

# CEPAL

## Review

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## Review

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## Growth and income distribution in countries at intermediate stages of development

Eduardo Sarmiento\*

This article analyses the relationship between growth and income distribution. The existence of a conflict between these two variables depends on a country's level of development. Such conflicts arise during intermediate stages of development, when growth is led by savings, and tend to disappear when growth becomes a knowledge-led phenomenon. Part of the reason for this is that saving is much more concentrated than education and technology are. The author contends that the conflict is not insuperable, however; in practical terms, it can be corrected by means of fiscal and educational policy measures.

There is no formal framework for the analysis of income distribution, nor is there any theory that permits us to formulate general statements about its determinants or to establish their relative importance. The analytical approach to this subject has been primarily empirical and has focused on identifying the traits and policies of countries that have successfully reconciled these two variables, for subsequent comparison with countries that have not been successful in this regard. The results of these comparisons suggest that income distribution is determined by the nature of initial conditions and the sequencing of development policies. To some extent, all countries have taken the same steps, but in widely varying orders. More than in any other area, the results achieved in terms of income distribution are closely related to the logical order of events and actions.

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## Introduction

For the past 40 years, Latin America's development process has been marked by a conflict between two objectives: growth and social equity. The comparison of six Latin American countries presented in the report entitled *Social Equity and Changing Production Patterns: an Integrated Approach* (ECLAC, 1992, p. 39) shows that countries which have advanced in one of these directions have not made progress in the other (see table 1). Argentina and Uruguay have the highest levels of social equity and the lowest growth rates, while Brazil and Colombia have the highest growth rates and the lowest levels of social equity (see table 1).

The experience of the Asian economies has been quite different. Israel, the Republic of Korea and Taiwan have made significant advances in improving income distribution within an overall framework of progress. The difference lies less in the scope of the measures adopted than it does in the order of their implementation. In all three of these cases, the sequencing of distributive policies has been very similar. The development process was preceded by a comprehensive agrarian reform programme which, later on, was reflected in the countries' industrial and overall urban structures. Industrialization was preceded and accompanied by a substantial increase in the entire population's educational level. Consequently, the skilled members of the labour force were able to find positions in which they could put their training to better use. During the intermediate stages of development, ambitious social programmes were undertaken to ensure that the entire population's basic needs were met, and extreme poverty was eliminated without seriously interfering with saving or growth.

Although it is true that in Latin America the same policies were tried, the order was different. Agrarian reform was initiated at a time when most of the population was already in the cities; its implementation was slow, it was subject to repeated interruptions, and its ultimate scope was no more than partial. The outcome was that the region did not manage to prevent its inequitable rural structures from being reproduced in urban areas. The elevation of educational levels was carried out in a piecemeal fashion. Skilled members of the labour force were unable to find positions where their training could be put to good use. And finally, social transfer programmes were carried out during incipient stages

Table 1

**LATIN AMERICA (SIX COUNTRIES): DISTRIBUTION OF HOUSEHOLD  
INCOME, BY QUARTILES OF PER CAPITA HOUSEHOLD INCOME,  
AND ECONOMIC GROWTH**

Country	Year <sup>a</sup>	Distribution indexes			Average annual growth of GDP 1970-1990 (%)
		Gini coefficient	Coefficient of average incomes		
			Richest 10%/poorest 25%	Richest 10%/poorest 40%	
Argentina	MA 1980	0.365	5.5	6.8	0.7
	MA 1986	0.406	6.2	8.5	
Brazil	MA 1979 <sup>b</sup>	0.518	8.9	17.1	4.5
	MA 1987 <sup>b</sup>	0.540	13.7	17.4	
	Urb. 1979	0.501	11.2	13.4	
	Urb. 1987	0.538	15.1	17.4	
	Rur. 1979	0.407	6.7	8.4	
	Rur. 1987	0.472	9.2	11.5	
Colombia	MA 1980	0.484	10.6	12.1	4.5
	MA 1986	0.467	10.2	11.6	
	Urb. 1980	0.472	11.2	11.8	
	Urb. 1986	0.449	10.3	10.4	
Costa Rica	MA 1981	0.340	5.1	5.0	3.4
	MA 1988	0.360	5.8	6.2	
	Urb. 1981	0.320	4.8	4.7	
	Urb. 1988	0.360	5.6	6.4	
	Rur. 1981	0.360	6.1	6.0	
	Rur. 1988	0.360	6.3	6.2	
Uruguay	MA 1981	0.350	5.0	6.0	1.4
	MA 1989	0.350	4.8	5.8	
	Urb. 1981	0.340	4.7	5.7	
	Urb. 1989	0.360	4.7	6.6	
Venezuela	MA 1981	0.370	6.0	5.3	1.1
	MA 1986	0.390	6.8	7.2	
	Urb. 1981	0.320	4.8	4.4	
	Urb. 1986	0.300	7.6	6.4	
	Rur. 1981	0.290	4.4	4.0	
	Rur. 1986	0.370	5.7	6.7	

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), *Social Equity and Changing Production Patterns: An Integrated Approach* (LC/G.1701), Santiago, Chile, 6 February 1992.

<sup>a</sup> MA: metropolitan area; Urb: non-metropolitan urban areas; Rur: rural areas.

<sup>b</sup> Represents an average of the figures for the Rio de Janeiro and São Paulo metropolitan areas.

of development (when most of the population was living in poverty) and were paid for by running up huge fiscal deficits which fueled inflation and put a damper on saving.

One of the main differences between the Latin American and Asian economies is that the latter started out with an acceptable level of social equity

and have not come under strong pressure to improve the distribution of income. For all practical purposes, the atmosphere in these countries has been sufficiently calm to allow them to channel their planning efforts towards the achievement of specific economic policy objectives, such as industrialization, export promotion, and increased saving. Latin

America, on the other hand, has been subject to a great deal of pressure to mitigate unacceptably high income differentials, and to some extent this has contributed to the emergence of populist governments that have tried to come up with quick ways of changing the social structure. Their efforts have focused on raising wages, distributing property and increasing government spending by means of money creation. In most cases, these policies have weakened saving,

boosted inflation and slowed growth. Although the effects have varied from place to place, the outcome has usually been a decrease in both growth and social equity, and in many cases these policies have therefore ended up hurting precisely those groups they had been intended to help. And since powerful groups have better buffers against adversity, the costs of the resulting crisis situations have chiefly been borne by lower-income groups.

## I

### A profile of growth and social equity

Low- and middle-income countries have a very different development profile from that of high-income countries. In the latter, the engine of development is technology. Economic growth is brought about by the advance of knowledge and, in general, by rising labour productivity. The benefits of a process of this type are received by the workforce and human capital, since the remuneration of labour rises in relation to that of physical capital. It also gives rise to a highly competitive export structure thanks to increases in productivity and transfers of knowledge that pave the way for an improved international position and for diversification. Furthermore, high income levels make it likely that saving will be fairly evenly distributed throughout the entire population and will be responsive to interest rates; thus, it will not be very sensitive to income distribution. None the less, problems of equity do arise within the labour force, and to some extent this is inevitable in a capitalist system. The fact remains, however, that because the acceleration of the growth rate will be the result of a better utilization of knowledge and the creation of new jobs, it is reasonable to expect it to be accompanied by greater social equity.

In developed countries, growth is less dependent on investment. In addition, saving is more evenly distributed among the population and is fairly interest-rate elastic. Consequently, an increase in the growth rate will not conflict with an improvement in real wages, or in distribution in general.

Middle-income countries exhibit quite different traits. The engine of growth is savings, and progress is dependent upon its expansion and efficiency. There is also an inverse relationship between savings and

household income and, since this relationship is not very sensitive to market stimuli, an increase in saving will probably be coupled with a worsening of income distribution. In fact, this appears to be a source of serious conflict between growth and income distribution.

Our troubles do not stop here, however. Developing countries lack the capacity to convert savings into investment. Most equipment is imported and must be paid for with foreign currency. At the same time, their comparative advantages are in primary activities which have only limited prospects in external markets, do not generate strong linkages within the production sector, and do little to promote scientific and technological development. The externalities associated with exports are chiefly generated in activities of a certain level of complexity.

In order to achieve the type of external sector that will help sustain a dynamic process of capital formation, a country must export manufactures that have some technological content. Unfortunately, this type of export activity does not occur spontaneously, and developing countries are therefore clearly at a disadvantage in relation to countries that have a head start on them. Moreover, their ability to compete is based on their ability to pay lower wages than the developed countries can, and this poses a serious obstacle to improved income distribution. Hence, at this stage, exports of manufactures represent another source of conflict between the objectives of growth and social equity.

The foregoing clears up a number of questions. Developing countries must have higher levels of

savings and lower real wages to sustain the same growth rates as the developed countries have. Under normal conditions, considerations of social equity place greater constraints on growth during intermediate stages of development. This sets up what appears to be a vicious circle: the countries are faced with greater inequalities but in order to rectify those inequalities, they must hold back their own progress; actually, what they need are special sorts of policy measures. The experiences of the Asian economies demonstrate that the outcome hinges on the State's ability to take selective action in well-ordered sequences.

The studies conducted by Kuznets 40 years ago yielded a similar result: the relationship between growth and income distribution varied depending on the stage of development. However, our interpretation of these findings differs from this. Kuznets' explanation of this phenomenon was based on a stylized argument relating to the differences between the levels of remuneration for factors of production in the traditional and modern sectors of the economy. According to this line of reasoning, during the initial phase of development economic growth would have a negative, but decreasing, impact on income distribution, while during the second phase it would have a positive and increasing effect. The changeover point would be reached when the modern sector accounted for about half of the country's output. Hence, Kuznets saw the conflicts between growth and income distribution as being caused by dualism and, therefore, as affecting low-income countries in particular.

Our interpretation, on the other hand, relates to the structure of the development model itself. Furthermore, the results are not very applicable to low-income economies, where the constraint placed on saving is offset by low capital/output ratios and opportunities for developing exports of manufactures are few and far between. Actually, the economies in which constraints on saving and on exports of manufactures are severe are those of middle-income countries.

This statement is corroborated by the experiences of countries with a long record of development. During this century, these countries have seen both an improvement in income distribution and rising growth rates. Things did not always work that way, however. In the nineteenth century, income-

distribution indexes in various European countries and in the United States were similar to the present indexes of Brazil or Colombia (Williamson, 1991). In the specific case of the United States, the increase in saving and economic growth seen in the mid-nineteenth century was coupled with a sharp deterioration in social equity. The differences between the characteristics displayed during these two periods are clearly related to the countries' structures of production. The link was very strong in the period before the industrial revolution, when growth was led by savings, and practically disappeared altogether in the period following that revolution, when growth came to be led chiefly by higher labour productivity and the development of new technologies.

In short, the nature of the conflict between growth and income distribution depends on the characteristics of the development process. During initial stages of development, it arises out of a situation of dualism; during intermediate stages, savings and exports are the source. Whereas in the first case we are dealing with a phenomenon over which the country has no control, in the second case the conflict can be addressed by means of appropriate State action taken in the proper sequence. This is how the Asian countries have managed to reconcile these two objectives much more satisfactorily than the Latin American countries. Finally, at advanced stages of development, the conflict tends to subside. The processing of knowledge into technology helps both to boost growth and to improve income distribution.

This does not mean that economies at intermediate stages of development cannot move forward without having a negative impact on social equity. Clearly, it is possible for a country to have low growth rates in combination with a relatively stable pattern of income distribution. The difficulty is to maintain high rates of economic growth while at the same time improving income distribution.

The solution does not lie in the forces of competition. On the contrary, the usual types of market-based formulas for stimulating growth actually work against an improvement in income distribution. Instead, the harmonization of these two objectives hinges upon some sort of fiscal policy action and the labour market.

## II

### Factor payments

Income distribution is a reflection of the different levels of payment received by factors of production. Modifications in that distribution stem from changes in factor payments or changes in factor distribution. Thus, in the case of Colombia, for example, the cycles that have been observed in this respect are related to changes in factor prices while the trends are related to variations in factor distribution. Within such a context, it is not surprising that income distribution may vary in accordance with the characteristics of the development process. Growth is led by different factors at different stages of development: by land during initial stages, by capital during intermediate stages and by knowledge at advanced stages. Consequently, the way in which growth affects income distribution will depend upon how the benefits derived from those factors are distributed.

The factor of production with the greatest tendency towards concentration is land. Although this tendency is mitigated by the urbanization process, capital, too, exhibits high concentration indexes. As will be shown in the following section, it is much more unequally distributed than labour income is. The most equitable distribution is probably that of education and knowledge since, owing to the public nature of educational services, lower-income strata have greater access to education per unit of income. Moreover, training and knowledge are subject to externalities which are not confined to the direct recipients but instead benefit the whole of society.

The way that factors are distributed in the course of a development process is not independent of the initial conditions or of history. A large part of urban capital is made up of surpluses from the agricultural sector. The better the distribution of rural income, the better the distribution of urban ownership will be. Therefore, countries that have undergone radical agrarian reform processes have managed to build more equitable urban property structures. Furthermore, individuals who have more capital and higher incomes enjoy greater access to education. In other words, countries that started out on the road to development within a relatively equitable framework are in a position to achieve more satisfactory structures during advanced stages of development.

At this point the relationship between social equity and development stages seems clear. One essential aspect of a development profile is determined by which factors are given a high priority or are in short supply and their consequent levels of remuneration. Since growth exerts upward pressure on the prices of scarce factors, social equity will improve if these factors are distributed more evenly and will worsen if they are more concentrated. This principle is directly applicable by virtue of the simple fact that knowledge and education are more evenly distributed than labour income is, and labour income is more evenly distributed than capital and land. Hence, in land- and savings-led development models, economic growth is inversely correlated with income distribution, whereas in technology-led models, both objectives lie in the same direction.

A transition from one stage of development to a higher one produces changes in income distribution. This is Arthur Lewis's famous dual-economy argument, on which the Kuznets curve is based. Suppose that under a feudal system the entire population was earning an income of \$5.00; then, as a consequence of industrialization, some individuals are able to shift over to the modern sector of the economy and earn \$10.00. Income dispersion –and, hence, income inequality– will increase at first and will then become more pronounced until the population is split evenly between the two sectors. Then it will begin to diminish and will disappear completely once the entire population has transferred over to the modern sector.

Something similar occurs during a transition from a savings-led model to a knowledge-led one. Generally speaking, an increase in equity can be expected, since knowledge and education are more evenly distributed than capital is. However, the change does not follow a straight line. As the wages of skilled workers rise relative to those of unskilled workers, the wage spread will widen at first and will continue to do so until the majority of the labour force has found employment in high-technology activities. As in the former case, after this point income distribution will tend to become increasingly equitable.

In our analysis it is helpful to distinguish between changes brought about by variations in remunerations and those attributable to the distribution

of factors. The former are the main causes of changes in income distribution within the framework of a given development profile; in this case, a rise in the growth rate can be expected to affect income distribution according to the distribution of the scarcest factor. Changes in factor distribution, on the other hand, are most evident when an economy is moving from one stage of development to another. Thus, the transition from a feudal economy to a capital-led model and from there to a

knowledge-led one will lead to an improvement in income distribution. These changes are not linear, however. Since the population cannot move from one stage to another all at once, inequality will increase at first, but this effect will later be corrected.

These trends are not inevitable, however. The potential conflict between the two objectives can be overcome by means of strategic measures aimed at both factor payments and factor distribution.

### III

#### Income distribution in Colombia

Perhaps one of the main difficulties in formulating an income-distribution theory lies in the fact that distribution is heavily influenced by the initial conditions in and characteristics of each economy. Earlier, we saw that the relationship between income distribution and growth is very different in middle-income economies and high-income economies. Since the behaviour of social variables is not the same everywhere, generalizations are subject to a great deal of uncertainty; less ambitious approaches are called for that combine empirical methods with theory. One option is to check theoretical hypotheses against the actual experiences of a given economy and then proceed to formulate general statements.

On this basis, we will now take a look at the determinants of income distribution in the light of Colombia's experience. Although this path will not lead us to a general theory, it will help to set up an analytical methodology that could then be applied to other countries.

Research on income distribution in Colombia has been limited by the nature of the existing supply of information. Currently, the country has statistics drawn from household surveys, national accounts and other lesser sources which provide sufficient information to arrive at an acceptable estimate. The analysis of these figures should take into account the differing reliability of the various sources and should be carried out at a sufficient level of disaggregation to facilitate the identification of changes and policy measures.

The overall approach used in the following analysis is based on the methodological considerations

discussed in previous sections and is aimed at identifying alterations in income distribution caused by changes in factor payments and factor distribution. Trends will be measured at three different levels. First, the share of gross domestic product (GDP) accounted for by income from labour and capital will be estimated. Second, we will analyse the incomes of wage earners and informal workers, as well as the earnings of large companies and of households. Third, we will examine the distribution of income from labour and capital. Finally, all of this information will be considered as a whole in order to analyse the overall trends in social equity within the Colombian economy.

Table 2 indicates the trends in the average income of the employed population in seven major cities and trends in per capita income. Based on the available information regarding the urban population and the employed workforce in these cities, an estimate of the share of urban GDP represented by urban labour income is also presented. This share, which had hovered around 50%, climbed during the period 1980-1983 and then fell sharply.

Table 3 contains information on wage earners' incomes taken from national accounts. The trend in this category of income is quite similar to the movement seen in urban labour income. It fell a bit less steeply because the increase in informal employment offset a small part of the decrease in the wage earners' share. In any event, in both series a sharp drop in labour's share of national income was observed from 1983 on.

Table 2

**COLOMBIA (SEVEN CITIES): URBAN LABOUR INCOME IN PESOS AND AS A  
PERCENTAGE OF GROSS DOMESTIC PRODUCT, 1980-1988**

*(Tens of thousands of pesos and percentages)*

	1980	1983	1985	1988
Average urban income <sup>a</sup>	10.20	21.55	29.42	56.17
Domestic income divided by total population <sup>a</sup>	4.94	9.02	14.1	31.6
Labour force as a percentage of urban population	36.5	35.5	37.5	39.2
Urban population as a percentage of total population	62.5	64.3	65.3	67.7
Urban labour income as a percentage of urban GDP	47	55	51	47

Source: National Household Survey, National Bureau of Statistics (DANE) of Colombia.

<sup>a</sup>In tens of thousands of Colombian pesos at current prices.

Table 3

**COLOMBIA: LABOUR INCOME AS A  
PERCENTAGE OF GROSS DOMESTIC  
PRODUCT AND REAL WAGES IN  
THE MANUFACTURING SECTOR,  
1970-1987**

Year	Labour income as a percentage of GDP	Real wages in manufacturing (index)
1970	39.0	102.4
1971	39.7	100.0
1972	39.3	96.2
1973	37.8	90.0
1974	37.2	85.4
1975	37.8	83.3
1976	37.1	85.4
1977	37.1	80.5
1978	39.7	89.9
1979	40.9	95.7
1980	41.6	96.5
1981	42.8	97.8
1982	43.1	101.1
1983	43.9	106.2
1984	43.4	113.9
1985	40.6	112.0
1986	38.2	114.6
1987	37.1	114.8

Source: National accounts.

Table 4 and figure 1 illustrate the trends in household labour income. Overall, the distribution did not vary significantly between 1980 and 1989, but it did fluctuate sharply, since it improved during the period 1980-1984 and worsened in 1984-1989; what is more, this last period includes a subperiod in which an upswing was observed (1985-1987) and another in which a downswing was recorded (1987-1989).

The information on capital rents cannot be compared with the information on labour income. The figures supplied by household surveys do not include retained earnings; hence, in general, the figures on capital gains are underestimates and are not comparable from one survey date to another. The available information on holders of financial claims and shareholders was used to make up for these shortcomings.

The information given in table 5 includes the Gini coefficients for checking accounts, bank-issued time deposit certificates (CDTs), savings deposits and constant purchasing-power unit (UPAC) deposits. The figures show that, in all four cases, 10% of the depositors accounted for over 70% of these savings. Not even deposits in bank savings accounts, whose distribution is the least unequal, departed from this trend; their Gini coefficients were around 0.7.

Table 4

**COLOMBIA: DISTRIBUTION OF HOUSEHOLD LABOUR INCOME,  
BY DECILES OF PER CAPITA HOUSEHOLD INCOME**

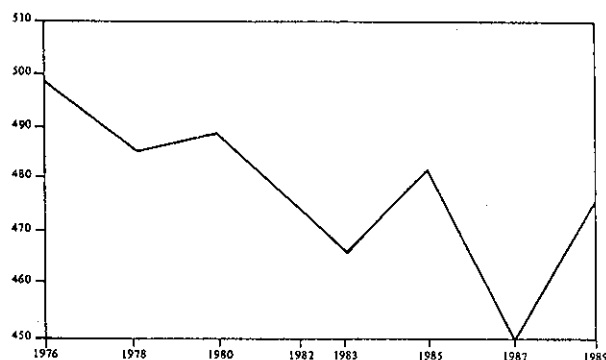
*(Percentages)*

Population	1976	1978	1980	1982	1983	1985	1987	1989
0-10	1.60	1.65	1.76	1.74	1.77	1.64	1.89	1.81
10-20	2.59	2.78	2.87	2.94	2.99	2.89	3.26	3.00
20-30	3.44	3.68	3.68	3.84	3.91	3.80	4.18	3.91
30-40	4.33	4.66	4.57	4.77	4.85	4.75	5.14	4.78
40-50	5.34	5.65	5.58	5.76	5.91	5.76	6.09	5.79
50-60	6.68	6.96	6.86	7.10	7.25	7.07	7.46	7.03
60-70	8.59	8.58	8.50	8.72	9.01	8.71	8.97	8.64
70-80	11.73	11.29	11.28	11.29	11.71	11.38	11.37	11.17
80-90	17.28	16.56	16.31	16.12	16.48	16.09	16.04	15.75
90-100	38.42	38.18	38.58	37.72	36.13	37.91	35.59	38.13
	100	100	100	100	100	100	100	100

Source: National Household Survey, National Bureau of Statistics (DANE) of Colombia.

Figure 1

**COLOMBIA: GINI COEFFICIENTS  
FOR PER CAPITA HOUSEHOLD  
LABOUR INCOME**



Source: Table 4 and calculations by the author.

The available figures on business enterprises are even more disconcerting. According to a sampling of 20 firms conducted by the National Securities Commission, 1% of shareholders owned 88% of the stock, and the Gini coefficient

was above 0.9 in this case. This finding fits in with the information gathered by other institutions. In fact, a 1982 study on 72 firms listed on the Bogotá Stock Exchange found that 0.6% of the shareholders owned 80.5% of the stock (Colombia, 1982). It is difficult to imagine a higher level of concentration than this, but the trend is actually becoming more pronounced year by year. Table 6 shows that the Gini coefficient climbed throughout the period 1974-1989, and that between 1982 and 1989 it rose from 0.96 to 0.98, which signifies a state of almost absolute inequality.

Information on property trends is scanty and suffers from a lack of comparability. Even so, it is evident that its distribution became more concentrated during the 1980s. For all practical purposes, it can be assumed that capital rents followed the same pattern.

It is not hard to summarize the above results. Between 1980 and 1984 conditions in terms of social equity did not change significantly. While the shares of labour income and capital rents remained fairly constant, the distribution of labour income improved and that of capital grew worse. Starting in 1984, however, the situation began to change dramatically.

Table 5

**COLOMBIA: GINI COEFFICIENTS OF CONCENTRATION, BY TYPE OF  
DEPOSITS IN MAJOR FINANCIAL INSTITUTIONS,  
AT YEAR'S END, 1987-1989**

	1987	1988	1989
<i>Banks</i>			
Checking accounts	0.8816	0.8818	0.8778
Savings accounts	0.7016	0.7214	0.7111
Term savings certificates (CDATs)	0.794		
	0.7115	0.7205	
Time deposit certificates (CDTs)	0.7523	0.5908	
	0.6172		
<i>Savings and housing loan associations (CAVs)<sup>a</sup></i>			
Savings deposits	0.8342	0.852	0.857
Regular deposits	0.6067	0.852	0.857
Constant-value savings certificates (CAVCs)	0.5892		
	0.5964	0.6591	
<i>Financial institutions</i>			
Time deposit certificates (CDTs)	0.7042		
	0.7242	0.7875	
Portfolio transactions	0.8214	0.7401	0.8972

Source: Statistics Division, Superintendency of Banks of Colombia.

<sup>a</sup> Constant purchasing-power units (UPACs).

Table 6

**COLOMBIA: GINI COEFFICIENT OF  
CONCENTRATION FOR THE 20 MOST  
HEAVILY TRADED FIRMS IN 1988,  
AS OF THE END OF EACH YEAR**

Year	Gini coefficient <sup>a</sup>
1974	0.887
1978	0.9174
1980	0.9442
1982	0.9578
1984	0.9559
1986	0.9694
1988	0.9752
1989	0.9765

Source: *Manual del Mercado Bursátil*, Bogotá Stock Exchange, and corporate records, National Securities Commission.

<sup>a</sup> The coefficient shown for 1974 was calculated on the basis of 18 companies (Compañía Suramericana de Seguros and Proleche were not included).

The relative position of labour income deteriorated *vis-à-vis* capital rents. The share of the total represented by wage earners' incomes shrank by about one point per year and that of independent informal groups' incomes held more or less steady despite the fact that this sector created the most jobs during the period. The household distribution of labour income also worsened, but capital rents climbed sharply. The main beneficiaries were large companies, whose profits jumped from 18% to 22% in four years. For business firms as a whole, the concentration of capital increased considerably.

In sum, income distribution changed radically in the later 1980s. In the last five years, a deterioration in the situation has been observed at all levels. The distribution of labour income worsened and labour's share shrank rapidly relative to that of capital. Moreover, the increase in capital rents was accounted for almost entirely by large firms, and the concentration of property became more pronounced.

## IV

### Trends and cycles

Long-term trends in income distribution are related to education, dualism and the concentration of capital. In Colombia, given the situation with regard to these factors, there is little hope of any significant change. Capital has consistently functioned as a factor of concentration. Dualism, for its part, does not appear to have had any major influence, since for the last ten years the Colombian economy has hovered around the cutoff point on the Kuznets curve. The changes in wage dispersion brought about by economic progress have been relatively negligible. In fact, the only force that has systematically promoted an improvement in income distribution is the increase in educational levels and its spread throughout the majority of the population. Unfortunately, the effect of this trend has been reduced by the ineffectiveness of the education provided to low-income groups and the lack of a parallel process of economic development that would provide better jobs for the pool of skilled manpower.

In figure 1, two phases can be detected, with the dividing line between them being the year 1984. In the first of these phases, the distribution of labour income improved and in the second it deteriorated. The same thing occurred with the share of labour income and salaries in the GDP (see tables 2 and 3). This is no coincidence. In 1984 significant changes were made in the management and direction of the Colombian economy. Initially, a harsh adjustment programme was implemented in accordance with International Monetary Fund (IMF) guidelines, and

later various types of measures were adopted in an effort to set up a neoliberal model. More specifically, large devaluations were made, interest rates were kept high, indirect taxes were substituted for income and wealth taxes, and social spending was cut. These adjustments were reflected in declining real wages, the contraction of labour income's share of GDP, and a worsening of the distribution of labour income.

The behaviour of income distribution confirms some of the statements made on the basis of theory. Long-term trends—which are a function of institutional variables such as education, dualism, demographic trends and the concentration of capital—can be accounted for by changes in the distribution of factors, while medium-term cycles are attributable to changes in factor prices.

Medium-term changes in income distribution have stemmed from macroeconomic variables. The deterioration seen in the late 1980s was closely linked to the implementation of a neoliberal model. Overall, the country's high interest rates, high exchange rate and indirect taxation were inversely correlated with real wages. The labour market's performance also had a strong influence on the distribution of labour income.

These adjustment policies and the institution of a neoliberal model were justified on the grounds that they were a means of speeding up growth. Their negative impacts on income distribution prompt us to ask whether there might not be other, less regressive means of accomplishing this. We will attempt to answer that question in the next section.

## V

### The nature of the conflict

Earlier, we saw how income distribution reacts to the variables associated with trends and cycles. The former include education, the concentration of property and dualism. The latter, on the other hand, are closely related to the labour market. Indeed, real wages are one of the main determinants of income distribution over the medium term. Within this context, the possi-

bility of making income distribution more equitable is determined by our ability to upgrade education, cut down on the concentration of property and boost real wages.

This diagnosis is well known, although not in an explicit manner. All these tools have probably been utilized in Latin America in an attempt to improve

income distribution. Many countries have undertaken various types of reforms to reduce the concentration of property, have instituted large increases in real wages and have broadened the coverage of educational services. Despite all this, they have made little progress in promoting greater equity, partly because many of these measures have led to a slowdown in economic growth or have triggered inflationary processes that ended up hurting the groups they were trying to help.

Table 7, which lists the chief determinants of growth and income distribution, reveals the presence of serious incompatibilities which to some extent confirm our initial statements: an increase in savings is incompatible with deconcentration of property and expansion of social spending, and industrial development based on exports of manufactures is incompatible with an improvement in real wages. Curiously enough, a model based on expansion of savings and exports of manufactures would lead to greater concentration of capital and lower wages.

There are also, however, factors which contribute to both growth and social equity at one and the same time. Perhaps the chief such factor is education. Expanding the coverage of education benefits poorer groups to a greater degree relative to their income, and thus constitutes a continuing force for the reduction of differences in opportunity. In addition, higher levels of education, in conjunction with a type of industrial development that enables an economy to absorb its more highly skilled labour force, raise labour productivity and increase labour's share of national income while at the same time speeding up economic growth.

Table 7

### FACTORS PROMOTING GROWTH AND MORE EQUITABLE DISTRIBUTION

Growth	Improved income distribution
Savings	Deconcentration of property
Technology	Technological progress
Education	Education
Exports of manufactures	Higher wages and an increase in labour income as a percentage of national income
Reduction of dualism	Increased social spending

Dualism is another pivotal –but in some ways uncertain– factor. In Colombia, the economy is now somewhere near the bottom of the Kuznets curve. The modern sector employs about one half of the labour force, and variations in this respect have only a marginal effect on wage dispersion. In future, everything will hinge upon the nature of the country's industrial development. If it is concentrated in large firms engaged in highly capital-intensive activities, then dispersion will increase. If, on the other hand, it is carried forward by medium-scale businesses which absorb a large proportion of the modern sector's labour force, then dispersion will diminish.

## VI

### Social security

Perhaps the area in which this conflict stands out in sharpest relief is the social security system. One of the main mechanisms of savings creation is the income differential between the younger and older generations and the fact that younger generations devote a smaller share of their income to consumption. This process is seriously disrupted, however, by poorly-designed social security systems that channel the total amount of incoming payments to pensions.

When this is done, retirees' incomes exceed the sum of contributions, and the difference represents a big loss in terms of savings.

The magnitude of this effect will depend on the size of the inter-generational income differential. If one generation's income is twice that of the other (which might be considered as a minimum estimate) then the social security system's implicit effect in terms of savings reduction will be equivalent to about

half of the system's obligated funds. Since these funds represent about 10% of GDP in the Southern Cone countries but only about 4% or 5% in the countries of the North, the cost of social security in terms of savings would amount to about five percentage points in the former and around two points in the latter. Overall figures corroborate these results. Thus, as a rule, an inverse relationship exists between payments into the social security system and saving rates.

Social security's distributive capacity is unquestionable—in theory. In a growing economy, the older generations receive a lower income during their working life than the younger generations do. Retirement pensions tend to be lower than the active workforce's wage levels; furthermore, individuals who make use of basic social services, such as health services, are generally disadvantaged in relation to the

rest of the population. In this sense, social security systems are an expression of solidarity that helps to improve the position of society's underprivileged groups. The end result is quite different, however, in incipient systems that have a very low, single rate of coverage (Colombia's social security system, for example, covers only 20% of the population). In such cases, the individuals covered by the system come from middle-income groups of skilled workers, civil servants and members of the armed forces, and the services provided by the system are often tailored to fit the requirements of middle-income groups rather than the basic needs of the majority of the population. Under these circumstances, serious doubts arise as to the distributive capacity of social security systems, since the transfers made to beneficiaries mirror the mean distribution of the population.

## VII

### Latin America's dilemma

The Latin American economy is faced with a dilemma. On the one hand, countries that take direct action to improve income distribution end up seriously jeopardizing their growth. On the other, countries that increase their saving and exports in order to stimulate growth end up losing ground in terms of social equity.

The cycles observed during the period 1977-1990 do not provide a great deal of information concerning the relationship between growth and equity in Colombia. Although the economy's growth was led by savings, the increase in GDP was below its historical average, though that is not the point of conflict. Perhaps the best illustration of what we have been saying is to be found in the information for the period 1984-1990. The neoliberal policies implemented during the latter part of the 1980s heightened inequality without having any significant effect in terms of economic growth. Apparently, the dose of medicine administered to the economy was not large enough (whereas it was sufficient, for example, in the case of Chile). The

stimuli provided for capital, in particular, did not bring about the hoped-for increase in savings which, in combination with exports, would have boosted investment, essential imports and production activity. In order to spur the economy to grow at rates above its historical trend, policy-makers would have had to provide greater incentives for capital and to have allowed income distribution to deteriorate further.

These findings continue to engender skepticism. The market does not resolve the conflict between income distribution and growth. In middle-income economies, the result is low rates of saving and commodity specialization. But traditional sorts of government action have not been at all successful in reconciling these two objectives either. In some cases such action has promoted better income distribution by sacrificing growth, and in others it has stimulated growth at a heavy cost in terms of social equity. Fortunately, some avenues remain to be explored, or at least refined, and it is indeed possible, by means of external action, to reconcile the two objectives.

## VIII

### Solutions

The conflict between growth and equity is less severe than is commonly thought. It is true that, within the framework of the usual sorts of market-based approaches, the only way to raise saving would be to permit a deterioration in social equity; if personal saving is interest-rate inelastic, then its expansion will be dependent upon a relative increase in the incomes of the higher-paid groups. But this does not occur within other, broader frameworks. There is evidence that saving is determined by the level of disposable income (Corbo and Schmidt-Hebbel, 1990). If this is so, then a tax increase designed to lower the fiscal deficit would help raise the economy's overall saving rate.

The conflict's impact on wages is not clear either. In developing countries, the educational levels of a considerable portion of the labour force are higher than those required in traditional sectors of the economy. If this part of the workforce shifts over into more complex activities, productivity will rise. If the relocated workers are not recompensed for this increase at all, or only in part, then advanced activities can pay wages equal to or higher than those paid by more traditional activities and yet still be paying lower wages than competitor countries are. This better utilization of manpower will thus permit the country to improve its international competitive position without sacrificing past remunerations.

The primary causes of the conflict between growth and distribution have to do with saving and exports of manufactures. In practice, attempts to use market-based measures to raise saving rates lead to a deterioration in income distribution. Similarly, the chances of expanding a country's exports of manufactures depend on its ability to keep wage levels below those paid by countries with a longer tradition of technological development.

Thus, fiscal policy emerges as an effective means of resolving the apparent conflict between saving and distribution. Since consumption is a function of disposable income, tax hikes aimed at boosting investment or cutting the deficit will lead to an increase in saving. This will not be brought about through a deterioration in income distribution but rather through a reduction in the consumption levels of groups with greater tax-paying ability.

Similar steps could be taken in the area of social security. Expanding the system's coverage, gearing its services to the satisfaction of basic needs and confining pensions to the poorest groups would help to improve income distribution. At the same time, this would prompt an increase in saving which the public sector could channel to investment or, if it wishes, to the private sector so that it could take charge of pensions above a certain level.

Likewise, education promises to be the principal means of preventing a conflict from arising between higher-technology exports and income distribution. The utilization of the educated labour force in more complex activities would raise productivity while still allowing wages to be kept below international levels in order to offset the disadvantages associated with the country's technological lag without weakening the position of the sectors in question relative to traditional activities or the past.

The constraints imposed by considerations of social equity are not linear in nature. More rapid growth entails a relative increase in the incomes of younger groups who have a greater saving capacity, as well as facilitating the development of activities that provide greater opportunities for learning and the absorption of technology. Both of these factors help to give policy-makers more leeway in their efforts to correct anti-equity biases.

The experiences of countries with a long history of development confirm the observation that constraints on income distribution are greater during the beginning and intermediate stages of development. Over the long term, progress and modernization help reduce inequality. The progress made by Europe and the United States in the nineteenth century paved the way for their progress in improving social equity during the twentieth century. Hence, suspending economic growth is the worst way to go about improving income distribution, since the end result may be a deepening of inequalities.

Income distribution is affected by negative forces generated by market conditions, rather than by growth itself. Perhaps the most important of these factors is the tendency for capital to become increasingly concentrated. In an economy such as

Colombia's, in which the returns on capital are high and saving rises with the level of income and capital, the greater the capacity for reproducing wealth, the faster its rate of reproduction. The concentration of property generates forces that tend not only to perpetuate but also to heighten that concentration. The other negative force is marginalization. The market does not have the capability to disseminate the benefits of growth throughout the entire population; inevitably, a considerable portion of the populace is bypassed. As we saw earlier, these phenomena tend to be countered by factors such as education, which appears to be the most powerful means of improving income distribution.

It is clear, then, that greater economic growth does not necessarily cause income distribution to worsen and that fiscal policy and education can mitigate possible conflicts between the two objectives.

The chances of making further progress towards a more equitable distribution of income are determined by our ability to modify trends that have an adverse effect in terms of social equity. In principle, high wealth and inheritance taxes and strict antitrust laws can be expected to weaken the forces that promote concentration. Similarly, policies aimed at ensuring the satisfaction of basic needs and eliminating extreme poverty will help reduce marginalization. The next logical question is whether this can be ac-

complished without interfering with economic growth and efficiency.

Part of the answer is to be found in the foregoing sections, where it is shown that heavier taxation of high-income groups will boost saving rates. Furthermore, if this is done through the use of wealth and inheritance taxes, then the degree of concentration will diminish.

A somewhat similar approach can be taken to the problems of marginalized sectors. Since higher-income groups have less of a propensity to consume, transfers to poorer groups can be expected to lower saving rates. This will not occur, however, if the vehicle for such transfers is higher income taxes, which usually reduce the consumption levels of high-income groups. Obviously, the success of this approach will depend on our ability to identify the target groups. In practice, the way to do this is to make the transfers in the form of social expenditure, which usually benefits the poorest groups more than would be expected in the light of their contribution to national income. In addition, with the help of appropriate programmes and well-designed follow-up surveys, policy-makers can control how much goes to each income group fairly accurately. Using such methods, they can ensure that the poorest 25% of the population receives 60% of those benefits and that the poorest 50% of the population obtains 90%.

## IX

### Conclusions

When we compare the experiences of countries with a long history of development and those of Latin America and Asia, we find empirical evidence that the conflict between growth and income distribution varies according to a country's stage of development. In the more advanced countries of Europe and the United States, this conflict was severe during the nineteenth century but abated in the twentieth century as these economies changed over to a knowledge-led model.

The situation in Latin America mirrors, to some extent, the conditions found in the above-mentioned countries in the nineteenth century. In the past 40 years, no country in the region has managed to surmount the conflict between growth and income

distribution. The Asian countries, in contrast, have been successful in moving towards both goals at the same time, thanks to the fact that they started off with relatively equitable conditions and have followed well-planned sequences of measures over extended periods of time.

The foregoing observations have clear policy implications inasmuch as the implementation of effective measures is a crucial factor in reconciling these two objectives in savings-led economies. By the same token, distributive policies cannot remain unchanged in different stages of development.

The history of the developed countries corroborates this analysis of the situation. Generally speaking, they have been modifying their distributive policies

as they progress towards increasingly knowledge-based models, and in recent years have begun placing less emphasis on progressive tax structures, social security plans and social expenditure. It does not make sense, however, for middle-income countries to follow this same path of change and reform. Their traits and needs are much closer to those exhibited by today's developed countries at the turn of the century.

It is often believed that economic growth is an obstacle to, or a trade-off of, income distribution. Observations of real-world situations do not bear this out. It has been found that, as a rule, the more advanced a country is, the better its income distribution will be. Theory tells us the same thing: expansion and modernization are in direct conflict only in economies suffering from an extreme case of dualism. From that point on, everything will hinge on the types of policies applied. At intermediate stages of development, the constraints imposed by considerations of equity can be mitigated by proper fiscal management and a strategy based on a combination of education and industrialization. What is more, these constraints tend to subside as countries attain higher growth rates and move on to more advanced stages of development. Finally, the possibility of such a conflict disappears once an economy reaches a stage where its development is based on the conversion of knowledge into technology; at this stage, economic growth and improved income distribution go hand in hand.

The above findings are encouraging, but not surprising. The countries of Asia and of Southern Europe have made advances in terms of both growth

and income distribution. It is usually not a question of choosing between State intervention and the market, since both are equally ineffective in harmonizing these two objectives. In practice, there are various types of State action, and its scope will depend upon the initial conditions and the sequencing of the measures to be applied. For example, in countries which did not carry out agrarian reforms and which lack an educated workforce, more aggressive redistributive policies are called for, and the potential for growth is probably lower. In general, appropriate fiscal policy, industrialization and education can be expected to ease the conflicts. A suitable policy mix involving action on these three fronts will help boost saving and exports of fairly complex manufactures without heightening the concentration of income or lowering real wages.

This conclusion should not come as a surprise to anyone. The Asian countries that have achieved high growth rates in combination with improvements in social equity have high saving rates, high levels of education and have made rapid progress in terms of industrialization. Perhaps the only difference between their policies and what we are proposing here is the tax structure. Many of the Asian countries started off with agrarian reforms that gave rise to a relatively equitable distribution of urban property. Consequently, for them, progressive tax structures were merely a method of sustaining or making a slight improvement in existing trends in the structure of property and income. In Latin America, on the other hand, broader-based action is called for in order to promote a swift change in that structure.

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