginalized from the modern-sector productive process and left to fend for itself in the informal sector. The political ramifications of such unattractive scenarios, given the region's history of violence and dictatorship, would be obvious cause for concern. Certainly they would be a discouraging prospect to a region that hopes to be increasingly integrated into the economy of the Western Hemisphere.

2. Growth and Trickle-Down prior to the 1980s

As the Latin American countries progressed through the 1960s and 1970s, it appeared that severe poverty might be more or less eradicated by another decade or so of "growth without redistribution" -- that is, growth within the context of an essentially unchanged and very high level of income inequality.[1]

Given their high levels of per capita income and low inequality relative to the region as a whole, the Southern Cone countries suffered lower incidences of poverty than the rest of the region. Somewhat comparable poverty lines suggest 1970s incidence of under 20 percent for these three cases, of somewhere between 20 and 30 percent for Costa Rica and Venezuela, and of over 40 percent for all of the other countries (see Table I). This outcome was a possibility because Latin America's average income was higher than in most of the Third World.

Over the 1950-80 period the region's per capita income rose by about 3 percent per year. With the poverty line that Altimir attempted to apply across countries for 1970, poverty incidence was about 38 percent of households (Table I).[2] The growth record over 1950-70 would suggest that poverty incidence in 1950 (using the same poverty line) was around 65 percent;[3] over 1970-80 it probably fell to somewhere around 25 percent. Had per capita income growth continued for the last two decades of the century at the 3 percent per year rate observed for 1950-80, poverty incidence would probably have fallen to about 10-15 percent.[4] With reasonably effective poverty redressal policies (targeted employment schemes, food schemes, etc.) of the sort that can more easily reach a large share of the poor when the incidence of poverty gets down to this relatively low level, it would have been realistic to think that no more than a few percent would have been critically poor.

3. The Crash and the Halting Recovery

This happy outcome was not forthcoming, of course, courtesy of the debt crisis and the periods of decline and difficult recovery that followed. The timing of the economic crises varied somewhat. The Southern Cone countries were already in difficulties of one sort or another by the mid-1970s, whereas for most of the others the onset was signaled by the international debt crisis of the early 1980s. Particularly severe short-period (2-4 years) declines in per capita income were suffered by Costa Rica, Chile, Peru, and Venezuela, while GDP per capita fell by over 20 percent during the 1980s in Argentina, Venezuela, Peru, Bolivia, and Nicaragua (though the first two regained some of that ground in 1991-92). For the region as a whole, per capita national income fell by about 13 percent over 1980-85, and it has fluctuated a little since then with no significant move-

1 As of the 1960s and early 1970s all of the Latin American countries had very high levels of inequality by the standards of other less developed countries, with the exceptions of Cuba (by then a centrally planned socialist economy), Argentina, and Uruguay. Somewhat less inegalitarian than those but still better than the regional average were Chile, Costa Rica, and probably Venezuela. The most common explanations of the lower inequality in the Southern Cone included their higher level of development (e.g., farther along in the Kuznets cycle) with associated development of social security systems, wage protection, etc., and their greater racial homogeneity.

2 Oscar Altimir, *The Extent of Poverty in Latin America*, World Bank Staff Working Paper (Washington, D.C.: The World Bank, 1982). Data were not available for all countries, but those excluded had only 12 percent of the region's population and were not obviously atypical in terms of degree of inequality. Since the data relate (in all or nearly all cases) to the distribution of households ranked by household income, the share of people below the poverty lines might be somewhat different from what these figures show, though it is not clear in which direction they may be biased.

3 Assuming the distribution of income for the region as a whole was not dissimilar to that observed for Colombia in 1970; Colombia's Gini coefficient was in the middle of the pack at that time.

4 If this extra period of growth brought with it a significant tightening of the labor market, then it would be realistic to expect the income share of the bottom few deciles to rise (though perhaps not the bottom decile or so), in which case the improvements cited might even understate the case.

TABLE I

POVERTY INCIDENCE BY COUNTRY, LATIN AMERICA, 1970

	Regional Population		*Incidence of Poverty*
	(Millions)	Percent	1970
Brazil	96	36.3	49
Mexico	52.8	20.0	34
Argentina	24.0	9.1	8
Colombia	21.3	8.1	45
Venezuela	10.6	4.0	25
Peru	13.2	5.0	50
Chile	9.5	3.6	17
Uruguay	2.8	1.1	
Ecuador	6.1	2.3	
Guatemala	5.2	2.0	
Dominican Republic	4.4	1.7	
Bolivia	4.3	1.6	
El Salvador	3.6	1.4	
Paraguay	2.4	0.9	
Costa Rica	1.7	0.6	24
Panama	1.5	0.6	39
Nicaragua	2.1	0.8	
Honduras	2.7	1.0	65
Latin America	264.2		38.53

Source: Altimir (1982).

ment either way (Table II). A brief spurt of modest growth over 1985-87 petered out by the late 1980s, the last three years of which all saw average growth of less than 1 percent. The situation improved again in 1991 and 1992, when growth averaged around 3 percent. The only countries that put together three or more consecutive years of at least 4 percent growth were Brazil (mid-1980s), Colombia (1986-88), and Chile (1986-92). With this sort of macroeconomic performance it was obvious that there would be many "losers" during this twelve-year period. The only countries that have not suffered a net decline in gross national income per capita between 1980 and 1992 are Colombia and Chile.

It goes without saying that, in one important sense, the poor have been the big losers from the "lost decade." The fact of being poor means that income declines and/or lost opportunities to achieve gains hurt more. Many observers have also argued that the poor have suffered greater percentage declines in income than have other groups in the society, further aggravating the crisis they have had to face. Others have argued that the bigger percent

TABLE II

TENDS IN OUTPUT, INCOME, AND OTHER MACROECONOMIC VARIABLES SINCE 1980 IN LATIN AMERICA AND THE CARIBBEAN (ÍNDICES: 1980=100)

	1980	*1985*	*1986*	*1987*	*1988*	*1989*	*1990*	*1991*	*1992*	*1988-1992*	*1980-1992*
GDP (Market Prices)	100.00	102.6	106.3	109.9	110.8	111.8	112.1	116.0	118.8	1.073	
Growth Rate		2.8	3.7	3.3	0.8	0.9	0.3	3.5	2.4	1.76	1.45
GDP Per Capita	100.0	91.8	93.3	94.4	93.2	92.2	90.8	92.2	92.7	.994	-0.63
Absortion of Goods & Services	100.0	93.9	98.1	100.3	100.9	101.4	101.7				
Consump-tion	100.0	100.4	104.3	106.4	107.4	108.4	108.9				
Investment	100.0	72.1	77.6	79.6	79.0	77.5	77.3				
Gross National Income	100.0	97.5	99.6	103.0	103.6	104.8	105.2				
GNI per capita	100.0	87.2	87.4	88.5	87.1	86.4	85.2				

Sources: for the first two rows, ECLAC, 1992, pp. 40-1; for the other rows CEPAL, 1991, p. 37.

losers have been certain middle-income groups -- for example, the paid blue- and white-collar workers employed in the modern sector. No very powerful theory is available to guide one's expectations on this matter, and the empirical evidence is partial and imperfect. Inevitably, the nature of the challenges facing the region in the 1990s is greatly affected by the problems of the 1980s, so it is important to get as precise a reading on them as possible.

4. The Policy Response

The debt crisis provided the push to induce and/or oblige the region to jettison its trademark import-substitution strategy for a more liberalized trading system, as well as to move towards adoption of the other elements of what is now a standard package of reforms to labor markets, financial markets, and the public sector. Some countries had already taken significant steps away from the traditional combination of protectionism and overvalued exchange rates, and the resulting bias against trade. Both Colombia and Brazil moved to encourage exports in the late 1960s; Colombia's adoption of a crawling peg exchange rate put an end to the systematic overvaluation of earlier years. These approaches were qualitatively similar to the East Asian policy syndrome: encourage exports but continue to protect imports. Chile went much farther as the Pinochet regime introduced the most free trade/free market system in the region, including a real import liberalization, with tariff rates down to 10 percent by 1980. Though they were raised somewhat in the mid-1980s, the average was back down to 15 percent as the decade came to a close.[5]

Argentina had an important liberalization episode between 1976 and 1982, in which the average effective rate of protection fell from 158 percent to 54 percent.[6] In the second half of the 1980s most of the countries of the region initiated significant reforms, varying in detail and in timing, and having few if any close precedents in the developing (or the developed) world.

5. Predicting the Distributional and Poverty Effects of Policy Reforms and Distributional Trends over the Coming Years

In any attempt to predict the medium-term future of income distribution and poverty in Latin America, one can draw both on analysis of how recent trends in structural variables and in policies would be expected to affect income distribution *and* on a reading of the record of countries that have undertaken some or all of the reforms far enough back in time to make their experience useful. Because the new policy package is so unusual in the history of the developing world (and hence hard to learn about from earlier precedents) and because its adoption is too recent for most of the countries involved to have generated a set of experiences from which one can learn much about its growth and distributional effects, the experience of Chile becomes central to any educated guess as to what the strategy may bring to the other countries of the region. With about twenty years having passed since the introduction of major reforms in that country, some conclusions can be drawn. It is not easy, of course, to sort out the effects of policy changes from those of the crisis itself and of longer-run structural trends dating back to the pre-crisis years.

Although most countries of the region did not witness major shifts in income distribution during the 1970s, some patterns hinted at possible changes in the not-too-distant future. Thus the sharp increase in real wages of lower-skilled work-

5 UNCTAD, *Trade Liberalization in Chile*, Trade Policy Series, no. 1 (New York: United Nations, 1992): 44.

6 Enrique A. Gelbard, "Changes in Industrial Structure and Performance under Trade Liberalization: The Case of Argentina," Ph.D. dissertation, University of Toronto, 1990, p. 46.

ers in Brazil during the "economic miracle" of the late 1960s and early 1970s, and the less dramatic increase in real wages in agriculture and some other sectors of the Colombian economy, suggested that these two economies might be on the verge of a tighter labor market and continuing wage increases, especially among lower-skilled workers.[7]

Second, the crisis was presaged in most of the countries by a period during which absorption was markedly above production, raising the question of who would get squeezed when that situation came to an end.

The crisis/stabilization episodes that occurred during the 1980s in most of the countries of the region may themselves have had significant distributional effects. Finally, the "structural adjustment" phase that followed -- and which involved increases in the relative incentives to exports, a pattern of privatization, financial deregulation of various stripes, and, in some cases, labor market reforms -- would be expected to have some distributional effects.

6. Observed Trends in Income Distribution

What do the data reveal about changes in the degree of inequality during the last fifteen years or so? It is noteworthy that there has been no detectable regionwide trend towards either improvement or worsening in the income distribution, i.e., the experience has varied significantly across countries and situations. Considerable uncertainty does surround the precise evolution of income distribution during the crisis and adjustment periods in most of the countries of Latin America; but in some, the general trends seem clear. In the group of countries for which we have some usable information -- and of which all but Colombia suffered significant declines in per capita income (by a total of, say, 5 percent or more over periods of 2-4 years) -- distribution clearly worsened in Argentina, Chile, and Mexico, probably improved in Colombia, and probably changed little in Brazil, Peru, Venezuela, and Costa Rica, unless a significant increase in the capital share occurred.[8]

The available evidence suggests that the declines in average per capita income that signaled the onset of the economic crisis were not systematically compounded by a worsening of distribution. If inequality did increase marginally in countries like Costa Rica, Brazil, and Peru at the heart of the crisis, the resulting increase in poverty was certainly less than that of falling per capita income itself. Where the increase in

7 Guy Pfefferman and Richard Webb, "Poverty and Income Distribution in Brazil," *Review of Income and Wealth* 29:2 (1983); Albert Berry, "The Effects of Stabilization and Adjustment on Poverty and Income Distribution: Aspects of the Latin American Experience," 1992, mimeo.

8 Usually the most useful and reliable information comes from household income surveys, but their main defect is the systematically weak reporting of non-labor incomes. When there is no reason to believe that the labor share has changed markedly or that the distribution of capital income has been altered, this underreporting is unlikely to greatly bias the estimated trends. During the 1980s, however, there is some reason to believe that the capital share has risen, as the result of higher interest rates, on government domestic debt among other things (David Felix and John P. Caskey, *Baker to Brady to Chance? Tinkering with the Latin American Debt Crisis*, Working Paper No. 140 ([St. Louis, Mo.: Washington University Economics Department, 1989]). During the crises themselves, a common pattern was government borrowing abroad or locally to shore up the exchange rate. This facilitated massive capital flight. Governments (e.g., those of Chile and Ecuador) essentially socialized private foreign liabilities, which are the domain of the rich; the Chilean Central Bank, pushed by the international banks to act as guarantor of private nonguaranteed foreign loans, subsidized debtors to the tune of about 4 percent of GDP over the period 1982-85 (Patricio Meller, *Adjustment and Equity in Chile* [Paris: OECD Development Centre, 1992]: 60). Later, when the crises had passed and structural adjustment begun, high interest rates remained the order of the day as part of the new financial orthodoxy. Our understanding of the net effects of the various impacts on capital incomes during this period is not adequate to say with certainty that the capital share has risen by enough to imply an overall trend to worsening since the onset of the crises, but that possibility must be borne in mind.

inequality was marked (Argentina and Chile) the opposite may have been the case. Poverty, however, is less prevalent in these countries (especially Argentina), to whose experiences we now turn.

Argentina and Chile. Argentina has by now a lengthy tradition of relative income equality, together with a singularly weak growth performance. Between 1974 and 1988 GNP grew by only 4 percent; at the heart of the crisis (1980-82) it fell by a dramatic 13 percent. Accompanying this macroeconomic failure has been an unusually sharp increase in income inequality, the Gini coefficient among income earners in greater Buenos Aires rising from 0.365 (1974-75 average) to 0.46 (1987-88 average).[9] Among plausible explanations are international trade policy and the real exchange rate. One hint at their role comes from the short-run inverse relationship that exists, over 1970-87 at least, between the real exchange rate (Argentine currency per dollar) and both the real wage and the ratio of the real wage to per capita income.[10] It is plausible, given the prominence of wage goods among Argentina's exports, that an increase in the real exchange rate (through devaluation, for example) would, *ceteris paribus*, lead to a decrease in the real wage rate and a worsening of the distribution of income. But it is clear that the decade-plus worsening of the income distribution cannot be fully explained by this link with the real exchange rate, since net worsening occurred even over periods (of several years) when there was no net increase in the real exchange rate.[11]

Other factors must have been at work. Perhaps the informal sector was expanding and the gap between formal- and informal-sector wages was widening. Possibly structural changes wrought by the change in trade policy worsened inequality; the liberalization episode referred to above led not only to a fall of 11 percent in manufacturing output between 1976 and 1982, but also to a decline of employment in that sector by 37 percent, as output per worker rose by a striking 41 percent.[12]

Many small and medium-sized firms exited, while many large firms cut employment, increased capital stock, and improved technology. Unlike Chile, Argentina's experience at this time was not characterized by high levels of unemployment or the destruction of the power of the unions. The rights of the worker against dismissal remained strong. It may be that under the conditions of macroeconomic stress and stagnation that characterized the country at this time, the maintenance of union power contributed not only to economic stagnation but also to the marked worsening of the distribution of income. It is also possible that the very large capital flight from the country played a role, by lowering the amount of capital available to complement the labor force. No doubt other factors were at work too.

Chile's experience is, as noted above, the most important from our perspective. The country has had two severe recessions

9 Data on the distribution among households in this same greater Buenos Aires region and among income earners in the country as a whole seem to move in parallel with those just cited for those time periods when they are available, which does not in either case include much beyond 1980. As a result it has been necessary to use the Buenos Aires earner data, but with considerable confidence that they do not misrepresent the trends that actually occurred among households in the nation as a whole (Albert Berry, "The Effects of Stabilization and Adjustment on Poverty and Income Distribution: Aspects of the Latin American Experience," 1990, mimeo.).

10 Berry, ibid., p. 31.

11 The relative price of tradeables to non-tradeables appears to have fallen between 1973-75 and 1986-87. Though the real exchange rate, defined as the nominal rate adjusted for relative inflation, rose somewhat over this period as a whole, inequality rose between subperiods when this rate did not rise (Berry, ibid., p. 39).

12 Gelbard, op. cit., p. 54.

since 1970, the first associated with Allende's overthrow, as GDP fell by 23 percent over 1972-75, and the second with the international debt crisis, with GDP falling by 14 percent between 1981 and 1982. After each collapse, growth resumed quickly and was strong, but the impact of the recessions was still to hold average annual growth over 1970-92 to only 3.2 percent (though registering an impressive 6 percent since 1984). Since 1973 the economy has undergone the most radical policy "reforms" of any nation in the region.

As of the late 1960s inequality was a little less severe than in most other Latin American countries. The data for greater Santiago indicate a sharp improvement during the Allende administration, followed by a sharp reversal such that by 1976 household income inequality was markedly worse than in the pre-Allende period and no longer superior to the levels observed in most other Latin American countries (Table IIIa).[13]

Less frequent but more solidly comparable data on the distribution of consumption among greater Santiago households show one of the largest deteriorations ever recorded statistically in a developing country, occurring primarily between 1969 and 1978 but also extending over the following decade (Table IIIb). Since it is reasonable to assume that distribution at the end of the Allende years was better than that of 1969 (to which the data refer), it would appear that the worsening occurred very sharply over the next five years, consistent with the evidence on the household distribution of income. If the national trend in consumption distribution were like that of Santiago, the consumption decline in the bottom quintile of households over 1969-78 would have been 40 percent.[14] Meller reports an increase in poverty incidence from 17 percent in 1970 to 45 percent in 1985, with poverty lines not more than 6 percent apart.[15]

Even if this may exaggerate the trend somewhat, there is no doubt that poverty increased sharply.[16] A special and interesting feature of the Chilean experience was the combination of make-work policies for low-income groups and targeted poverty redressal, which seems to have helped to limit the most serious poverty impacts of the negative income trends just discussed. Comparison with Argentina is useful in assessing the degree to which trade policy

13 Paradoxically, the data on distribution among income recipients, while showing the same cycle as for the household distribution, do not indicate that the level of inequality was greater in the late 1970s than in 1970. This anomaly, still to be fully explained, does not greatly diminish the likelihood that household distribution did worsen significantly. A problem with the Chilean information, as with that for Argentina, is that distribution data over time are only available for greater Santiago, not for the country as a whole. But Santiago is probably fairly representative of the country, as suggested by the similarity of measured inequality for the few years for which both city and national data are available. There is no automatic inconsistency in the different trends shown for the income recipient and the household distributions, since the relationship between the two can change with family composition or with the participation of secondary workers. Still, of course, it would be possible to have more confidence in the conclusions suggested here if this difference were already satisfactorily explained.Another inadequacy of the available calculations is their failure to take account of changes in the relative prices of the consumption items purchased by different income classes. Over the course of the 1980s the increase in the relative price of food may have made the distribution trends worse than the figures on nominal distribution of income make them out to be. Note that the suddenness of the increase in recorded inequality between 1975 and 1976 may be related to the severe inflation at the time, which can produce volatility in the estimates.

14 Over that period private consumption per person fell by about 13 percent and the share of the bottom quintile by 32 percent.

15 Meller, op. cit., p. 23.

16 The high incidence of television sets (over 70 percent), refrigerators (49 percent), radios (83 percent), and bathrooms (74 percent) even in the lowest quintile throws some question on the 45 percent figure, though it is true that some of these items probably became much more prevalent due to the low prices that came with the import liberalization around 1980.

TABLE IIIa

COEFFICIENTS OF THE DISTRIBUTION OF INCOME AMONG HOUSEHOLDS AND AMONG INCOME RECIPIENTS IN CHILE, 1960S TO 1987

	Greater Santiago			*Chile*
Year	Income Recipients	Households Ranked by Income	Households Ranked by Per Capita Income	Households Ranked by Income
	(1)	(2)	(3)	(4)
1960-64	0.496	0.464		
1965-69	0.508	0.482		0.455[c]
1970	0.52	0.495	0.434	
1971	0.50	0.47		0.46
1972-74	0.46	0.44	0.423[b]	
1975	0.40	0.47	0.413	
1976	0.53	0.53	0.489	
1976-80	0.518[a]	0.518	0.475	
1981-87		0.537	0.500	

Sources: Col. 1 is from Berry, 1990, Appendix Table Ch. 4, and Cols. (2) and (3) are from the same source, Tables Ch. 1 and Ch. 3, with data of Table Ch. 1 used where available, and complemented with those of Table 3 where not. Col. (4) is from CEPAL, 1986, Cuadro 5.1.

a Excluding 1980.

b 1974 only.

c Average of two estimates for 1968 only, from the same survey (CEPAL, 1987, Cuadro 5.1).

may have played a role in the increasing inequality of both countries. In Argentina distribution did worsen during the liberalization episode (1976-82), and there has been a clear negative relationship between level of equality and devaluation over the 1970s and 1980s. But since the exchange rate fluctuated without clear trend until the late 1980s, while inequality seems to have trended upward rather systematically, other factors were clearly at work, major changes in the labor institutions not among them. This is consistent with the hypothesis that changes in the degree of openness have been a significant factor in both countries.

A number of the policy steps taken by the Pinochet regime would be expected to foster inequality. The extensive privatization, mainly carried out during the severe recession of 1972-74, led to acute concentration of ownership and the formation of large conglomerates.[17]

17 Meller, op. cit., p. 27. Note that the direct effects of this concentration might be felt almost entirely within the top 10 percent of the income distribution.

TABLE IIIb

THE QUINTILE DISTRIBUTION OF CONSUMPTION AMONG HOUSEHOLDS IN GREATER SANTIAGO, 1969, 1978 AND 1988

(Percent of total consumption)

Quintile	*1969*	*1978*	*1988*
1	7.6	5.2	4.4
2	11.8	9.3	8.2
3	15.6	13.6	12.6
4	20.6	21.0	20.0
5	44.5	51.0	54.9
Total	100.0	100.0	100.0

Source: Ffrench-Davis, 1992, p. 16.

Curtailment of agricultural credit to small farmers led to land concentration as well. Preferential financing to small entrepreneurs was cut back. Perhaps most important was the reform of the labor legislation, which relaxed worker dismissal regulations, suspended unions (until 1979, when they were again authorized to operate, but with many restrictions), greatly reduced the social security tax paid by employers, and reduced other nonwage costs as well. After the second crisis (1981-1983), wage indexation was abolished and replaced by a real wage "floor," specified to be the real wage prevailing in 1979. Wealth and capital gains taxes were eliminated, profit tax rates were substantially reduced, and public employment was greatly cut back. Unemployment rates (for greater Santiago) rose to unprecedented levels, in the neighborhood of 20-25 percent (depending on the definition used). Only in 1989 did this rate fall below 10 percent, but since then the fall has been continuous, to just 5 percent in 1992.[18] According to French-Davis, average wages in 1989 were still 8 percent lower than in 1970, and in 1992 they were probably marginally above the 1970 level[19] -- a very slow recovery indeed. The coverage of the minimum wage was restricted considerably, and its level fell in the 1980s. Fringe benefits had been greatly reduced from their 1970 level, and public expenditure per capita in health care, education, and housing had also decreased.

One striking feature of the post-1973 period in Chile and an important aspect of the evolution of the labor market was a sharp increase in the relative income of persons with university and vocational secondary education vis-à-vis those with less education.[20] This shift was clearly a proximate cause of the worsening in income

18 Economic Commission for Latin America and the Caribbean, *Preliminary Overview of the Economy of Latin America and the Caribbean 1992* (ECLAC, 1992): 42.

19 Ricardo Ffrench-Davis, "Economic Development and Equity in Chile: Legacies and Challenges in the Return to Democracy," paper presented at the conference "The New Europe and the New World: Latin America and Europe 1992," Oxford University, September 1992, p. 15. If the series cited by Ffrench-Davis (the source of the wage data is INE) is consistent with that reported by ECLAC (1992, ibid., p. 44), which shows an increase of 11.7 percent over 1989-92, then the 1992 figure is 3 percent above that of 1970.

distribution, but it remains to be explained exactly why it happened. Robbins's analysis indicates that it was not primarily the result of shifts in the composition of employment among industries, but rather a "within sector" phenomenon. It may reflect a greater relative payoff to higher education under a more open economy, a possibility hinted at by the apparent importance of university training for small or medium-sized firms to achieve success in manufacturing exports in Colombia[21] and other countries. Alternatively, it may be more a result of the dismantling of union power and the changes in Chile's labor legislation. Further analysis on this point will be important for the benefit of countries that have liberalized recently or are now in the process of liberalizing.

Among the issues in the interpretation of the Chilean and Argentine cases are whether the traditional (and still relatively) high levels of social expenditures in these countries mean that the poor are in fact less poor than they might appear to be -- and better able to weather the storm of economic adjustment and the effects of a worsening distribution of *private* income. Table IV presents some relevant evidence on this point. Chile, fourth behind Uruguay, Venezuela, and Mexico in terms of 1988 per capita GDP (expressed in constant purchasing power dollars), ranked higher by such other criteria as average years of schooling for adults aged twenty-five and up (ranking first as of 1980, with 6.1 years), adult literacy (tied for third in 1985 at 92 percent), access to health services (first in 1985-87 at 97 percent), and among the leaders in share of national income spent by the state on health services, education and primary education, and expenditure on and coverage of social security benefits. As a reflection of all of these, the life expectancy of about seventy-two years was fifth in the region, and was significantly exceeded only by Cuba and Costa Rica. The improvement of 14.7 years between 1960 and 1990 was exceeded only by a few countries that started much lower, like Peru and Guatemala. The UNDP's *Human Development Report* of 1991 ranked the country second only to Uruguay in Latin America in terms of overall "quality of life." Ffrench-Davis comments positively also on the country's capacity to build low-cost housing effectively, and on the massive food programs for preschool and school children.[22] Indicators like child mortality continued to move favorably during the 1970s and 1980s (though short-term movements in these figures may not be accurate).

Whatever welfare interpretation one places on the income distribution shifts of these last two decades in Argentina and Chile, it is important to consider their causes. In Chile it may be presumed that wealth shifts associated with the "socialization" of the debts of important economic actors were a factor, as was the general favoritism towards the rich relative to the earlier period (through tax policy, credit policy, the undoing of land reform, etc.). Although they do not have easily predictable effects, the fact that there were such sharp shifts in trade policy[23] and in labor market policy naturally puts the spotlight

20 Donald J. Robbins, "Relative Wage Structure in Chile, 1957-1992: Changes in the Structure of Demand for Schooling" (Harvard University, manuscript, 1994).

21 José Francisco Escandón and Albert Berry, "Colombia's Small and Medium Exporters and Their Support Systems" (Washington, D.C.: The World Bank, 1993, mimeo).

22 Ffrench-Davis, op. cit., p. 12.

23 The effects of freer trade and globalization on income distribution will be related, among other things, to where Latin America's comparative advantage falls. Given the middle-income status of most countries of the region, that advantage may rest less on unskilled than on fairly highly skilled labor, in which case the Heckscher-Ohlin effects of freer trade may be to increase the incomes of the latter group more than those of the former, especially given that the higher-skilled groups are also more mobile internationally and therefore likely to be affected directly (not just through trading patterns) by developed country wage levels.

TABLE IV

POVERTY INCIDENCE AND INDICATORS OF THE STANDARD OF LIVING AND OF SOCIAL SERVICES IN SELECTED COUNTRIES OF LATIN AMERICA

Country	*Life Expectancy at Bith*		*Percent with Access to Health*	*Adult Literacy Rate (1985)*	*Real GDP per Capita ($PPP)*	*Mean years of School*	*Public Health Expenditure as % of GNP*		*Public Education Expenditure as % of GNP*		*Percent of Public Educ. Expend. Primary*	*Social Security Benefits Expend. (% of GDP)*
	1960	1990	1988	(25+)		1980					1987-88	1980
	Services											
	1985	1987	1988	1985	1960	1986	1960	1986	1960	1986	1960	1986
Cuba	63.8	75.4		92		5.7	3.0	3.2	5.0	6.2	20.4	7.1
Costa Rica	61.6	74.9	80	92	4320	5.6	3.0	5.4	4.1	4.5	37.7	6.3
Panama	60.7	72.4	81	86	3790	5.9	3.0	5.7	3.6	5.4	39.3	0.5
Uruguay	67.7	72.2	82	95	5790	6.1	2.6	2.7	3.7	6.6	35.8	7.5
Chile	57.1	71.8	97	92	4720	6.2	2.0	2.1	2.7	4.0	51.9	5.4
Argentina	64.9	71.0	72	95	4360	6.0	1.3	1.6	2.1	3.3	—	—
Venezuela	59.5	70.0	—	86	5650	5.3	2.6	2.2	3.7	4.3	20.7	1.1
Mexico	57.0	69.7	—	85	5320	4.0	1.9	1.7	1.2	2.8	23.7	1.5
Colombia	56.6	68.8	60	85	3810	5.2	0.4	0.8	1.7	2.8	39.9	1.3
Brazil	54.7	65.6	—	79	4620	3.3	0.6	2.4	1.9	3.4	52.3	4.6
Paraguay	63.8	67.1	63	88	2590	4.6	0.5	0.2	1.3	1.0	36.6	—
Dominican Rep.	51.8	66.7	80	80	2420	4.3	1.3	1.4	2.1	1.6	44.4	0.5
El Salvador	50.5	64.4	58	69	1950	3.4	0.9	0.8	2.3	1.9	60.3	1.0
Ecuador	53.1	66.0	64	83	2810	5.4	0.4	1.2	1.9	4.2	45.7	1.6
Peru	47.7	63.0	75	82	3080	5.7	1.1	0.8	2.3	2.2	31.1	—
Honduras	46.5	64.9	74	68	1490	3.0	1.0	2.6	2.2	5.0	46.6	—
Guatemala	45.6	63.4	34	52	2430	4.0	0.6	0.7	1.4	1.8	38.2	0.8
Bolivia	42.7	54.5	64	73	1480	4.0	0.4	0.4	1.5	2.9	54.4	2.3
Nicaragua												

a) Excluding Cuba.

Source: United Nations Development Programme (UNDP), *Human Development Report 1991*, Oxford University Press, 1991, 122-153 for data on social services; Altimir, 1982, for data on poverty incidence.

on them as possible causes. For many observers, the tearing down of labor market institutions is an obvious source of worsening; though this prediction would be far from obvious in a country with a relatively small "protected" segment of the labor force and a large unprotected one, in a relatively advanced and highly urbanized developing country like Chile, a negative effect is quite plausible. Such a worsening might be especially strong in an economy where large rents come from a high-productivity mining sector and where the public sector and other service activities might be thought of as living off those rents. When the public sector shrinks and wages are more closely linked to the marginal product of labor in the private sector, one might expect wages to fall more than in many other types of economy.

Mexico. Because Mexico's income distribution data have been less complete than those of most other major countries of the region, it is not possible to trace the record back in time with a high degree of confidence. Fortunately the household surveys of 1984 and 1989 do provide valuable, and hopefully fairly comparable, evidence relating to the crisis period and the first part of the adjustment process. They indicate a worsening of distribution over that period (the Gini coefficient of per capita household income rising from 0.49 to 0.52)[24] which is serious but less extreme than those of either Argentina or Chile. There is, of course, the possibility that the first years of the crisis (before 1984) saw some worsening (or for that matter improvement). More important will be the patterns since 1989 and over the next few years, given the suggestion from the experiences of Chile and Argentina that liberalization may have been a factor in the worsening observed in those countries. Given its recent entry into NAFTA, Mexico may have an unusually fast integration into a larger external economy, so it may be of particular importance to analyze the factors that have been at the root of the distributional deterioration in the earlier liberalization experiences of the region.

Colombia and Venezuela. Colombia and Venezuela have a special place in this discussion because they are the two Latin American countries where a fair case can be made that distribution showed some net improvement over the 1970s and 1980s, though in each case there is a possibility that some deterioration has occurred in the last few years. For Colombia, Londoño's detailed study suggests a marked decline in the Gini coefficient between 1971 and 1978, from 0.532 to 0.481, and essentially no change from then until 1988, when the figure stood at 0.476.[25] The figures for Venezuela suggest a somewhat similar picture in that distribution im-proved during the years of fast income growth in the 1970s, then stabilized during the economic slowdown (Colombia) or decline (Venezuela) in the 1980s.[26] An important part of the story in Colombia is the unusually marked decline in earnings differentials across educational levels and between

24 Diana Alarcón, "Changes in the Distribution of Income in Mexico during the Period of Trade Liberalization," Ph.D. dissertation, University of California, Riverside, 1993, p. 105.

25 Juan Luis Londoño, *Income Distribution in Colombia 1971-88: Basic Estimation* (Report to the World Bank, 1989). In this Colombian case a complicating factor is the presumed failure of the figures to pick up most of the income generated in the illegal drug trade. Its inclusion would probably raise the estimated inequality somewhat.

26 Comisión Económica para América Latina, *Antecedentes Estadísticas de la Distribución del Ingreso: Venezuela, 1957-1985* (Santiago: United Nations, 1988). The Venezuelan survey data, which begin on a systematic basis in 1976, show a gradual decrease in inequality from that point until the early 1980s, with the Gini coefficient falling from 0.44 to 0.39 by 1982-83, after which there was little change, at least up until 1987 (pp. 30-31). The data refer only to monetary income from labor or self-employment, perhaps helping to explain the relatively low levels of calculated inequality and creating somewhat greater doubts as to the validity of any conclusion one reaches as to trends over time than would be the case with better data. (Reported income falls short of consumption as estimated in the national accounts by 15-25 percent).

genders, declines identified for the period 1976-90 but especially concentrated in the late 1970s while the economy was still growing rapidly.[27] Rural earnings were also showing considerable improvement at this time.[28]

One interpretation of the contrasting experiences of Argentina/Chile and Colombia is that Colombia, being at a distinctly earlier level of development than the other two, was just reaching a turning point in terms of labor market conditions that both the others had attained earlier. Another is that the different distributional outcomes reflected different rates of growth. Over 1970-1990, for example, Colombia's GDP grew by 142 percent (4.5 percent per year), while that of Chile rose by only 66.5 percent (2.6 percent annually) and that of Argentina by a disastrous 18 percent (less than 1 percent per year). If the contrast was due more to differences in policy, the intriguing hypothesis would be that Colombia's positive experience was due to the absence of a major shift in trade policy or perhaps in labor policy.

Brazil and Costa Rica. Brazil did not undertake major policy reforms during the 1980s, although its economic performance was very erratic. Between 1980 and 1983 per capita income fell by about 15 percent, after which it recovered fairly strongly through 1986, then slipped again. There were bouts of extreme inflation and a major heterodox attempt to bring it under control. Income distribution, which worsened somewhat between 1960 and 1970, has shown no trend since then. Through 1987 the reported Gini coefficient for the distribution of income among Brazilian households (ranked by total household income) never moved outside the 0.584-0.597 range, while the share of the bottom 50 percent of the population fluctuated within the 12.2-12.9 percent range.[29] Since then the indicators of inequality have been somewhat less stable, but no net change has been registered.[30]

Some social indicators continued to advance during the 1980s, albeit less rapidly than before. World Bank data on life expectancy, infant mortality, food production per capita, and the share of the population with access to electricity all show improvements between 1980 and 1987, whereas the share with access to safe water fell. Some improvements may be the result of past investments; low levels of current investment will take their toll in the future.

Brazil's growth performance during the 1980s was comparable to Colombia's, and its level of development was not far from Colombia's (per capita income was somewhat higher, but most social indicators were about the same), leading one to ask why that country did not see the narrowing of earnings differentials and accompanying improvements in income distribution observed in Colombia. One hypothesis is that the high prominence of the public sector contributed to keeping up the wages of high-income occupations.[31]

Costa Rica brought a tradition of social and political stability to the trials of the

27 Jaime Tenjo," Evolución de los retornos a la inversión en educación 1976-89," in *Educación, mercado de trabajo y desarrollo en Colombia*, special issue of *Planeación y Desarrollo* (Bogota: Departamento Nacional de Planeación, 1993).

28 Ministerio de Agricultura y Departamento Nacional de Planeación, *El desarrollo agropecuario en Colombia, informe final: Misión de Estudios del Sector Agropecuario* (Bogota: Editorial Presencia, 1990), p. 228.

29 Rodolfo Hoffmann, "Evolucao da Distribucao da Renda no Brasil, entre pessaos e entre familias, 1978-86," in *Mercado de Trabalhoe e Distribucao da Renda*, ed. Gulherme Luis Sedlacek and Ricardo Paes de Barros (Vina Coletanea, 1989); Rodolfo Hoffmann, "A distribucao da renda no Brasil em 1985, 1986 e 1987," *Revista de Economía Política* 9:2 (April-June 1989): 122-126.

30 Fluctuations in the measured Gini coefficient have been associated with the rate of inflation and the real exchange rate, and the Gini did reach historically high levels around 1990-91 but has since returned to the normal range (see the data presented in Eliana Cardoso, "Cyclical Variations of Earnings Inequality in Brazil," *Revista de Economía Política* 13:4 (52) (1993).

31 A hypothesis communicated to me by Ricardo Paes de Barros.

1980s, and it came off a strong postwar economic performance in which average GDP growth exceeded 6 percent over 1950-80. A good social service system gave the country the highest life expectancy in Latin America, with the exception of Cuba, and the absence of an army allowed it to allocate more resources to civilian uses. Growth in the 1970s was fragile, however, based on an expansionary monetary and fiscal policy, a fortuitous increase in coffee prices in 1976-77, and much investment financed by foreign savings. There was a continuous expansion of public-sector employment.[32] The second oil price hike, rising interest rates, and the world recession brought a sharp 14 percent decline in GDP over 1980-82, a 23 percent fall in income per capita, and a 25 percent cut in real wages. At the depths of the trough, a new president with ties to labor and (through his party) to previous social legislation took office, buoyed by a high level of public support and confidence. Over the next few years an adjustment program was put in place, including tax increases, weakening of the power of unions (union strength had lain mainly in the public sector), privatization, and new incentives for exports, especially nontraditional ones. The program has been relatively successful in reestablishing a decent growth performance, about 4 percent per year (through 1992) after returning to its pre-crisis GDP level in 1985. Policy changes were less extreme, more gradual, and less erratic than in Chile, and much more successful (at least through 1990) than in Argentina. In contrast to both those cases (especially Chile), real wages did not long remain low, as the indexing mechanism that linked nominal wage increases to past inflation was left in place with only mild modification. So when tightened monetary and fiscal policy brought inflation quickly to heel, real wages moved back to or near their previous peak in only three or four years. The national unemployment rate also returned quickly to its normal range of around 5 percent. Income distribution, less unequal than in most Latin American countries, does not appear to have altered significantly in the course of the crisis, though it is possible that some concentration has occurred in the subsequent recovery.[33] Overall, however, this must tentatively be counted one of the more successful adjustment performances in the region, in the sense of reestablishing growth without a lengthy period of significantly higher poverty than before.

7. Lessons, Challenges, Implications, and Questions for the 1990s and Beyond

No *definitive conclusions* can be derived from the sort of comparisons of country experiences presented above. However, those experiences do appear to be consistent with the following *hypotheses:*

(1) More open trade regimes *cum* devaluation contributed to the observed worsening distribution in Chile, Argentina, and Mexico.

(2) The dismantling of labor institutions, "socialization" of debts held by the rich, and other distributionally regressive policy steps also contributed to the worsening in Chile.

(3) In the absence of such policy shifts, with moderate economic growth, and with labor markets starting to tighten up at the lower end while supply rose quickly in the higher-skill categories, Colombia entered a phase of declining inequality. Venezuela may have done the same. Brazil, which, broadly speaking, met these same conditions, might have begun to see improvements but for the upward influence of the

32 Timothy H. Gindling and Albert Berry, "The Performance of the Labor Market during Recession and Structural Adjustment: Costa Rica in the 1980s," *World Development* 20:11 (November 1992).

33 No very adequate over-time comparisons have yet been made due to noncomparability among the sources of data (Gindling and Berry, ibid.).

public sector on the earnings of high-income employees and/or other unidentified factors. More generally, it may be the case that Colombia is the first of those Latin American countries traditionally characterized by extreme inequality to turn the "distribution corner" and that its experience may, under favorable circumstances, be replicated by several others of that group in the coming years.

(4) Costa Rica, a country with relatively high average income, a middling level of inequality, and a strong system of social services -- thus comparable to Chile and Argentina in many respects -- weathered the crisis years with no major shift in distribution (at least until the late 1980s, when the evidence becomes unclear).

While the picture as a whole raises very serious questions about the implications of the sort of policy package now being widely adopted in Latin America and elsewhere, the fact that the two cases of sharpest increases in inequality are relatively high-income countries with traditionally moderate levels of inequality and with strong systems of social services means that the social cost of increasing inequality has been much less than it might have been. Comparable increases in inequality in the poorer countries of the region would have had a much greater impact on poverty and, accordingly, much higher social cost. In most of those countries many of the poor are found in agriculture, so trends in their incomes would weigh more heavily in the overall distributional and poverty outcomes than was the case in Chile and Argentina.

Optimists have argued that the opening up of trade should be expected to raise the relative incomes of agricultural workers, and since the erosion of the labor institutions that mainly protect a subset of urban workers would probably have little effect on them, it is possible that the overall effects of policy shifts in the trade and labor market areas would be quite different from what they have probably been in Chile and Argentina. Recent evidence on this point is not encouraging, however. A significant feature of the 1984-89 period in Mexico was the contribution of a widening gap between urban and rural incomes to the overall increase in inequality, and of the sharp decline in income from agriculture and livestock as a share of rural income.[34] In Colombia an unprecedented increase in the gap between urban and rural incomes has appeared within the last two years, coincident with the process of liberalization. It is increasingly clear that in such countries there is a major part of the agricultural sector that cannot compete easily with an onslaught of imports, and whose labor resources are unlikely to be quickly mobile to other sectors.

The incidence of poverty can in any country be thought of as reflecting per capita income and the distribution of that income. Deterioration in the level of either variable will accentuate poverty. Short-run accentuation of poverty might, however, happen to be associated more with one variable than the other, and in fact this seems to have been the case in Latin America. There is not much evidence to suggest that the accentuation of inequality coincided with declines in per capita income. Though such an association appears to characterize Brazil around 1990 and perhaps Argentina more generally, it is clear that the quantum leaps in poverty in the countries that have suffered them came mainly from the decline in per capita income. Trade liberalization and certain changes in labor market institutions, both of which may have played significant roles in the accentuation of inequality, have normally and fortunately been undertaken when per capita incomes were at least not falling, so their impact on poverty is more likely to have been to slow a reduction that might otherwise have taken place.

34 Alarcón, op. cit., pp. 139, 148.

The full story on how the trauma of these past years has affected the distribution of income, poverty, and welfare in Latin America, and whether it will leave a permanent imprint on those variables in future, cannot be told until there is better information on the distribution of capital incomes, of rural incomes, and of social services. It is conceivable, though not likely in my judgment, that the capital share has risen regionwide by enough to suggest worsening distribution in nearly all of the countries, or that relative rural incomes have moved positively enough so that the record reviewed here appears unduly negative.

The fact that some welfare indicators other than recorded incomes did continue their upward trend, albeit usually more slowly than before, is reassuring with respect to the welfare cost of the crisis itself, but it needs to be better understood. It may mainly reflect the fact that there are significant lags between investment and payoff in these areas; it may imply that service provision fell significantly less than did expenditures (plausible since wages are the main cost of education and those wages fell); or it may suggest that some of the improvements (e.g., in child mortality) are substantially independent of macroeconomic performance and/or increasingly influenced by efficient targeting programs.

Several further implications/questions following from the evidence reviewed above are worth noting.

(1) It is essential to reestablish healthy growth if poverty alleviation is to pick up where it left off in the 1970s. Although no one would argue that the typical Latin American pattern of economic expansion with extreme inequality is anywhere close to ideal, growth of that sort is certainly better than no growth at all when it comes to poverty alleviation. Hopefully, more equitable growth can be achieved at some point in the future. But in the meantime, growth of any sort must be welcomed. Indeed, some evidence suggests that a continuation of the earlier growth patterns would soon bring a number of Latin American countries to a phase of declining inequality. The sharp increase of unskilled real wages in Brazil during the "economic miracle" of the late 1960s and early 1970s suggests that fast growth may have a large "trickle-down" for an economy at this stage. A tempting hypothesis is that several of the Latin American economies are close to turning the corner towards labor scarcity; every year that their attainment of that point is delayed by weak macroeconomic performance can have a heavy cost in terms of poverty unalleviated.

(2) The confidence with which many Latin American leaders viewed the future of their countries fifteen or so years ago has evaporated in the trauma of the last decade. It is no longer defensible, if it ever was, to assume that growth will by itself reduce poverty at an *adequate* rate. Poverty redressal and income support systems must be studied with care and implemented where promising. The above-cited Chilean programs seem to have made an important difference in that country. Several other countries have made interesting innovations in recent years, ones which deserve close attention and in some cases replication elsewhere. Evidence on the inefficiency, at least from the perspective of poverty alleviation, of "social" expenditures in Brazil could probably be found in many other countries. The message is that it is not necessary to greatly increase spending in this area to achieve much more poverty reduction.[35]

(3) While probably not inevitable, there is plenty of scope for the application of the policy reforms so widely initiated in

35 William McGreevey et al., *Brazil: Public Spending on Social Programs: Issues and Options,* World Bank Report 3, 7086-BR (Washington, D.C.: The World Bank, 1988). More precisely, if it is necessary, the reasons are bureaucratic ones rather than technical or economic ones. The 1990s are not a time when Latin American countries can afford to be gentle with the inefficient parts of their bureaucratic apparatuses.

the 1980s to have negative distributional impacts. It will therefore be a challenge to design and carry out necessary reforms with an eye on avoiding significantly perverse effects on income distribution. The record in Costa Rica is encouraging in this regard. Strong fiscal steps were taken and union power was reined in, but existing wage-setting institutions appear to have prevented the drop in the real wage from lasting.

Together with the importance of more careful and professional design of policy packages will be prompt and in-depth monitoring of welfare outcomes and their relationships to policy. For example, if higher real exchange rates are prone to worsen distribution in Latin America, this should become quickly manifest as the trends of the late 1980s become clear (peraps in the next five years); many countries have much higher rates than they did as of the mid-1980s (major exceptions are Peru, Mexico, and Brazil).[36]

(4) Since both trade and labor market reforms, and perhaps some of the others currently in vogue (financial markets, privatization, etc.), carry the threat of a negaive impact on income distribution, an impact whose duration cannot at this time be anything but guessed at, it would clearly be dangerous from a poverty point of view to undertake such reforms when per capita incomes are falling due to macro crisis. To do so would give rein to two sources of increasing poverty at the same time.

(5) An important consideration when the labor market is slack due to poor macroeconomic performance is that the employment- and income-generating potential of the small-to-medium-scale sector of the economy be taken full advantage of. Some progress has been made with respect to the micro-enterprise or informal sector, with the concerned assistance of nongovernmental organizations of both national and international origin. Less attention has been directed to the fairly small but not micro-level firms. There is some concern that the trade, fiscal, and capital market reforms will be applied in ways not conducive to the success of this group, whose potential is little understood and whose interests have received little attention from the key policy makers in most countries of the region. In increasingly open economies it will be important that these firms' capacity to export, either directly or indirectly through effective intermediaries or through subcontracting arrangements, be fostered. Evidence from countries like Korea and Indonesia strongly suggests that this will require proactive government policy.[37]

(6) Latin America has seen a considerable shift towards democratic regimes and the correspondingly greater public participation during the last couple of decades. While this is a source of much hope, the need for more openness, more accountability, and recognition of the interests of a wider range of economic groups has tested and will test the political acumen of national leaders. It is not surprising that some of their concessions to group intersts seriously hamper growth, worsen distribution (often in less than obvious ways), or both. The pressures of popular groups can immobilize a government that needs to undertake certain trade or labor market reforms, just as the pressures of the rich can make fiscal reform difficult or impossible.

36 For a useful set of estimates see ECLAC 1992, op. cit., p. 47.

37 Based on the conclusions of an ongoing World Bank study of the export success and support systems of small and medium-sized manufacturing firms in Korea, Indonesia, Japan, and Colombia.