1. Introduction

Most of the Latin America countries which have introduced market-friendly economic reforms during the course of the last two decades have also suffered serious increases in inequality; the systematic timing coincidence of the two events suggests that the reforms have been one of the causes of the worsening distribution. That major increases in inequality have occurred in many Latin American countries over the last two decades is now generally accepted (Altimir, 1992; Morley, 1995). This study adds new information for a few countries (Colombia, Costa Rica, Ecuador), but its main focus is on the possible causes of those increases, a complicated question because so many different currents have affected the region over this period—the crisis, the reforms, technological change, terms of trade shifts, and others. Morley (1995) and others have argued that much of the observed increase in inequality was related to the economic crises suffered by nearly all of the countries. This might suggest that the optimists who predicted positive distributio nal outcomes from the reforms (e.g. Krueger, 1988) will eventually be vindicated, after the negative effects of the crises have played themselves out. While we agree that this factor played a significant role, the fact that inequality appears to be significantly higher in the post-crisis period (Altimir, 1992) implies that other important factors were also at work. Of these, the reforms are suspect because of their content and implicated by the timing coincidences with the increases.1

2. Background to the Distribution Crisis

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. This outcome was a possibility because of Latin America’s higher average income than characterizes most of the Third World.

Over the period 1950-80 the region’s per capita income rose by about 3% per year. With the poverty line which Altimir (1982) applied across countries for 1970, poverty incidence was about 38% of households. The growth record over 1950-70 would suggest that poverty incidence in 1950 (using the same poverty line) was around 65%; over 1970-80 it probably fell to somewhere around 25%.2 Had per capita income growth continued over the last two decades of the century at the 3% per year observed over 1950-80, poverty incidence would probably have fallen to about 10-15%; with reasonably effective poverty redressal policies (targeted employment schemes,
food schemes, etc.) of the sort which 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.

Although most countries of the region did not witness major shifts in income distribution during the 1970s, some emerging patterns hinted at possible improvements in the not too distant future. Thus, the sharp increase in real wages of lower skilled workers 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 labour market and continuing wage increases, especially among those lower skilled workers (Pfefferman and Webb, 1983; Berry, 1990). In the case of Colombia, urban distribution did in fact improve over at least the latter part of the 1970s.

This process of poverty alleviation, Latin American-style, was interrupted by the economic downturns of the last two decades and the difficult recoveries and attendant social and political strains which followed. The timing of the economic crises varied somewhat in response to country-specific policies and exogenous shocks; the Southern Cone countries were already in difficulty by the mid-1970s, while for most of the others the onset was signalled by the international debt crisis of the early 1980s. Crises involved macroeconomic imbalance, hyperinflation and the resulting need to stabilize; international payments imbalance calling for structural adjustment away from production of non-tradables to that of tradables; output losses associated with the need to stabilize and curtail imports; and, due to the above combination of events, rapidly falling absorption, real wages, and living standards. In an extreme case like Peru, per capita income fell by 21% over 1974-85, while real wages fell by over 50% (Vedera, 1994; Cox Edwards, 1992). For the region as a whole, 1990 per capita output was about 8% below the 1980 level; per capita income had fallen by about 15% due to the negative shift in the region’s terms of trade over that decade. 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% during the 1980s in Argentina, Venezuela, Peru, Bolivia and Nicaragua (though the first two regained some of that ground in 1991-92). With this sort of macroeconomic performance it was obvious that there would be many “losers” during this period. The only coun-

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2 In extrapolating the poverty index backward and forward from the base estimate for 1970, this rough estimate assumes that the relative price of goods and services entering the basket which defines the poverty line did not change over time, and disregards any effects of the changing distribution of population between rural and urban areas (which have different poverty lines in a given country due to the different prices faced by families). The latter bias would suggest that the figures presented overstate the reduction in poverty incidence over time. Though imprecise, the figures do suggest a very large total reduction over 1950 to the present had the pre-1980 trends continued.

3 If this extra period of growth brought with it a significant tightening of the labour market, it might have been realistic to expect the income share of the bottom few deciles to rise (though perhaps not the very bottom decile).
tries which did not suffer a net decline in gross national income per capita between 1980 and 1992 were Colombia and Chile, but in the latter case this was mainly because the recession hit earlier.

The debt crisis provided the push to induce and/or oblige the region to jetison 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 labour 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 practice of encouraging exports while continuing to protect against imports. Chile went much farther as the Pinochet regime introduced the most free-market system in the region, including a real import liberalization bringing tariff rates down to 10% by 1980; though they were raised somewhat in the mid-1980s the average was back down to 15% as the decade came to a close (UNCTAD, 1992, 44). Argentina had an important liberalization episode between 1976 and 1982, in which the average effective rate of protection fell from 158% to 54% (Gelbard, 1990, 46). 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.

The 1990s have promised better things. Though per capita output in 1995 was still a bit below that of 1980 and per capita income nearly 10% below, the regional growth rate through 1995 was close to 3%, hardly dramatic but enough to edge per capita incomes up by about 5% since 1990 (CEPALC, 1995, 49, 50). A few really strong performers—especially Chile and for a period Argentina—have created the hope that others will be able to follow and that the region as a whole might be able to get back to the healthy growth rates of the 1960s and 1970s. Some of the return of optimism is based simply on the better growth performance of the early 1990s. Some is based on the dramatic return of capital, both flight capital which had previously left and new foreign capital coming in (Culpeper, 1993), some on the entry of Mexico and the planned entry of Chile into NAFTA and the expectation that other Latin countries will benefit from membership in a free trade block, and some on the widespread more general belief that the currently more market-friendly economic policies have been a change for the better vis a vis those of the pre-crisis period.

How well-founded are these hopes? Would a return to growth under the new more open economic regime bring a quick reduction of poverty and a gradual decline in the historically high levels of inequality characterizing this part of the world? This is a possible implication of recent analyses (e.g. Morley, 1995) which conclude that in-
equality tends to rise with recession and fall with prosperity. What policies will be most important to achieve growth with rapid poverty alleviation? The urgency of dealing with this region’s unnecessary poverty—unnecessary because the relatively high level of average income implies 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 sharp declines in per capita income which resulted.

While many analysts expect market-oriented reform packages in general and trade liberalization in particular to improve the growth performance of less developed countries (LDCs), predictions as to their employment and distributional impact have varied widely and on balance been less positive. The main source of concern on this front is not the predictions of the theory, which are in any case ambiguous (see below), but the empirical evidence on the aftermaths of liberalization experiences around the world. The transition towards market economies in the Eastern European countries appears to have led to rapidly widening income inequality (Milanovic, forthcoming); less dramatic market reforms have frequently been accompanied by widening gaps elsewhere as well, including both industrialized countries and a number from the developing world (Berry and Stewart, 1996).

This paper focuses on how labour market outcomes, and especially the distribution of income, have been related to economic policies and events in Latin America over the past twenty years. Its immediate raison d’être is the accumulating evidence that the market-friendly policy shift has been systematically associated with an abrupt and important deterioration in income distribution. Striking increases in inequality have occurred concurrent with market-oriented policy packages in seven of eight countries discussed in some detail here. While it is too early to tell what has happened or is happening in some of the other countries, and it appears that Costa Rica has avoided this unhappy outcome (see below), the regional record thus far makes it clear that any optimistic expectations as to the distributional impact of the reform package should be discarded. The main question for a given country is whether its implementation will or will not be accompanied by a large negative shift in distribution; a neutral outcome should be cause for satisfaction. The pivotal underlying question is whether the observed association between reform and increasing inequality is a causal one. If so, it is urgent to ascertain which components of the policy package are most responsible for the outcome; hopefully it is not those which are most likely to contribute to a strong growth performance.

The paper does not dwell on the implications of the end of the debt crisis and the above mentioned policy shifts for economic growth. Whether growth will or will not be rapid (say 5% per year for the region) is tremendously important, of course, since even a fairly severe worsening of income distribution over the medium term might not be too difficult to weather if average incomes were rising fast enough to spread
some of the fruits of growth to those at and near the bottom of the income pyramid. But it would be incautious to take for granted a growth rate rapid enough to push distributional concerns into the background. One reason is that most of the impressive growth performances in the Third World have taken place in somewhat less market-friendly contexts, with Hong Kong and post-1985 Chile perhaps the only very notable exceptions. Another is the obvious problem which a number of LAC countries have been suffering in the management of their exchange rates, the continuing proclivity towards overvaluation and the resulting sluggish and erratic regional growth—only as high as 3.5% in one of six years in the 1990s. Finally, in spite of the new-found access to foreign capital, gross domestic investment has not yet approached its pre-crisis level of about 25%. All of these problems might be substantially resolved within five years or so, but the grounds for such an expectation are not overly strong, so the prudent response is to take seriously the possible implications of any sharp deterioration in distribution, along with the other unwelcome evidence—that temporary jobs, part-time jobs, and more generally job insecurity are a growing feature of labour markets in the region.

Before turning to the empirical evidence on the timing of income distribution changes shifts in Latin America and the hypotheses suggested by that timing, we review some of the current interpretations for negative trends in distribution and/or other worrisome aspects of labour market outcomes in this and other parts of the world.

3. Explanations for Negative Distributional Trends

Trends in inequality in Latin America and in developing countries generally are only very partially understood, due to deficient data bases and limited quantitative analysis. The prominent Kuznets (1955) hypothesis—that distribution typically worsens and then improves over the course of development is supported (according to most interpretations) by the labour surplus model (Fei and Ranis, 1964), which suggests a worsening of inequality while labour remains in surplus and an improvement when a country’s labour market begins to tighten up (Berry, 1983; Fields, 1980). Cross-section studies have generally supported the Kuznets idea (Adelman and Robinson, 1989), though the over-time studies in developing countries have produced generally ambiguous results (Fields, 1991). Since the income levels of most Latin American countries are towards the middle or upper part of developing country range, this theory would suggest declining inequality over the remaining phases of their development.

Among structural features, the distribution of agricultural land as well as of other productive assets (Loehr and Powelson, 1981), the distribution of education (Ram, 1989), the size structure of firms, and the degree of openness to international markets have all received some attention (Bourguignon and Morrisson, 1989; Fields, 1984). It is well recognized that the speed and pattern of technological change could have a significant effect on distribution (Fei and Ranis, 1964). There has been
less analysis than in developed countries of the impact of economic cycles, partly because the sort of cycle so prevalent in the industrialized countries has not been generally present in a similar form in the LDCs, but Morley’s recent work (1995) advances this line of research for LAC. While structural and exogenous factors have been heavily emphasized as determinants of both levels and trends of inequality, confidence appears to have grown over the years that policy can also play an important role. Adelman and Robinson (1989, 1961), for example, believe that although early stage worsening is inevitable, what happens thereafter depends a great deal on policy. Ranis (1987, 397) argues that the stellar performance of Taiwan, in avoiding early stage worsening and achieving improvement in the middle stages of development, owes much to the policies of strong support for agricultural and rural non-agricultural growth in a small farm setting, and of support for labour intensive exports.

Our central concern in this paper is with economic policy and distribution, specifically with the impact of the market-friendly policies adopted in varying degree by most LAC countries over the last decade or so, including trade and foreign investment liberalization, privatization and general downsizing of the public sector, and labour market reforms. Our main interest is in the more lasting impacts of policies; a major challenge in interpreting the LAC record is to distinguish which effects are short-term and which will persist.

The possible impacts of trade policy have been widely discussed. The view that freer markets generally increase inequality, perhaps especially popular among non-economists, has been countered by the basic Hecksher-Ohlin theory that the freeing of trade should shift factor demand in favour of unskilled labour and of agriculture and thereby improve the distribution of income (e.g. Krueger, 1988). At the empirical level there has been a major debate in the U.S. on whether increased imports are mainly responsible for the increase in wage differentials observed since 1975 (Katz and Murphy, 1992; Bound and Johnson, 1992).

Wood (1994, 1995) has argued that trade with labour abundant developing countries hurts unskilled workers in industrial countries. Interpreted in the Hecksher-Ohlin framework, this finding would suggest a positive effect on the incomes of unskilled workers in LDCs. Regardless of the impacts of trade on the demand for labour and capital at the production level, however, there are important economies of scale in the commercial and financial aspects of international trade. This helps to explain why large firms dominate trade in many sectors. Since a plethora of evidence (Liedholm and Mead, 1987) indicates that capital intensity is positively related to firm size, one would expect globalization, in giving an edge to larger firms, to raise the capital intensity of exporting industries. The resulting upward push on the returns to capital and downward pressure on those of labour would tend to offset the opposite effects of factor reallocation among industries (the Hecksher-Ohlin effect). Finally, as noted in the country discussions below, one might anticipate quite different results from freer trade depending on the surrounding ma-
croeconomic conditions, and in particular on the level of the exchange rate.

Symmetrical with simple trade theory is the proposition that foreign investment should improve the functional distribution of income in the host country by raising the capital/labour ratio and hence the ratio of wages to returns to capital. Feenstra and Hanson (1994), who link foreign investment to an observed widening wage dispersion between higher skilled and lower skilled workers in Mexico, are thinking of a different mechanism, in which activities which are shifted from the source country to the host country when the capital flows from the former to the latter are less capital and skill intensive than the average in the former and more capital and skill intensive than the average in the latter. As a result the capital and skilled labour share of income rises in both countries.

Much of the developed country literature suggests that unions, minimum wages and other types of labour market legislation usually narrow earnings differentials, either because they prevent the exploitation of relatively un-defended workers or because they prevent differences in ability from being reflected in earnings levels. Though this view is also present in the LDC literature, there is stronger competition from the position that such protection increases the inequality of labour income, since it is often limited to a small labour elite; its impact on overall distribution is more complicated, and depends in part on how much of the rents taken by protected labour are at the expense of capital (and which segments of capital owners) and how much at the expense of the rest of labour. The strength of this argument presumably depends on the size of the protected group, which tends to increase with the level of development. Morley’s (1995, 160-163) conclusion that cutting minimum wages in the course of adjustment in Latin America worsened income distribution and poverty, and the similar results reported by Lustig (1996) make it clear that this issue merits serious attention, as does the evidence reviewed below from Chile, Argentina and other countries.

Predictions on the distributional impacts of financial reforms tend to parallel those for labour reforms. One view is that a better functioning market will improve the access of smaller firms previously excluded by the oligopolistic character of the market and the high rents created by the legislated negative real interest rates and through this improve the position of such firms, raise the demand for labour (since small firms are relatively labour intensive) and thus improve income distribution (Fry, 1988, Chap. 7). The other is that, while such positive effects may be present they will be outweighed by the loss of credit schemes targeted to smaller firms (World Bank, 1991).

Since most public sector employees are middle class and middle income people, it is reasonable to assume that the direct effects of the shrinking of this sector will be felt mainly by the upper and middle deciles of the distribution. But if former public sector employees “bump” workers in lower income categories down, the ultimate (general equilibrium) effect on earnings distri-
bution might be more complicated. And the overall impact of downsizing will clearly depend on whose jobs are cut out; at one extreme might be surplus bureaucrats or workers in inefficient state enterprise, and at the other the staff of rural health clinics or primary schools.

While many structural factors no doubt play a role in the evolution of income distribution over the long term, some are unlikely to be behind the sharp recent changes witnessed in many LAC countries. This probably includes educational policy/performance, demographic trends, and small enterprise policy/performance. On the other hand, trade policy, labour policy, the size and character of the public sector, technology change, and the business cycle are all obvious possible candidates.


Although it is difficult 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, the clear preponderance of negative shifts in income distribution around the time of the introduction of policy reforms is unmistakeable, and is not readily nor fully explicable by other obvious candidates like stage of the cycle, technological change, rate of inflation, etc. The evidence reviewed here comes from Argentina, Chile, Colombia, Dominican Republic, Ecuador, Mexico, and Uruguay. In no country with satisfactory data do we have clear evidence of the opposite pattern. Costa Rica appears to be an exception to the general pattern; its distribution probably remained roughly constant during the reform period. Preliminary analysis for Jamaica indicates that expenditure distribution improved over 1991-1993 as major trade liberalization was being initiated, so it may turn out to be an “exception” as well. Several other countries have not undertaken the reform package far enough back in time to generate useful data by now, and for others the data are of too questionable quality. We

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4 Most of the data used to measure distribution and its changes over time come from household surveys. Sometimes these are national in scope; more often they refer to urban areas or even just to the main metropolitan area. Usually they refer to income and only infrequently to consumption, which is unfortunate since the latter figures are usually more reliable. When available, the distribution of income among families ranked by per capita family income is used, but often time series are not available on this basis and one must revert to a simple ranking by total family income. The data base could be better in other respects also. Judgment as to which countries have satisfactory information for purposes of this analysis depends on the over-time consistency of the way the data are collected, the level and stability of apparent completeness of income reporting as judged by comparison with national accounts data on national income, and the extent to internal inconsistencies reported by analysts using the data. Valuable reviews of distribution data for many LAC countries appear in the ECLAC series Antecedentes de la Distribucion del Ingreso en (name of country). Several countries have been excluded from consideration for want of what we judge to be adequate quality data. For those included, specific data problems are brought to the reader’s attention when relevant.

Though the true and the reported trends in distribution could differ substantially in almost any of the countries discussed here, the conclusion that a generally significant increase in inequality has occurred may be defended on the grounds that: (i) though in many cases the conceptually preferable series is not available (e.g.
organize the discussion around groups of countries whose experiences appear to share a number of relevant characteristics.

**Chile, Argentina and Uruguay**

The three Southern Cone countries differ from the rest of the LAC nations in that all introduced significant liberalizing economic reforms in the early or mid-1970s, before similar efforts were undertaken elsewhere in LAC. The cases thus offer a longer period during which possible impacts of the reforms might have been felt. Argentina and Chile suffered unusual worsening of income distribution, with high unemployment an aspect of the period in question in Chile, and falling labour incomes for the lower deciles the dominant feature in Argentina. Uruguayan data are somewhat suspect in terms of quality/comparability over time, but they too suggest a major deterioration of distribution.

**Chile’s experience** is the most important from our perspective, since the policy experiments date well back in time and, despite some vacillation, their basic direction has been maintained subsequently. There have been two severe crises since 1970. The first occurred at the beginning of the Pinochet government, and was most severe in 1975 as austerity measures were applied and GDP fell sharply; the second occurred in 1982-83 as a result of a series of internal and external factors: overvaluation of the peso due to nominal pegging of the exchange rate, liberalization of the capital account, financial manipulation and speculation in a setting of near-total deregulation, together with the external shocks which were then laying the groundwork for the international debt crisis (Meller, 1992, 31). After each collapse growth resumed quickly and was strong, but their impact was enough to hold average annual growth over 1970-92 to only 3.2%, in spite of an impressive 6% 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 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 (Table 1) and no longer superior to the levels observed in most other Latin countries. Less frequent but possibly more 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 continuing over the decade which followed (Table 2). Since it is reasonable to assume that distribution at the end of the Allende years was at least marginally better than that of 1969 (to which the data refer), it would appear that the worsening was dramatic over the first 5 post-Allende 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%.

Meller reports an increase in poverty incidence from 17% in 1970 to 45% in 1985 with poverty lines not more than 6% apart (Meller, 1992, 23). Even if this may somewhat exaggerate the trend, there is no doubt that poverty increased sharply. 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.

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 (Meller, 1992, 27). 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 labour legislation, which relaxed worker dismissal restrictions. The short-run movements of the various distributions coincide rather closely. The main question is how large a total shift occurred between the pre-Allende period and the late 1980s when inequality began to diminish. The consumption distribution figures, important both because of their presumed greater accuracy than income data and because they should be a good measure of welfare, show an incredible twelve percentage points jump in the Gini coefficient (from 0.31 to 0.42). The household distribution series suggests an increase of about five points between 1970 (which seems representative of late 1960s, judging by the series for income recipients) to 1987-89; the Gini of the more interesting household per capita distribution rose by about 6.5 points. The probable increase in the Gini of the most interesting distributions was thus somewhere between important (6 points) and dramatic (12 points).
regulations, suspended unions (to 1979, when they were again authorized to operate, but with many restrictions), greatly reduced the social security tax paid by the employers and reduced other non-wage costs as well. After the second crisis (1981-1983) wage indexation was abolished, 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 substantially reduced, private banks and other debtors bailed out with public funds,12, and public employment greatly cut back. Unemployment rates (for greater Santiago) rose to unprecedented levels in the neighbourhood of 20-25% (depending on the definition used). Only in 1989 did this rate fall below 10% but since then the fall has been continuous, to just 5% in 1992 (ECLAC, 1992, 42). 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. According to Ffrench-Davis (1992, 15) average wages in 1989 were still 8% lower than in 1970; as of 1992 they were probably marginally above the 1970 level13, a very slow recovery indeed.

One feature of the post-1975 period which probably contributed to increasing income inequality is an increase in the relative income of persons with university vis a vis those with less education. Robbins’ (1994) analysis indicates that the increase was not primarily the result of shifts in the composition of employment among industries, but rather a “within sector” phenomenon. It might reflect a greater relative payoff to higher education under a more open economy or the dismantling of union power and changes in labour legislation in Chile.

Until the early 1980s, Argentina had a long period of very slow growth—only a total of 4% between 1974 and 1988 with a dramatic fall of 13% at the heart of the crisis (1980-82). Accompanying this macroeconomic failure was an unusually sudden and large increase in inequality, the Gini coeffi-

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10 The high incidence of television sets (over 70%), refrigerators (49%), radios (83%) and bathrooms (74%) even in the lowest quintile (Meller, 1992, 25) throws some question on the 45% figure. Some of these items probably became much more prevalent due to the low prices which came with the import liberalization around 1980.

In any case there appears to be no serious doubt that poverty, as normally measured, was substantially more widespread in the late 1980s than it had been in 1970 (CEPAL, 1990).

11 See Ritter (1992, 27) who points, inter alia, to the rapid decline in the infant mortality rate as reflecting in part the increased coverage and careful targeting of some social expenditures towards the health and nutrition of expectant mothers and young children. See also Corina et al (1987, 110-111).

12 These bailouts (“unregistered central bank subsidies” were of major proportions, averaging over 4% of GDP during 1982-85 (Meller, 1992, 60). They undoubtedly contributed importantly to the increase in inequality over this period, by damping the effects of the crisis/recession for capital owners while wage and employment trends were hitting workers hard. Little of the impact of the bailouts is likely to be reflected in the household survey data, however, given the normally severe under-reporting of high capital incomes.

13 If the series cited by Ffrench-Davis (the source of the wage data is INE) is consistent with that reported by ECLAC (1992, 44), which shows an increase of 11.7% over 1989-92, then the 1992 figure is 3% above that of 1970.
cient among income earners in greater Buenos Aires rising from about 0.36 over 1974-76 to somewhere within the range 0.41-0.46 from 1978 on (Marshall, forthcoming, Tables 4A and 4B). Since then the level of concentration has fluctuated without clear trend; after falling in the early 1980s it reached a temporary peak in 1989 (under intense inflation), fell back to the previous level from which it has varied little although the share of the bottom 30% has continued to fall somewhat; from an average of 11.6% over 1974-76, it fell to the 10.5 range in the early 1980s and was by 1994 down to 8.5%.

One apparent determinant of short-run movements in the level of earner inequality is the real exchange rate; its role is suggested by the short run inverse relationship, 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 (Berry, 1990, 31). 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 longer-run worsening of the income distribution cannot be fully explained by this link with the real exchange rate since net worsening occurred over periods when there was no net increase in the real exchange rate. Other factors must therefore have been at work. 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% in manufacturing output between 1976 and 1982, but to an employment reduction of 37%, as output per worker rose by a striking 41% (Gelbard, 1990, 54). Many small and medium firms exited, while many large firms cut employment, increased capital stock and improved technology. It is also possible that the very large capital flight from the country played a role, by reducing the capital available to complement the labour force. Changes in labour policy almost certainly played a significant role; the bulk of the increase in inequality since the mid 1970s occurred between 1976 and 1978 as the new military government fixed wages, repressed trade unions, eliminated collective bargaining and the right to strike, and reformed the labour code to the detriment of workers (Cortes and Marshall, 1993). Unlike Chile, Argentina’s experience at this time was not characterized by high levels of unemployment.

Though the tearing down of labour market institutions would not perhaps be an obvious source of worsening in

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14 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 which actually occurred among households in the nation as a whole (Berry, 1990).

15 Fiszbein’s figures on the distribution of income among households, cited in Morley (1995, 30) show a sharp increase in the Gini from 0.40 in 1985 to 0.45 in 1988 and the Psacharopoulos et al figures show a big increase between 1981 (0.41) and 1989 (0.48). These are not greatly different from the earner distribution trends presented by Marshall (forthcoming).
countries with small “protected” segments of the labour force and large unprotected ones, in relatively advanced and highly urbanized countries like Chile and Argentina such an effect is quite plausible. It might be especially strong in an economy where large rents come from a high productivity mining (Chile) or agricultural sector (Argentina) and where the public sector and other service activities have been living off those rents. When the public sector shrinks and wages are more closely linked to the marginal product of labour in the private sector, one might expect wages to fall more in such a setting than in many other types of economy.

Uruguay’s story has fascinating similarities and differences with each of the other two countries. Protectionism and monetary mismanagement have prevailed over most of the post-war period, and average growth has been very slow. For such a small economy, Uruguay has been relatively closed, with the export/GDP ratio sometimes as low as the 10-14% range. Economic stagnation and high inflation gradually engendered social and political instability in the 1960s, leading eventually to a military coup in 1973. The new economic team installed in 1974 introduced a program of price stability, relaxed some of the existing controls on foreign trade and capital movements, and liberalized labour markets (Allen and Labadie, 1994, 10). Their severe distaste for strikes showed in their reaction to a general strike called by the National Confederation of Workers (CNT); it was quickly disbanded, employers were given the right to fire anyone who did not return to work, and 12,000 public and 4,000 private sector workers were fired (Allen and Labadie, 1994, 12). Neither the union movement nor collective bargaining played any visible role for 10 years. Meanwhile, import licensing and quotas were abolished between 1974 and 1977, the level and dispersion of tariffs was reduced and export taxes on agricultural goods cut. Average growth over 1974-78 of about 4% per year was led by export-oriented industrial activities—clothing, leather goods, shoes and fishing (Favaro and Benson, 1993, 195); the investment rate rose from 10% to 19%. The deficit remained high, however, due to increased spending on the military and on public investment projects, which offset the fall in the areas of wages and transfers. Attempts to restrict monetary growth were offset by inflows of cash, especially from Argentina. The initial trade reforms of 1974 were followed by a trade liberalization program that attempted to simplify the tariff structure and to reduce the level of protection gradually to the target of 35%; but the plan to shift resources toward the tradables was not fulfilled because the impact of the trade liberalization was more than offset by an exchange rate overvaluation felt necessary as part of the stabilization effort.

The defeat by a significant margin of a 1980 referendum called by the military on constitutional change marked the first step toward the re-opening of the political system (Allen and Labadie, 1994, 14). Unions started to reappear as it became clear that the military wanted to hand the reins over to the civil society, and the new movement
proved at least as militant as the old.

Wage councils were reinstituted in 1985, along with the return to democracy (Allen and Labadie, 1994, 15). A couple of years of fast recovery were once again followed by stagflation. Williamson (1990) cites the lack of deregulation in the labour market, where firing was again almost impossible, payroll taxes heavy and trade unions still strong, as a possible source of the still sluggish growth performance.

It seems clear that inequality has increased since the early 1960s, but neither the timing, the degree nor the characteristics of the worsening are well understood. The data for the Montevideo household distribution suggest a very large increase between the early 1960s (Gini around 0.37) and 1984 (Gini of 0.48). But the pattern is not continuous (Berry, 1995, Table 6), and some of the early 1980s observations might be outliers. A conservative guess, based on a comparison of the average of the three figures for the period 1961-62 to 1967 (0.385) to that of the three over 1980-84 (0.441) would be an increase of 5 or 6 points. The reported inequality of earned income among Montevideo households rose very fast over the 1970s, but the sources consulted have no observations for the 1980s.

The 1970s are of particular relevance because of the important policy changes introduced at that time. Most of the evidence points to a substantial increase in inequality during these years, including the sharp fall in wages and the apparently large widening in the earnings differentials across educational levels. Favaro and Bension (1993, 276) suggest that the opening of the economy, the reduction in the relative size of the government, and the prohibition of labour union activity all contributed to increasing inequality. They believe that the behaviour of the labour market during previous decades was greatly influenced both by the unions and by the state’s participation in the wage boards, in the determination of wage levels, and as employer of a significant share of the labour force. These factors, they feel, weighed in favour of a more uniform wage structure than would have resulted from market forces, created disincentives for more skilled workers, and led to considerable emigration by this group. The Uruguayan experience is widely interpreted as one in which, whatever their impact on distribution, labour market rigidities and imperfections have been an important drag on economic growth.

Mexico and the Dominican Republic

Mexico and the Dominican Republic did not undertake major policy reforms until the 1980s. In each case the crisis hit in the early 1980s. The Mexican experience is of special importance and interest given its status as the first developing country to enter a free trade area (NAFTA) with large developed countries. The country grew rapidly during the 1970s (second only to Brazil among major LAC countries), but then ran afoul of its debt build-up and achieved an average growth of only about 2% since 1980, with the 1990s performance still in that range in spite of the major policy reforms of the late 1980s. In contrast to Brazil, whose balance of payments was ne-
negatively affected by the oil price hikes, Mexico eventually benefitted from them, but by the late 1970s was attempting to maintain a level of expenditures inconsistent with its tax effort, and turned to heavy foreign borrowing to make up the difference. The debt crisis brought an output decline of about 8%, a serious bout of inflation, and a sharp decline in real wages of about 30% over 1982-86. The slow growth and instability of the early 1990s (including the financial crisis of 1994) has been associated with a large capital inflow and the resulting overvaluation of the exchange rate.

Mexico’s industrial development was nurtured under a rather typical import substitution policy regime which provided moderate levels of effective protection to manufacturing, and which included a number of sector specific infant industry programmes giving increasing emphasis over time to export targets and to price competitiveness (Ros, 1994, 208). Policies were overhauled in the 1980s in response to the debt crisis; liberalization was undertaken in the late 1980s. In spite of the severe macroeconomic turbulence, current trade patterns and industrial structure are a continuation of past trends, this “smooth” transition attributed by some (e.g. Ros, 1994, 209) to a combination of successful import substitution in the past and the fact that the debt crisis and declining terms of trade forced macroeconomic policy to provide unprecedented levels of exchange rate protection which facilitated the adjustment of industrial firms to a more open economy.

Over Mexico’s long period of rapid growth up to the debt crisis in the early 1980s it appears that most wages rose substantially (Gregory, 1986) and that inequality either fell (as argued by Hernandez-Laos and Cordoba (1982) or stayed about constant. Alarcon and McKinley (1994) report that the Gini coefficient of total household income (grouped data) rose from 0.43 in 1984 to 0.475 in 1992, most of the increase having occurred by 1989 (Table 3).16 The main winners were the top decile, whose share in total household distribution rose from 32.8% in 1984 to 37.9% in 1989 (Alarcon, 1994, 87).

The increased inequality among households is similar to that observed in other countries of the region. What is unusual about the Mexican case is the dramatically increased concentration among wage and salary earners, whose Gini coefficient rose moderately from 0.419 in 1984 to 0.443 in 1989, then leapt to 0.519 in 1992 (Alarcon and McKinley, 1994, Table 5), probably one of the highest Gini coefficients of wage income observed anywhere. The variance within virtually all groups exploded over 1989-92 (Alarcon and McKinley, 1994, Table 4), but most especially at higher levels of education, in the border states, in urban areas, in export manufacturing industries and, surprisingly, among union workers. While there was no increase in income variance among “poor” workers (in-

16 Evidence that the number of super-rich has increased rapidly in Mexico (two Mexicans were included in Forbes magazine’s 1991 list of billionaires, but the 1994 list included 24) may mean that these data understate the increase in inequality, since household surveys essentially never include evidence from that very small group of very rich families. Only after more detailed analysis, involving a wider range of methodologies, will the Mexican story become clearer.
cluding domestic service, helpers and unskilled labourers in industry, street vendors and urban agricultural workers (Alarcon and McKinley, 1994, 18), for the “elite” occupations (professionals, managers, supervisors, etc) at the other extreme the Theil L indexes more than doubled.

The group most clearly achieving a relative gain over the two periods were those with higher education (Alarcon and McKinley, 1994, Table 7). An independent source of evidence (data from the annual industrial surveys) indicates that the earnings gap between non-production and production workers in manufacturing has been widening since 1985 after a previous downward trend. In that earlier phase the ratio fell from nearly 3.0 in 1965 to its low of about 1.85 in 1985; it then moved back up to about 2.2 by 1988 (Feenstra and Hanson, 1994, Figure 3).

The Mexican story as currently understood involves a number of puzzles. Though the stresses of the crisis beginning in 1982 were severe, and though certain income gaps (e.g. between poor and non-poor states) did widen, the overall measured increase in inequality was modest, according to the household distribution data. But the sharp widening of wage dispersion in the 1989-92 period, and the evidence of widening gaps between more and less skilled workers are cause for concern. Have increased openness\(^\text{17}\), the declining importance of traditional labour market institutions, or technological change played a role?

Feenstra and Hanson attribute the widening wage gap by skill level to the inflow of capital; Mexico’s FDI boom of the late 1980s was large in relation to the existing capital stock. The key idea in their interpretation is that a movement of capital from the North to the South (in this case the U.S. and Mexico respectively) lowers the relative wages of unskilled workers in both countries because the activities transferred to Mexico when capital moves in that direction will be more skill-intensive than the previous Mexican average but less skill intensive than the previous American average. As predicted in the theory, the relative wage movement in Mexico parallels that observed of the U.S. In Mexico the increase in the skilled/unskilled wage ratio was greatest in the border region (50% for both hourly and annual wages — Feenstra and Hanson, 1994, 33).

The Dominican Republic’s economy grew rapidly until 1977. The external crisis hit in the early 1980s and led to an adjustment program composed of fiscal, monetary and exchange rate elements, that continued until 1986 by which time the adjustment had taken place and growth returned. The new 1986 government stimulated the economy through an ambitious programme of public investment, in pursuit of which it shrunk real current expenditures, contributing to a fall in the real

\(^{17}\) At least two econometric studies have addressed the relationship between trade liberalization and employment and/or wages in the manufacturing sector. Feliciana (1993) finds no impact of liberalization on industry-level employment. Revenga (1994), using panel data over 1984-90 for medium to large plants, does obtain a negative and significant coefficient for the impact of the tariff (or tariff equivalent) reduction on employment. While valuable in assessing the impact of liberalization on manufacturing, such studies do not provide an adequate guide to its economy-wide impacts.
wages of government workers (Sanatan and Rather, 1993, 54). Inflation broke loose in this period, after relative stability up until 1984. Just prior to the major devaluations beginning in 1984, a combination of overvaluation and declining terms of trade had pushed the current price export/GDP and import/GDP ratios to quite low levels (under 15% and under 20% respectively) for the Dominican Republic; they then rose sharply to 30% or above since then. The constant price series have been less volatile.

Sanatan and Rather (1993, 55) report that after a small decline in inequality between 1976 and 1984—the Gini apparently falling from 0.45 to 0.43, there was a sharp jump to 0.51 in 1989. The authors blame the inflation, among other things, for this deterioration. Its timing means that the growing trade ratios may also have played a role.

Colombia and Ecuador

Colombia and Ecuador are among the relative late-comers to the market-friendly policy package, pushing it vigorously only in the early 1990s. Colombia has the distinction of being perhaps the only country to adopt the package without being under severe pressure of circumstance to do so. Though the post-implementation period is too short to provide definitive answers with respect to the labour market effects of the apertura and other recent reforms, there appears to have been a sharp reversal a previous (and perhaps unique) equalizing trend in the urban distribution of income. If the negative trend apparent through early 1993 were to continue for a few more years the accumulated worsening might match the extreme cases like Chile and Argentina. Urban unemployment, however, has remained low by Colombian standards, though some industries have clearly been hurt by the import liberalization.

Since the late 1960s Colombia’s macroeconomic performance has also been among the best in the region. GDP growth averaged 4.4% over 1970-93, second only to Brazil’s 5.1%, and the economy was least affected by the debt crisis and accompanying recession. In the early 1990s (through 1994) growth has been a little above average for the region, at about 3.5% per year. This creditable performance, which dates from the late 1960s, has been based on generally good exchange rate management since the switch to a flexible rate in 1967, a trade regime offering incentives both for import substitutes and for exports, and a relatively prudent fiscal and monetary policy, under which fiscal deficits never reached the unsustainable levels of a number of other LAC countries and monetary growth was accordingly more modest. Growth did slow in the early 1980s as a result of the Dutch disease effects of coffee and foreign indebtedness booms between 1975 and 1982, reflected in the real appreciation of the peso and a mini-episode of import liberalization around 1980. Export promotion was downgraded at this time, not as a result of an explicit decision but of short-term macroeconomic considerations. The deterioration

\textsuperscript{18} The statistical evidence is matched by a growing concern in Colombia that the new "model" is having an adverse effect on income distribution (Sarmiento, 1993).
ting situation led to a rapid reversal of more than a decade of import liberalization; the economy became more closed with the constant (1975) price import/GDP ratio falling from 22% in 1982 to 14.4% in 1984, then fluctuating in the 16-18% range through 1991 (Berry and Tenjo, 1995, Table 2). Since the mid-1980s there has been renewed industrial growth, but the presumably falling returns from the ISI elements of the model and the acute change in the external conditions facing the country led to a radical turnabout in policy in 1990-91, and the adoption of a more explicitly outward-oriented strategy (Ocampo, 1994, 145). The Gaviria administration (1990-94) came to power committed to continuing and accelerating an already initiated process of liberalization, which was accompanied by a partial freeing of exchange controls, more open access to foreign investment and a liberalization of the labour market. The apertura was carried out quickly, though its effects on imports were delayed. Growth, which had recovered to average 4.5% over 1985-90, fell to a low of under 2.5% in 1991, from which it has gradually accelerated to somewhere in the range 4-5% in 1993-94. The fixed investment ratio (current prices), stable at 17-18% of GDP during most of the 1980s, fell to around 15% over 1991-93. It is still too early to do more than guess at the growth effects of the new strategy.

As noted above, it is fairly generally accepted that income inequality decreased in Colombia between the early 1970s and the 1980s, both in urban areas and for the nation as a whole, and both for earners and for households (Londoño, 1989). An important part of the story is the unusually marked decline in earnings differentials across educational levels and between genders, declines especially concentrated in the late 1970s while the economy was still growing rapidly and in the early 1980s when it was not (Tenjo, 1993). Rural earnings were also showing considerable improvement at this time (Ministerio de Agricultura y Departamento Nacional de Planeación, 1990, 228).

Our main concern here is with the period beginning in the late 1970s, during which the economy went through a brief episode of liberalization (early 1980s), then a sharp reduction in openness followed by a gradual re-opening through the rest of the 1980s and the abrupt apertura of the early 1990s. Labour market reforms occurred mainly around 1990, though union power was clearly weakened by the recession of the early 1980s. Estimates of income distribution by Berry and Tenjo (1995) in three of Colombia’s largest four cities (Bogota, Medellin and Barranquilla) reveal a significant and continuous decline in inequality between 1976 and 1990, more striking among earners (whose Gini coefficient fell from 0.50 to 0.41) than among persons ranked by per capita family income (where the decline was from 0.52 to 0.46—see Table 4). Among earners, the relative income of the top to the bottom decile fell from 28.6 fold to 18.8 fold. Inequality bottomed out in 1990 (data refer to March) after which it has increased sharply, especially that among earners (where the Gini coefficient rose from 0.41 to 0.47), but significantly also among persons (Gini up from 0.47 to 0.51). Among earners the
1990-93 period saw significant declines in the income share of the first six deciles (30.8% to 27.4%), while the only major gainer was the top decile (36.2% to 40.4%—see Berry and Tenjo, 1995, Table 4a). In percentage terms the biggest losers were the lowest deciles; the first decile saw its share fall by 23% from 1.93% to 1.48%, about the level of the late 1970s.

Trends in level of concentration of each of the major components of personal income parallel those of total income (Berry and Tenjo, 1995, Table 5). The very similar time patterns of the distributions of labour and of business incomes suggest close links between the markets in which the two types of income are determined. The reversal of the former positive trend in the level of inequality mainly reflects the increasing concentration of business income.

Unfortunately, Colombia does not have systematic national household surveys which include the rural areas along with urban ones. Rural data are available for 1988 and 1992; they suggest little change in inequality between those two years (the respective Gini coefficients being 0.46 and 0.45). But while urban incomes rose by 18% between 1990 and 1993, rural incomes fell by at least 5% over this period (Lora and Herrera, 1994), probably due in part to the production problems of the agricultural sector in 1992 and in part to the price impact of the apertura. This significant widening of the urban-rural income gap, together with a constant level of inequality in rural areas (at least over 1988-92), could imply an even larger increase in inequality at the national level than for the urban areas; it also suggests that, depending on where the poverty line is drawn, the percent of population in poverty was probably increasing over the early 1990s. Given the uncertainty and incompleteness of the rural data, however, it must be conceded that the opposite could also be true, i.e. the national trends could be better than the urban ones.\(^\text{19}\)

**Ecuador** experienced rapid economic growth during the 1970s, when the country became an oil exporter. The domestic reinvestment of export earnings led to an intense process of Import Substituting Industrialization (ISI) and agricultural modernization. During the late 1970s, as oil exports stagnated, growth was achieved at the cost of foreign borrowing. As the external situation deteriorated, this growth strategy became unsustainable. Two natural disasters added to the woes of the late 1980s—coastal floods in 1983 and a major earthquake in 1987. Though export quantum grew at 6.3% per year between 1980 and 1993, terms of trade worsened by 36% in the same period as oil, coffee and cacao prices all plummeted; this terms of trade shock was a determining factor in poor economic performance, particularly over the late 1980s. Only a very modest

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\(^{19}\) This case is argued by Londoño (1996, 15), who accepts that the distribution of labour income became more concentrated between 1988 and 1993, but estimates that a correspondingly marked decrease in that of non-labour income for the economy as a whole offset the former effect, such that the Gini coefficient of income among households (the ranking criterion is not noted) was essentially unchanged between 1988 and 1993. As with most other countries of Latin America, it will take some time and reflection before a consensus is reached on what has been happening to incomes of the various groups in the rural areas.
degree of export diversification has taken place.

The initial downturn in 1981-83 was less severe than in many other countries—GDP dropped about 3% and national income per capita by about 10%—but the recovery has been weak and halting, in spite of a moderate advance in the early 1990s. Only in 1992 did per capita income reattain its pre-crisis level. In spite of its lacklustre performance, however, the country did not experience hyperinflation, a dramatic income decline, or violent social unrest, as in the cases of Peru, Bolivia and other countries of the region.

Ecuador implemented structural adjustment policies from 1981 onwards. Generally the process can be characterized as gradual, slow, selective, highly conflictive, and still incomplete. A stable political consensus on economic policies was never reached, and social conflict resulted in frequent setbacks. In addition to the expected opposition from popular sectors and the middle classes, interest groups from the dominant classes resisted adjustment policies threatening their specific interests were; thus reduction of state subsidies and import duties create conflict and was implemented slowly and painfully. By contrast, interest and exchange rate liberalization were judged to be favourable or at least acceptable by agro-export elites, and were in place by 1984. SAP implementation speeded up and became more consistent from 1988 onwards, at least partially as a result of a more effective and stronger involvement of the international financial institutions. Although trade barriers were reduced from 1984 on, the most important step was adopted in 1990, when import tariffs were reduced to somewhere within the range 5 to 80% (with most products — except vehicles — between 5 and 30%) and most import restrictions were lifted. The result was a dramatic expansion of consumer goods imports by a factor of nearly five between 1990 and 1994.

Labour deregulation was pursued continuously during the period; real minimum wages declined and labour legislation was reformed to “increase flexibility and eliminate rigidities unattractive to foreign investors” (de Janvry et al., 1993, p.79). The reduction of the state apparatus was also pursued throughout the 1980s (except for a right-wing “ populist experience” between 1986 and 1988) and speeded up in the early 1990s. Between 1982 and 1990, public sector employment fell from 13.5% to 11.4% of the total. Public expenditure, meanwhile plunged dramatically from 21.6% of GDP (current prices) in 1981 to 11% in 1992 (Laurrea, 1995, Table 7). Public consumption and social services (education and health) have been particularly hard hit.

The evolution of functional income distribution points strongly toward increases in inequality over 1980-84 and over 1987-91 (Laurrea, 1995, Table 9). Since 1980 the (paid) wage share of value added fell dramatically from about 30% to less than 15%. Between 1982 and 1992 the total wage bill declined by 43.4% in real terms while net business income rose by 53%. Among capitalist groups, landowners (and farmers) were particularly benefitted du-
ring the 1982-1986 presidency of Fe-
bres Cordero, a spokesperson of the
nation’s agro-export elites; a strong
devaluation favoured agricultural and
fishing exports and real business in-
come of these sectors rose by 46.5%.
From 1988 to 1992, when the social
democrat Rodrigo Borja held office,
income transfers primarily benefited
the manufacturing elites; their income
rose by 7.6% per year.

Urban household survey data availa-
ble since 1987 corroborate the above
evidence on the functional distribu-
tion, pointing to a sharp increase in income
concentration among both earners and
households around 1990 (Larrea,
1995, Tables 10 and 11). The Gini co-
efficient among earners (based on
unadjusted income data) jumped from
an average of 0.431 in 1988-1990 to
an average of 0.483 in 1992-1993.
Household income distribution follows
a similar, albeit smoother, ascending
path. The evolution of real income by
income stratum discloses a severe
deterioration for the poorest half of the
population, exceeding 25% for the
bottom quintile, an unstable or slightly
declining situation for the next 45%,
and a sharp improvement (of 25%) for
the richest 5% (Larrea, 1995, Table 10);
income of the top decile relative to the
bottom one rose from 24 fold to 30 fold
using unadjusted data. Larrea (1995,
Table 12) estimates urban poverty in-
cidence to have risen from 66.3% in
1988 to a peak of 73.8% in 1992, after
which a decline occurred in 1993.

The timing of this recent accentuation
of inequality suggests that trade libe-
ralization and the reduction of public
employment could have played a role.
The former may have adversely affec-
ted small scale production, given the
dramatic expansion of consumer good
imports, and/or induced a wave of te-
chnological change. Concentration in-
creased between 1988-1990 and
1992-1993 for both wage and non-
wage income—3.3 and 7.3 percenta-
ge points respectively, and for both for-
mal and non-formal activities—9 and
4.6 points respectively. This pattern is
consistent with rapidly rising incomes
for a subset of business people lea-
ding to the increased variance both
within the non-wage category and
within the formal sector; a negative
impact of trade liberalization on small-
scale enterprises could have contribu-
ted to it. Though the increase was less
marked, wages became more concen-
trated as well. There was a strong de-
cline in real minimum wages since 1980
which, together with some labour mar-
et deregulation, could have played a
role in the declining labour share.

Costa Rica:
Reform Without Widening Gaps?

On the evidence available to date,
Costa Rica appears to be the only LAC
country to undertake significant mar-
et-friendly reforms without suffering a
large widening of income differentials—an increase in the Gini coeffi-
cient of say five percentage points or
more.20 This nation brought a tradition
of social and political stability to the
trials of the 1980s, and came off a
strong post-war economic performan-
ce in which average GDP growth ex-

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20 Other possible candidates, both of which
have liberalized too recently for the evidence
to be clear at this time, are Peru and Jamaica
(see Berry, 1995).
ceeded 6% over 1950-80. A good social service system gave it 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. The second oil price hike, rising interest rates and the world recession brought a sharp 14% decline in GDP over 1980-82, a 23% fall in income per capita and a 25% cut in real wages. At the depths of the trough a new president with ties to labour 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 non-traditional ones. It has been relatively successful in reestablishing a decent growth performance, about 4% per year (through 1995) after returning to its pre-crisis GDP level in 1985. Policy changes were less extreme, more gradual and less erratic than in Chile. Real wages did not long remain low, as the indexing mechanism which linked nominal wage increases to past inflation was left in place with only mild modification so that 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, around 5%.

Costa Rica’s income distribution, while unequal, has historically been less so than in such extreme cases as Brazil. Trejos and Sauma (1994) report that measured inequality among households fell during the crisis and again during the adjustment period (which they date as 1982-86), then rose sharply over 1985-87 and tended to fall after that. The increase between 1985 and 1987 could reflect the first effects of the liberalization, but it could also be due to a change in survey methodology at that time. Qualifications related to the uncertain quality of the Costa Rican data notwithstanding, the best guess at this time is that there was no significant, lasting negative impact of the post-1986 reforms on the level of inequality in Costa Rica. Trejos and Sauma report Gini’s of essentially the same magnitude in 1993 as in 1980, the nearly three percentage point decline between 1980 and 1985 being balanced by the four point increase over 1985-87. Since there is some likelihood that the latter increase is illusory, there is a corresponding possibility that this Gini (i.e. the Gini reflecting these families and the types of income included) actually fell between 1980 and 1993, and that it was about constant between 1985 and 1993. In that case, Costa Rica stands as an exception to the general tendency for such reforms to be associated with sharply increased inequality.

21 Communication from T. Gindling. Problems of comparability might be somewhat less severe in estimates of the distribution of income among earners, but our estimates of distribution among (paid or unpaid) workers reveal the same sort of abrupt worsening in 1987 as characterizes the household estimates.
One broad interpretation of the process of change in Costa Rica is that it shares many elements with other LAC countries but there are differences in degree, timing and abruptness. For example, while the earnings differentials by skills do stop falling, they do not increase sharply at the time of economic liberalization. And though the variance of salary incomes rose for a couple of years after liberalization began, it then continued its downward movement. It is possible that when changes are made more gradually as in Costa Rica, they do not produce as great a negative impact on distribution as when the same degree of policy change takes place more quickly.

5. Lessons, Challenges, Implications and Questions

The LAC countries are launched in a different, more outward-oriented and less interventionist economic model, which shows clear signs of working well in some countries but has been slower than might have been hoped in allowing the region to recover its former growth. Unless growth accelerates quickly in the next few years, and in some countries even if it does, it will once again be overoptimistic to assume that growth will prove an adequate antidote to poverty in the short-medium run. The reasons are summarized below.

a) Distribution has worsened significantly, if not dramatically, in most countries undertaking market-friendly economic reforms

Among LAC counties for which the statistical evidence is adequate to reach any conclusions on this issue, the only probable exception to this generalization is Costa Rica—Jamaica and Peru may turn out to be as well but this remains to be seen. In general, insufficient data are available to judge whether the distribution of secondary income (after allowing for taxes, transfers, public provision of goods) has moved differently from the primary distribution or not. Effective targeting has made a positive impact in some cases, but the reduction of government activity may have had a regressive effect, as may the changes in tax systems toward the greater use of indirect taxes.

The country experiences reviewed above suggest that the “normal” observed increase in inequality accompanying reforms is 5-10 percentage points as measured by the Gini coefficient of primary income (Table 5). It seems likely that this increase is typically the result of a jump in the share of the top decile, most of this accruing to the top 5% or perhaps to the top 1% (as in the cases of Colombia and Ecuador households) while most of the bottom deciles lose. In the three Colombian cities analyzed by Berry and Tenjo, the share of the bottom decile (the biggest loser in percentage terms) fell from 1.75% to 1.45% of total recorded income. At a moderate GDP per capita growth rate of 2% per year, it will require nearly 10 years of distribution-neutral growth to recover the “lost ground” implicit in this income share decline. If per capita income growth could be accelerated to, say, 5%, the recovery period would be only four years. In Ecuador, where the percentage decline for the bottom decile was
sharper (from 2.2% to 1.5%), nearly 20 years of distribution-neutral growth at 2% per year per capita would be needed and about eight years at 5%.

b) The close association between adoption of market-friendly economic reforms and accentuation of inequality is a cause for serious concern

No definitive conclusions as to what underlies the observed increases in inequality can be derived from the comparison of country experiences alone. In a number of cases they have occurred during economic downturn or crisis (Chile, Argentina, Mexico, for example) but in other cases they have not (Colombia, Ecuador); in the former cases post-crisis inequality, while sometimes less than the peak level sustained during crisis, is without exception markedly higher than the pre-reform level. Thus, although the economic cycle has clearly played a role in the increases observed, it cannot in any obvious way be held accountable for the large, lasting (at least to date) shift toward inequality. On the basis of the country experiences and the limited microeconomic evidence on the various elements of the reform package and on other hypothesized causes of worsening, we suspect that ongoing technological change, more open trade regimes, the dismantling of labour institutions, and the “socialization” of debts (whereby the state makes itself responsible for certain private debts which might otherwise threaten macroeconomic or financial stability) have all had lasting negative impacts on distribution. The effect of the scaling down of the public sector (directly and via the privatization of public enterprise) seems less clear. Increasing foreign investment has also been proposed as a source of worsening (in Mexico, for example), but judgment should probably be reserved on this point also. Many questions remain with respect to how these various factors interact among themselves and/or complement each other, both in terms of their growth effects and their implications for income distribution.

Trade and labour market reforms have been consistent elements of the reform packages instituted in the LAC countries where distribution has worsened significantly. Real exchange rate devaluation has often been present, but overvaluation has also been frequent, sometimes a result of capital inflow surges. In each case it is easy to see mechanisms whereby the effects on distribution might be negative, and in each case there is at least some empirical evidence suggesting that those mechanisms are at work. In the case of trade, for example, it appears likely that the comparative advantage of the region does not lie in unskilled labour-intensive products. Import liberalization appears to shift the price vector in favour of better-off families. Although optimists have argued that the opening up of trade should be expected to raise the relative incomes of agricultural workers, the evidence on this point is not encouraging. 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 (Alarcon, 1993, 139, 148).
Colombia an unprecedented increase in the gap between urban and rural incomes appeared in the early 1990s, coincident with the process of liberalization. In such countries it appears that a significant part of the agricultural sector cannot compete easily with an onslaught of imports and that its labour resources are not easily mobile to other sectors. Rural-urban mobility is of course greater in the middle run, and over time the issue becomes more and more that of whether the urban economy can create enough of the kinds of jobs which match people’s skills.

Meanwhile, labour market reforms which decrease job protection and labour’s bargaining power appear to open the way for wider wage and salary differentials among individuals. Sharply falling real minimum wages during the course of adjustment (e.g. Mexico, Peru) probably contributed to worsening distribution and to poverty, as argued by Morley (1995, 32). A tentative guess would be that the trade and labour market-related elements of reform packages may underlie most of the negative trends in reported figures on distribution.

The “socialization” of international and other debts in order to save teetering financial and non-financial enterprises has doubtless had a significantly negative impact on distribution as well, as detailed most clearly for the case of Chile by Meller (1992). This was in part a crisis-response policy, less germane to our present concerns than the now ongoing financial liberalizations. But such liberalization has itself contributed to financial crises, both during the 1970s and 1980s (Diaz-Alejandro, 1985) and more recently, Mexico once again providing the most dramatic example. Both Argentina and Mexico have recently engaged in official bailouts to contain banking crises. Solid evidence is yet to appear on the distribution impacts of financial liberalization apart from those occurring via financial crisis cum bailouts, but there are plenty of reasons to suspect that these too could be negative, and that, as in the area of trade policy, some hopes will prove to have been excessively optimistic.

The impact of foreign investment is another area in which the conventional wisdom, based on a two-factor model in which an increase in the capital stock would raise the relative returns to labour, may be off base for the LAC region. But further analysis will be necessary before much can be said with confidence in this area. The same goes for the impact of the downsizing of the public sector.

22 The drought which afflicted much of rural Colombia in 1992 probably played a role, as may the falling coffee prices and the lowered income from that crop.

23 Even more striking is the experience of Paraguay, unique among Latin American countries in having pursued an outward-oriented growth strategy based on the rural economy, more or less systematically since the 1950s (Weisskoff, 1992a, 1531). Some of the exports (e.g. cotton) were produced by small peasant farmers, using hybrid seed, chemical fertilizers, and other modern inputs. Yet Weisskoff’s (1992b, 173) estimates indicate the inequality increased sharply between 1972 and 1988, the Gini coefficient (calculated from his quintile shares) rising from 0.531 in 1972 to 0.564 in 1982 to 0.596 in 1988.

24 Though they may also, of course, be important in opening the way for lower skilled workers to enter the paid labor force, as noted by Londoño (1996, 13) with respect to the rapid rural-urban shift of workers from the late 1980s in Colombia.
c) Neither theory nor the record has provided much evidence on how lasting the negative distributonal effects will turn out to be.

Since many of the economic reform episodes reviewed above are recent, it might be hoped that many of the accompanying negative effects will turn out to be temporary, associated either with the economic crises suffered by most countries and/or with the transition to a new model, and hence likely to peter out with time and the adjustment of economic actors to the new reality.

Analysts differ in their assessments of the extent to which the observed increases in inequality were mainly the result of the economic downturns suffered by the countries of the region. Morley (1995) argues that the cycle-distribution tie has been very close and tends to conclude by implication, and by a more positive interpretation of the recent experiences of Chile and Colombia than given here, that recovery under the new policy package will produce an acceptable distribution. His conclusion that the best policy to reduce poverty in economies mired in stagnation and underutilization of capacity is to get the economy moving is certainly valid. And it may be true, as he argues, that economic downturns were the main factor underlying the increases in inequality observed in a number of LAC countries during the 1980s.

Altimir (1992) agrees that economic recovery and the abatement of inflation are bringing relief on the poverty front, but believes that there are increasing grounds for suspecting that the new setting under which the economies are functioning and the new rules of public policy involve greater income inequalities and more precarious employment situations than in the past. In his judgment, most countries now on a normal (i.e. non-recovery) post-crisis growth path are more inequitarian than in the pre-crisis period. His views on this point are consistent with the evidence presented in this paper.

The main ray of hope that the observed worsening is transitory comes from Chile where some series (e.g. Riveros, forthcoming) indicate an easing of inequality since the early 1980s; other data show no improvement as recently as the early 1990s. However this information puzzle is resolved, it is clear that current inequality remains well above that of 1970, but not clear whether any recent improvement, if present, should be interpreted as the reversal of the initial impacts of the new model or simply the result of another process, such as the tightening of the labour market predicted by labour surplus theory.

d) It is urgent to achieve better combinations of growth and distribution than those of the last two decades.

Whether or not the economic reforms are in fact culpable for most of the distribution worsening which has occurred in Latin America, it is clear that policy needs to be framed in such a way as to respond effectively to that trend. Some priority policy areas seem clear: education/training systems—clearly important in light of the danger that low skilled persons are being left behind;
small and medium enterprise policy, important given the major role this sector plays in the creation of productive employment; poverty redressal, whether through better targeting or otherwise, in light of evidence that considerable social spending has not in the past been very efficiently carried out, and the fact that under conditions of rapid economic change such systems must be unusually adept in order to do their job well. While their general importance may be easily accepted, the precise policy formula most likely to bear fruit in each of these areas is much less clear. Designing it has high priority. Better information and more analysis of the determinants of income distribution areas will be needed for policy to become more professional in this area.

Comparisons with the East Asian success stories naturally raise the question, why cannot Latin America also achieve growth with equity by way of a strongly outward oriented development strategy? Though for reasons discussed above, it was probably simplistic to think that such an outcome would be an automatic result of the strategy now being pursued, the lessons of the East Asian experience are nonetheless relevant. Making exports more labour intensive is one key element of the model, and policy does need to focus on it. Most of the East Asian economies subsidized exports in various ways, and their labour markets facilitated a moderate or high level of average labour intensity of those exports. Some Latin America countries have subsidized labour intensive exports; all should think seriously about how to facilitate them.

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verty and Income Distribution: Aspects of the Latin American Experience" mimeo.
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Symbols:
- **R** - distribution of income among income recipients
- **H** - distribution of household income among households ranked by household income
- **Hcy** - distribution of income among households ranked by per capita household income
- **Hnc** - distribution of consumption among households ranked by household income or consumption (not clear—see note “a”).

Note: We assume the figures of Cols. 1, 2, and 4 are based on ungrouped data.
a) The phrasing in the source (Meller, 1992, 22) suggests that families are ranked by family income (not per capita income or consumption). Data are presented only for the shares of the bottom and middle 40% groups and the top quintile. Accordingly they underestimate the Gini coefficient considerably. There may be a possibility that the ranking criteria were different as among the years for which the figures are reported.

b) Gini coefficients calculated from quintile distribution presented in Ritter (1992, 81). The true Gini’s, based on the ungrouped information, would be a couple of points higher.

Sources: Col.1: CEPAL, 1987. Whereas the other figures in this column were estimated by CEPAL’s Division of Statistics and Quantitative Analysis, an alternative figure (0.49) was presented for 1973; it was estimated by the “Programa de Actividades Conjuntas “ELAS/CELADE”.

Cols. 2-5 are from Riveros (forthcoming). It remains to be clarified that the definitions given here are the correct ones. The figure for 1988 would seem to be a typo, given that the bottom 40% share rises rather than falling in that year. The 1990 figure has been added tentatively to the series on the basis of figures reported by Morley (1994, 8), who shows the same 1987 figure as does Riveros (0.53) and adds this one, citing Pardo et al.

Col. 6 is from Meller, 1992, 22. Cols. 7, 8 and 9 are calculated from quintile data presented in Ritter (1992, 81) and from decile shares presented in INE (1995, 14)—the latter are in parentheses. Although the figures do not agree, since Ritter cites INE as his source we presume that the basic data are the same.
### Table 2
The Quintile Distribution of Consumption Among Households in Greater Santiago, 1969, 1978 and 1988
(Percent of total consumption)

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Source: Ffrench-Davis, 1992, 16
Table 3 / Selected Data on Distribution in Mexico, 1984, 1989, and 1992

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<th>Share of Total Income</th>
<th>Gini &amp; Psuedo Gini</th>
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* Calculations are based on grouped data. Households are ranked by total household income.

a) From Alarcon, 1994, 112.

b) ibid, p.87, 121.

Source: Alarcon and Mckinley, 1994, Table 2, exept as noted.
Table 4 / Income Distribution Trends in Colombia Since 1976

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<td>1992</td>
<td>0.494</td>
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<td>1993</td>
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<td>0.467</td>
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</tbody>
</table>

\(^a\) Bogotá, Medellín and Barranquilla.
\(^b\) The data refer to the major urban centres of Colombia plus a few smaller centres.
Sources: Columns 1 and 2 are calculations by the authors using DANE household surveys for March of each year. Income has been corrected for truncation problems (see appendix on methodology). Column 3 is from Reyes, 1987, p 81.
<table>
<thead>
<tr>
<th>Country</th>
<th>Main Period of Worsening</th>
<th>Degree of Worsening, main period</th>
<th>Degree of worsening, to present</th>
<th>Characteristics of main Period of Worsening</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina (Greater Buenos Aires)</td>
<td>1976-78</td>
<td>8 points, followed by some easing</td>
<td>8 points</td>
<td>Liberalization, labour repression, no net growth</td>
</tr>
<tr>
<td>Chile (Greater Santiago)</td>
<td>1974-76</td>
<td>7-9 points</td>
<td>7-9 points</td>
<td>Liberalization, labour repression, sharp recession</td>
</tr>
<tr>
<td>Uruguay (Montevideo)</td>
<td>1976-79 or 1982-84</td>
<td>9 points or 7 points</td>
<td>not available</td>
<td>Liberalization, labour repression, growth or recession, increased exports, transition towards democracy</td>
</tr>
<tr>
<td>Mexico</td>
<td>late 1980s</td>
<td>3-5 points</td>
<td>3-5 points</td>
<td>Liberalization, some labour reform, slow growth</td>
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<tr>
<td>Dominican Republic</td>
<td>In period 1984-89</td>
<td>8 points</td>
<td>not available</td>
<td>May have coincided with adjustment</td>
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<tr>
<td>Colombia (three major cities)</td>
<td>1990-92</td>
<td>4-7 points</td>
<td>4-7 points</td>
<td>Liberalization, labour market reforms, moderate growth</td>
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<tr>
<td>Ecuador (Urban)</td>
<td>1989-91</td>
<td>5 points</td>
<td>5 points</td>
<td>Liberalization, labour reforms, slow growth</td>
</tr>
<tr>
<td>Costa Rica</td>
<td>1985-87 (?)</td>
<td>0-4 points (?)</td>
<td>-1 to +3 points</td>
<td>Liberalization, mild labour reforms (?), moderate growth</td>
</tr>
</tbody>
</table>

Notes: (i) Distribution worsening measured in percentage point increases of the Gini coefficient; (ii) Depending on data availability, the Gini coefficient may refer to income earners, households ranked by household income, households ranked by per capita income, or other distributions available. Completeness of income coverage varies with the case, as discussed in the text.