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GLOBALIZATION AND RISING LABOR INEQUALITY IN LATIN AMERICA

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Introduction

From its outset, the central concern of development theory has been to shift resources from low to high-productivity activities. The pioneers of modern development thinking emphasized the disadvantageous international context for primary commodity exporters. Industrialization would help establish a new development pattern for peripheral economies. It was to raise productivity of the entire labour force thereby enabling higher remuneration and living standards for workers. To jumpstart industrialization protectionist policies were needed. For decades, the trade pessimism of the pioneers of development thinking, such as Prebisch, has been widely criticized, unjustly in part, as they insisted early on the importance of stimulating exports of manufactures and regional trade agreements.[1] The predominant view at the time was that the rise in productivity for the economy at large should be policy induced, present-day conventional wisdom has it that such will be triggered automatically by market forces under free-trade rules. Yet, till today Latin America's worries are with both insufficient labour productivity growth and adequate employment creation. Worries about the region's high inequality and persistent poverty follow largely from here.

From its start, a central part of this debate has focused on the growth and distribution trade off. While development should lead eventually to poverty reduction, the welfare of important parts of society may lag behind during the period of transitional growth to an industrial society. Historical evidence shows that development has been an inegalitarian process in many ways. Early development theory is often seen to have

provided the theoretical foundations for what some – in line with Kuznets – consider being an empirical regularity. Lewis' model for one predicts growing inequality during the period of transition growth as a growing profit share in national income is required to finance industrial investment (Lewis 1954). All this could lead us to believe that the founding fathers of classical development theory were firm believers in 'trickling down' mechanisms. Of course, much of the development policy debate since the 1970s to date has geared around the question how the development process could be made less unpleasant and that indeed growth and poverty reduction could go hand in hand. The fact of the matter is that also the founding fathers were very much concerned with income distribution and, indeed, believed that conditions could be created such that eventually growth and redistribution would go together even though during the transition income distribution would likely be a source of conflict. Lewis (1955) and Prebisch (1961), for instance, showed this awareness quite forcefully in the 1950s and early 1960s. The argument focused on the primary distribution of income and the pattern of growth rather than on redistribution through taxation and social spending, but theorists probably favoured a combination of the two.

Development economics as it was laid out by its founding fathers, such as Kurt Mandelbaum (later, Martin), Rosenstein-Rodan, Nurkse, Prebisch, Leibenstein and others very much emphasized the obstacles to industrialization and physical and human capital formation in developing countries, with income inequality and poverty being both cause and effect. The obstacles that had to be overcome to achieve development, included foreign-exchange bottlenecks, a lack of social overhead capital (including human capital) needed for the generation of positive vertical externalities and increasing returns to scale, and insufficient domestic linkages to stimulate employment and income generation supportive of modern growth. Modern growth economics and more in particular the new, endogenous growth theories try to address similar issues, but curiously enough ignoring by and large the contributions of development theory.

The links between income distribution, market size and industrialization have been central to development economics from its foundations. Productivity growth in

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[1] See Prebisch (1959 and 1984).

agriculture might lead to an increase in the size of the market for manufactured goods, making it profitable for manufacturing firms to shift to an increasing returns to scale technology. In this story income distribution becomes pivotal for economic growth. Too much equality might lead to insufficient savings and investment finance, whereas too much inequality would lead to a lack of wage-goods demand. Both ills would lead to development traps of too little capital formation and/or a smaller demand for manufactured goods, leading in turn to a delay in industrialization. The notions of "too much inequality" and "too much equality" are of course somewhat fuzzy and it would suggest that one could define an optimal income distribution or an optimal degree of inequality consistent with a maximum sustainable growth rate. To my knowledge the concept of an "optimal income distribution" has never been developed, although from an analytical point of view development theory might have benefited from it.

The development debate took a different route of course. One reason being that the critics of classical development economics saw that economic openness would present the solution to the problems of industrialization. These critics, such as Bhagwati (1985: 299), emphasized that the alleged "export-elasticity pessimism" provided the weak chain in the argument, which had led the pioneers of development economics focus on closed economies and misconceived policy advice of protectionism and import substitution.[2] If the problem arises from a lack of demand, opening of the economy to international trade would be the way out of the vicious circle. However, the point of founding fathers such as Rosenstein-Rodan and Prebisch, was not merely a problem of low elasticities, trade pessimism and a lack of demand. The more essential point was the need to create technological externalities (such as learning by doing and ensuring adequate social overhead capital) and which would leave the overall argument in tact, also in the open economy.[3] In current day language, the heart

[2] The critique has also been restated more recently by other less orthodox economists like Krugman (1992) and Stiglitz (1992).

[3] Murphy, Shleifer and Vishny (1989a,b) and Ros (2001) provide modern formalized reinterpretations of the basic notions put forward by Rosenstein-Rodan. They argue that the critique of Bhagwati and others in fact is only valid in the case of "horizontal pecuniary externalities", that is demand spillovers across final producers of traded goods. In a closed economy, the profitability of a shoe factory – to take Bhagwati's example – will not only depend on its own production function, because it will also be dependent what other producers do, such as textile producers. When the economy opens up, the adoption of new, modern techniques in textile production will still affect the domestic demand for shoes, but the domestic demand for shoes no longer would form a constraint on the profitability of

of the matter then becomes whether the economy possesses adequate infrastructure, human capital and entrepreneurial skill (learning by doing) to take advantage of the opportunities provide by the global economy.

The policy environment has changed dramatically of course. The founding fathers saw economic planning, aid and trade protection as important instruments to overcome the perceived development bottlenecks. Today's conventional wisdom is that globalization and free movement of commodity and capital flows have become prime movers of growth and development. Building on recent research conducted in a large number of Latin American countries I will argue that economic liberalization has not brought the type of Big Push that its advocates had hoped for. Further, the 'post-modern' growth process seems to have exacerbated inequality rather than having resolved it. Is it too early to judge and will the initial bumpy ride bring us eventually to more steady waters of productivity growth and improvement of living conditions for all or have the Latin American economies side tracked into a wrong way needing new directions?

The move towards liberalization in Latin America

Looking back from the beginning of the 21st century, the most striking aspect of economic policy in developing economies during the last 10–15 years has been the spread of packages aimed at liberalizing the balance of payments, on both current and capital account. Dramatic leaps toward external openness took place throughout Latin America, Eastern Europe, Asia and parts of Africa. Together with large but highly volatile foreign capital movements (often but not always in connection with privatization of state-owned enterprises), this wave of trade and financial deregulation redefined the external environment for a major part of the non-industrialized world. In Latin America, the stabilization and structural adjustment efforts immediately following the debt crisis of the early 1980s had focused mainly on fiscal and monetary adjustment and realignment of exchange rates. Then, in the late 1980s and early

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modern techniques in shoe production. However, when vertical externalities pose the central problem then Rosenstein-Rodan's fear of a development trap remains. A shoe factory producing in isolation

1990s, came drastic reductions in trade restrictions and domestic and external financial liberalization, almost simultaneously in most countries. Steps were also taken toward restructuring tax systems and deregulating labour markets.

All these changes are very recent. It will take time before their full effects on growth, employment, income distribution and poverty can be fully assessed. Still, external liberalization marks a dramatic switch in development policies away from the traditional regime of widespread state controls and import substituting industrialization, much of which – it can be held – found justification in the insights of the pioneers of development. So, one would expect to see major consequences. The old regime to a large extent was built on the infant-industry argument to create 'learning-by-doing' externalities and enhance Hirschman-type domestic linkages so as to lay the foundations of a sustainable growth process. Import substitution did yield moderate to high growth for a prolonged period of time, as GDP growth averaged over 6% per annum and productivity (measured as output per worker) doubled between 1950 and 1970 (Stallings and Peres 2000). Despite the relatively successful growth performance, the pioneers of development economics were among the first to observe the flaws of the policy regime even before the economies ran out of steam and macroeconomic problems started to mount.[4] The protectionist regime was criticized for failing to promote efficient and competitive industrial production (and thereby providing a source of 'structuralist inflation'), for creating insufficient employment and for failing to reduce income inequality. Sectoral balance and income distribution formed a central element in the critique: the protectionist policies had biased relative prices in favour of capital-intensive industrial production, causing employment creation to lag behind population growth and skewing income distribution against wage earners and farmers. Widening inequalities set a limit to the growth of the domestic market and thus to further growth. The solutions had to be found in redistribution policies as much as economic opening. As said, in the final event, full economic liberalization became the dominant paradigm of the new policy regime, characterizing the end of classical development economics as a factor of influence in shaping development policies.

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would face high cost intermediate inputs such as services and infrastructure, yielding multiple disequilibria of the sort Rosenstein-Rodan hinted at. Murphy et al. and Ros have modeled this.

[4] See for instance, Prebisch (1961, 1963) and Hirschman (1968).

A fundamental question now is whether the liberalization of trade and capital flows will be better at meeting the developmental goals of growth, equity and poverty reduction. Will a world system in which national economies are highly integrated in commodity and capital markets (in terms of increased transaction flows and tendencies toward price equalization) promote equality and reduce poverty?

The reforms have been justified by expected increases in efficiency and output growth. Governments and international institutions promoting them have been less explicit about the distributional consequences. A predominant view is that liberalization is likely to lead to better economic performance, at least in the medium to long run. Even if there are adverse transitional impacts, they can be cushioned by social policies, and in any case after some time they will be outweighed by more rapid growth.

The supply-side story

This policy view basically stems from supply-side arguments. The purpose of trade reform is to switch production away from non-tradables and inefficient import-substitutes toward exportables in which countries have a comparative advantage. Presumed full employment of all resources – labour included – enables such a switch to be made painlessly. Standard trade theory based on the Heckscher-Ohlin model and Stolper-Samuelson theorem (HOS) would predict further that workers in developing countries would benefit from freer trade as this would conduce them to specialize in production more intensive in the use of the abundant factor, presumably (unskilled) labour. Under the given assumptions this should be conducive of greater income equality.

Opening of the capital account is supposed to bring financial inflows that will stimulate investment and productivity growth. A recent defense based on cross-country regressions for Latin America (Londoño and Székely 1998) argues that equity is positively related to growth and investment. In turn, these are asserted to be positively related to structural reforms, so that liberalization is seen to support low-income groups.

This story contrasts with findings of many other studies which, referring in particular to the effects of trade reforms, find that opening domestic markets to external competition is associated with greater wage inequality (Robbins 1996, Wood 1994, 1997 and Ocampo and Taylor 1998).

Much of the increase in wage inequality and unemployment in several countries over the last two decades has been attributed to the change in the structure of labour demand in favour of the skilled workers. This is reflected in the overall increase in the returns to education for skilled labour and in some countries in the rise of unemployment among individuals with less qualification (Freeman 1995, Gottschalk and Smeeding 1997). Economists, however, do not agree on the causes of the change in the structure of labour demand.

This controversy is based mainly on the HOS model and interpretations given to the recent wave of technological innovations, that has had strong impacts on the structure of labour demand.[5] To the extent that developing countries have abundant unskilled labour, the increasing inequality is puzzling. In accordance with the HOS, developing countries should specialize in the production of goods intensive in unskilled labour, thus increasing the relative demand for this factor and reducing wage differentials. This raises doubts about the capacity of the importance of the HOS model to explain, at least in the short term, the rise of wage inequality in developing countries. An alternative hypothesis suggests that the recent opening to trade observed in several developing countries unchained a simultaneous process of technological modernization and increase of capital stock, provoking a positive impact in the demand for skilled labour and the consequent increase in the returns to human capital and in the dispersion of wages.[6]

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[5] This literature is known as the skill-biased technological change (SBTC) hypothesis. It is claimed that labour demand in many advanced economies has shifted away from unskilled workers toward skilled workers as a consequence of technologies that require less workers but higher skill levels. The SBTC hypothesis has no *direct* link with trade, at least in the case of developed countries, although the same does not seem to be true for developing countries. The SBTC hypothesis is seen as the main theoretical alternative to the view that trade is the key cause of the rising wage inequality

[6] For a review of the literature on trade liberalization and labour markets in developing countries, see Arbache (2002).

In general, empirical research shows that the impact of trade liberalization on wage inequality in developed countries is modest. This can be partly explained by the small proportion of products imported from developing countries (Krugman 1995, Desjonqueres et al. 1999). Although the empirical findings for developing countries are mixed, there is growing empirical evidence showing that openness is being associated with an increase, not a decrease, in the relative demand for skilled workers and rising wage inequality, thus rejecting the predictions of the HOS model (see e.g. Robbins 1996, Robbins and Gindling 1999, Beyer et al. 1999, Hanson and Harrison 1999, Cragg and Epelbaum 1996, Feenstra and Hanson 1997).

Empirical evidence on the effects of trade openness on employment in developing countries has also found unexpected results in light of the HOS model. If developing countries are full of unskilled workers, openness will lead to an expansion of employment of unskilled labour intensive sectors, which are supposed to dominate their economies, thus increasing employment. Márquez and Pages (1997) estimated labour demand models with panel data for 18 Latin American countries and found that trade reforms had a negative effect on employment growth. Currie and Harrison (1997), Revenga (1997) and Ros (2001) have analyzed the cases of Morocco and Mexico, respectively, and found a modest impact of reductions in tariff levels and import quotas on employment that was partly due to firms cutting margins and raising productivity.

It seems that while Latin American and other countries have experienced an increase in wage dispersion after trade liberalization, East Asian countries have observed an improvement in income inequality indicators after a strong export-led strategy was introduced in the 1960s and 1970s. In line with this view, Wood (1994, 1997) has found evidence on rising demand for unskilled labour and a decline in wage inequality in South Korea, Taiwan and Singapore following trade liberalization. These cases are consistent with the hypothesis that the integration of developing countries to the international economy is accompanied by a reduction in income inequality and greater employment as claimed by Krueger (1983, 1988). This apparent contention among experiences could suggest that the issue is an empirical matter rather than only a theoretical puzzle. However, maybe not all pieces of the puzzle have been put on the table: there are some other variables to be put in the equation.

Demand-side issues

While there may be important supply-side effects to trade reforms, one should not overlook the effects of aggregate demand on growth and distribution – a central theme of development economics – and the impact of capital inflows on relative prices – an issue underestimated by the pioneers. The import-substitution model relied on the expansion of internal markets with rising real wages as part of the strategy. Under the new regime, controlling wage costs has come to centre stage. As long as there is enough productivity growth and no substantial displacement of workers, wage restraint need not be a problem because output expansion could create space for growth of real incomes. But if wage levels are seriously reduced and/or workers with high consumption propensities lose their jobs, contraction of domestic demand could cut labour income in sectors that produce for the domestic market. Income inequality could rise if displaced unskilled workers end up in informal services for which there is a declining demand.

Rising capital inflows following liberalization tend to lead to real exchange rate appreciation, which could offset liberalization's incentives for traded goods production and force greater reductions in real wage costs. On the demand side, capital inflows may stimulate aggregate spending through increased domestic investment (either directly or through credit expansion) and lower savings (credit expansion triggering a consumption boom). However, aggregate demand expansion may prove to be short-lived if the consequent widening of the external balance is unsustainable and volatility of short-term capital inflows and lack of regulatory control puts the domestic financial system at risk.

The thrust of these observations is that the effects of balance of payments liberalization on growth, employment and income distribution come from a complex set of interactions involving both the supply and the demand sides of the economy. Income redistribution and major shifts in relative prices are endogenous to the process, and there are no facile conclusions about the effects of liberalization.

Growth, distribution and poverty in Latin America: recurring problems

While there are no simple conclusions, evidence from a comparative study of the post-liberalization performance of 17 Latin American and Caribbean economies during the 1990s suggests that the diverging outcomes are closely associated with the precise issues that concerned the pioneers of development. [7] The differences in outcomes have much to do with the links between market size, employment and income distribution and the adequacy of social overhead capital (including human capital investment).

Most Latin American countries achieved moderate growth rates in the 1990s. However, aside a few exceptions, it is hard to speak of a strong and sustained recovery from the dismal performance of the 1980s. What is more, toward the end of the decade growth had tapered off in many countries due to emerging domestic financial crises – as was the case in Paraguay, Colombia and Ecuador – or external events. Adverse foreign shocks included the impact of the Asian crisis on capital flows to Brazil with spill-over effects on neighbouring countries, particularly Argentina, and of falling export earnings for most primary exporting economies due to plummeting commodity prices. While also for Latin America it is true that poverty falls with growth (see Figure 1), there are important deviations from the trend line strongly associated with specific macroeconomic conditions and, more in particular, with the pattern of growth.

Macroeconomic conditions

Let us first look at some of these macroeconomic conditions. Particularly in the first half of the 1990s, capital inflows to most countries increased substantially and brought both aggregate demand growth and real exchange rate appreciation (with a few exceptions, see below). The latter outcome has been consistent with reductions in inflation, which helped support higher average real wages in most countries. The surge in capital inflows produced expansionary macroeconomic cycles and the associated real wage increases lifted domestic market constraints. Growth would accelerate and poverty would fall during such episodes, but rather than constituting a

'Big Push', the overall picture is one of macroeconomic 'go-stop' cycles (Taylor and Vos 2001), as wages and aggregate demand strongly contract as capital inflows slow down. This is further corroborated by the fact that exports in only few country cases provided the engine of growth during the 1990s. Private spending in most cases proved to be the major source of growth, with consumption growth more often than investment being the major driving force (Table 1). Remarkably, export-led growth has been closely associated with macroeconomic policy regimes, which maintained either relatively competitive exchange rates or a credible system of export incentives, or both. These cases by and large coincide with those that also managed relatively strong poverty reduction effects (such as Chile, Dominican Republic, El Salvador and Guatemala) as export growth in these cases induced strong employment growth. This finding may require further in-depth analysis, but at first sight should raise some skepticism about the virtues of fixed exchange-rate regimes or dollarization, which are popular policy options these days in the region. Also, to the extent export promotion schemes facilitate externalities to export producers (either by providing social overhead infrastructure or reducing costs), one might see shades of the pioneers of development theories. Further, capital flow volatility has been damaging, generating high economic and social costs (De Feranti et al. 2000, World Bank 2001). Hence, while we label it differently these days, regulation of financial markets and related institutional reforms may well be seen as an essential ingredient of what Rosenstein-Rodan and others called the social overhead capital required to generate the positive externalities required to achieve the 'Big Push'.

Patterns of growth and inequality

So far, the liberalization attempts have yielded only modest aggregate productivity increases in most countries (Table 2). In most cases, as could be expected, there was greater productivity growth in traded than in non-traded sectors. The change in aggregate productivity is the result of the sum of productivity changes by sectors, weighted by sectoral output shares, plus the reallocation of labour from low- to high-productivity sectors (see Taylor and Vos 2001). Findings from the country studies indicate that within-sector productivity shifts and output growth rates largely determined the aggregate outcomes, i.e. not much of a shift from low to high

[7] The findings of the study have been published in Spanish (see Ganuza, Taylor, Paes de Barros and

productivity sectors to drive overall productivity growth. Typically, relatively small employment reallocation effects were found, but in a few cases – Guatemala, Mexico, Panama and Ecuador – there were important labour reallocation effects with low productivity agriculture or urban informal services serving as 'employers of last resort'. Hence productivity growth has remained rather sector specific and is not lifting all boats as was hoped for.

Turning to the pattern of growth and income distribution, the most generalizable result is that the inequality of primary incomes increased almost across the board during the 1990s (Table 3). When separated from other influences, it turns out that trade liberalization has been the major cause of this rise in inequality (see Ganuza, Barros and Vos 2001).[8] Trade liberalization came with a skill-twist. Looking deeper inside sectoral adjustment patterns, one finds that the drive towards efficiency gains has led to the adoption of more skill-intensive technologies in many instances driving abundant unskilled workers into unemployment or low-paid informal sector employment. Shortage of human capital, which one may define as another 'Big Push' element, has driven up income inequality. Virtually without exception, wage differentials between skilled and unskilled workers rose in Latin America during the post-liberalization period. Excess labour was typically absorbed in the non-traded, informal trade and services sectors (as in Bolivia, Colombia, Costa Rica, Ecuador, Panama and Peru), or – as happened in a few cases – traditional agriculture served as a sponge for the labour market (Panama in the late 1980s, Guatemala and Mexico). The sectoral patterns have not been uniform. In Argentina, for instance, productivity increases in the traded goods sector affected workers of all skill levels. Wage rigidity being greater for unskilled workers, there was a reduction in earnings inequality in the sector, but greater inequality in Argentina was due to rising income concentration in the non-traded sector along with greater skill-intensity of new investment and to the rise of unemployment in the traded goods sector. By contrast, in Mexico reorganization of manufacturing production was found to be a major source of greater

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Vos 2001) and are soon to appear in English (see Vos, Taylor and Paes de Barros 2001).

[8] This result is obtained using a microsimulations approach by which we simulate and disentangle labour market outcomes in terms of effects on participation rates, unemployment, employment structure, remuneration structure and remuneration levels and simulate the impact of each labour market effect on inequality and poverty at the household level. The counterfactuals for this analysis were based both on before and after-liberalization observations and on CGE model results. See Ganuza, Barros and Vos (2001) for the description of the methodology.

skill demand, pushing up wage inequality in the traded goods sector with many of the displaced workers absorbed by agriculture, at least until 1994. In Brazil, productivity growth produced employment losses in the manufacturing sector. Labour demand fell for everyone in modern manufacturing, but skilled workers suffered the most. Real hourly wages fell for both skilled and unskilled workers in modern industry, but slightly less for unskilled workers, showing – as in Argentina – greater rigidity in wage adjustment at the lower end; hence *skilled-unskilled income differentials* showed a slight decline. As indicated, in most other cases such productivity growth in traded goods sectors pushed up skill differentials in that sector along with the gap between formal and informal sector workers.

The picture is not entirely gloomy as far as primary income distribution is concerned. In El Salvador, rapid employment growth of unskilled workers, particularly in export sectors, offset widening between group skill differentials. In Chile, overall labour market tightening was probably the main factor behind reduction of wage differentials in the 1990s. In Brazil, elimination of hyperinflation and labour demand shifts toward the unskilled have been factors underlying the dampening of primary income differentials. Trends have also been influenced by minimum wage policies, as in Ecuador, where upward adjustments in the minimum wage allowed for a temporary decline in earnings inequality (1992–1995) despite an overall rising trend (1990–1998). In Jamaica, real exchange rate appreciation implied a relative price shift in favour of non-traded activities, which in an overall stagnant economy attracted many unskilled workers from rural areas and the agricultural sector. As urban living standards are generally higher and real wages were allowed to grow, the sectoral employment shift explains the reduction in overall income inequality among workers despite the widening wage gap between the skilled and unskilled.

As shown by Figure 2, rising per worker differentials do not necessarily translate into rising inequality and poverty at a household level. The cases of rising inequality clearly predominate once more (east of the vertical axis), but so do episodes where poverty fell during the 1990s (south of the horizontal axis). Economic growth evidently helped reduce poverty, also where liberalization pushed toward greater inequality. Only in few cases – particularly Chile, Guatemala and El Salvador – was

poverty reduction associated with moderate to strong export-led growth and falling inequality. In most other cases, growth recovery following a surge in capital inflows allowed for an expansion of aggregate demand and sufficient overall employment growth or a rise in real wages to produce a reduction in poverty. In Mexico and Argentina, the rise in inequality has been associated with labour demand shifts favouring skilled workers, employment shifts into informal activities or unemployment. On balance these effects have led to a rise in poverty despite positive per capita growth. In other cases, changing labour market conditions have triggered strong labour supply responses, including rising female participation, as in e.g. Panama and urban Ecuador. Elsewhere, emigrant remittances (Central America, Dominican Republic, Cuba) or social security transfers (e.g. Costa Rica) have a strong positive influence on reduction of poverty and inequality at the household level.

Conclusions

The development context has changed dramatically. Yet where it comes to issues of development and distribution, the early development thinkers emphasized the right issues of sectoral balance and investment in social overhead capital, even though they may not have had all the right policy answers. In line with the spirit of the time they were probably affected by too much trade pessimism and perhaps a too great believe in the virtues of planning and protectionism. It is fair to say though that none of the pioneers believed in autarkic development and all saw that eventually the full benefits of trade could be reaped by opening up the economy, not blindly, but in a fashion that would lead developing economies out of development traps. Development still could and likely would be rather "unpleasant", as Kurt Martin has put it (Martin 1991). The pioneers did not have a clear recipe as to how to make development a more pleasant process during the transition and instead warned for too much inequality as much as for too much equity, which both could hamper modern economic growth. Here's the problem economists have been unable to resolve to date, despite more sophisticated analytical methods and much improved data to study income distribution and poverty.

The issue is not a mere ethical concern about people's deprivation. It is also about growth and growth dynamics. The core issue of economic development is to move resources (labour in particular) from low to high productivity sectors thereby creating new growth dynamics. This is what structural adjustment should be about and this is not a one-time process, but rather a revolving one. It is also likely not a smooth and continuous process, but one which tends to come in spurts, "Big Pushes". If, as in post-liberalization Latin America, the spurt lacks dynamism or is hampered by macroeconomic volatility, new development traps may emerge. As indicated, efficiency gains in some sectors (say manufacturing) have led in several instances to an expulsion of labour to low-productivity sectors (say informal services). Such labour reallocations have been important sources of widening income gaps. This generally has put a constraint on domestic market growth. Surges in capital inflows, rather than export drives, have been the major source to overcome demand constraints. Volatility in capital markets thus has directly affected growth, causing recessions and poverty increases along with downswings in capital inflows.

The challenge is to make sure we bring back into the equation the fundamental concepts of sectoral balance, social overhead capital (broadly defined) and vertical technological linkages. Policy incentives should be such as to enable a more dynamic growth process to happen. In the empirical discussion, a few concrete policy issues came to the fore, such as credible export promotion policies as a potential element to promote certain technological externalities, human capital investment, and improved institutional frameworks and macro policies to reduce uncertainty stemming from financial volatility. None of this implies we should give a clarion call for a return to wide-ranging trade intervention policies and import substitution. But blind liberalization does not work either. The insights from old development theory already taught us that there are high costs associated with the existence of fragmented markets, inadequate institutional frameworks to guide market processes and large income inequality. Our research and policy advice should focus on such issues.

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Growth and Poverty in Latin America

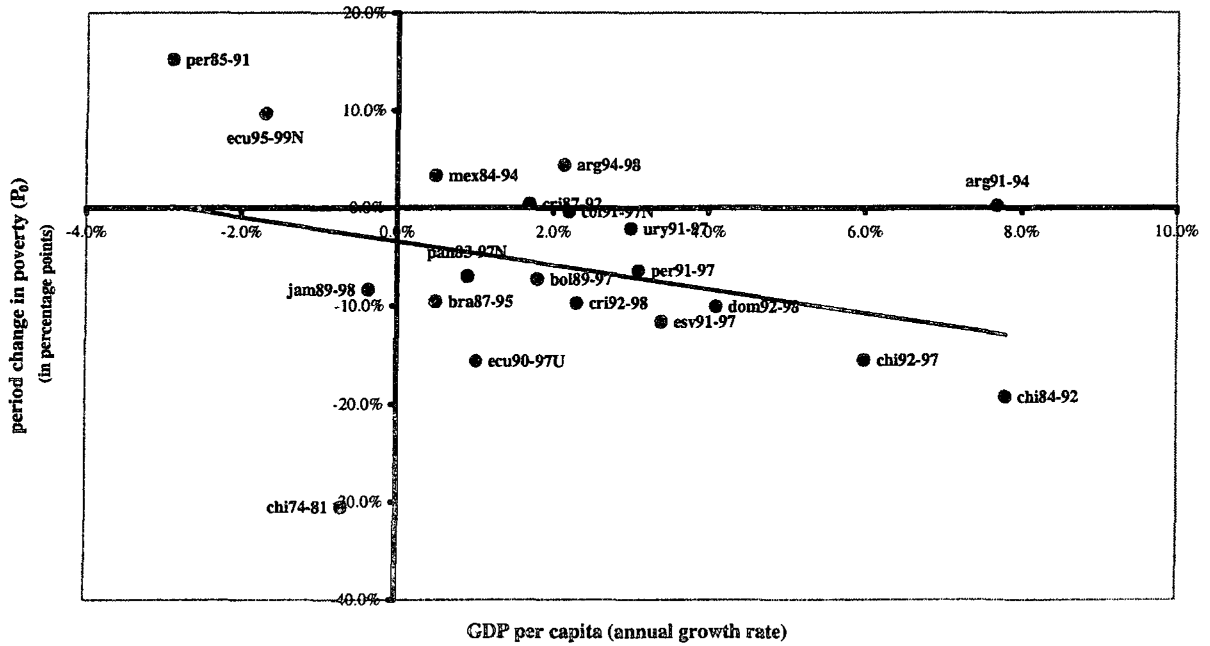

Figure 1 Growth and poverty in Latin America in the 1990s

Poverty and Inequality (p.c. household income) before and after liberalization

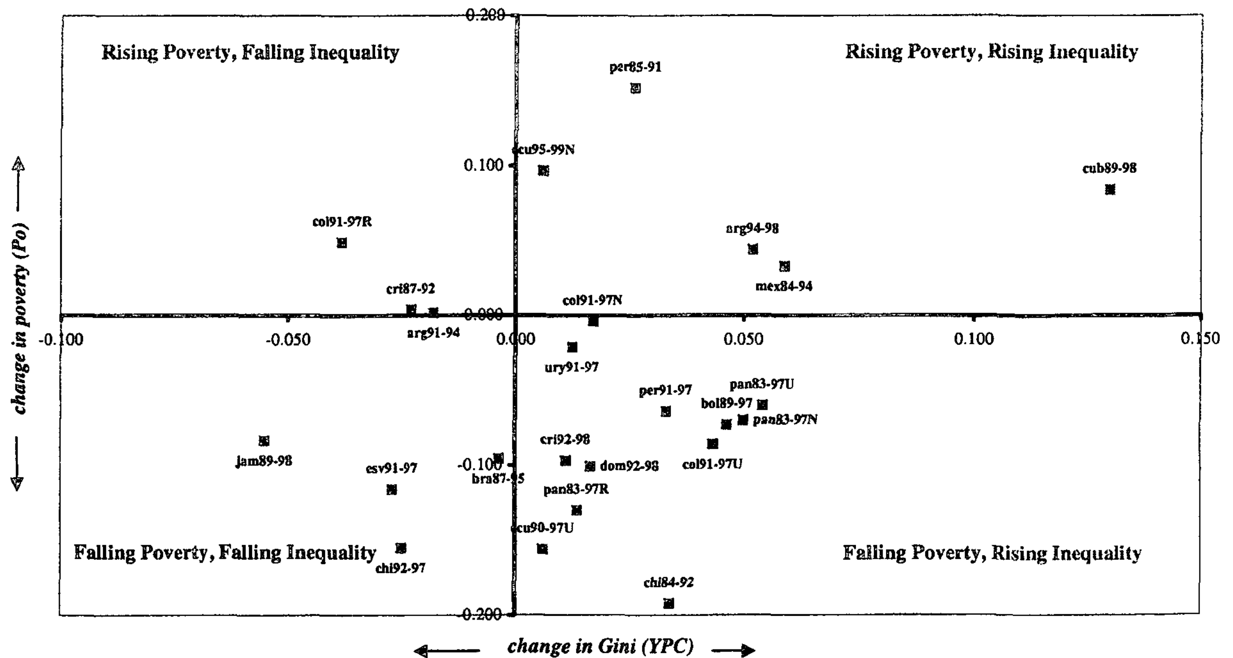

Figure 2 Poverty and inequality (of per capita household income) in Latin America before and after liberalization

Table 1 **Factors of growth in Latin America in the 1990s**
(by aggregate demand decomposition)

	Country	Periods	Principal source of demand growth	Aggregate demand growth (% per year)
1	Argentina	1990–94	Private consumption boom	8.9
		1995–96	Private demand contraction	-4.6
		1996–98	Private demand (C,I) recovery	6.5
2	Bolivia	1980–85	Private consumption and gov. spending	-1.5
		1986–89	Export led	2.1
		1990–97	Export led	4.8
3	Brazil	1982–86	Government spending and exports	-0.9
		1987–91	Government spending	3.0
		1992–94	Private spending and gov. spending	0.9
		1994–97	Private investment and consumption	5.2
4	Chile	1970–74	Private and government consumption	1.0
		1976–81	Consumption squeeze, export growth	9.4
		1985–89	Investment, exports	8.4
		1990–97	Investment, exports	9.4
5	Colombia	1990–92	Exports and government spending	2.2
		1992–95	Private consumption boom	9.6
		1995–98	Private demand contraction	1.5
6	Costa Rica	1985–91	Export led	5.7
		1992–98	Export led	6.5
7	Cuba	1989–93	Private demand squeeze	-13.7
		1994–98	Public spending and export recovery	7.0
8	Dominican Rep.	1993–99	Private demand and export led	7.5
9	Ecuador	1988–91	Private demand	4.4
		1992–98	Export led	2.9
10	El Salvador	1990–95	Investment and export	8.2
		1996–97	Export	0.1
11	Guatemala	1986–91	Consumption led	3.4
		1991–98	Consumption led	5.0
12	Jamaica	1980–89	Private consumption led	2.0
		1990–92	Export led	8.1
		1993–98	Private demand and export contraction	-3.1
13	Mexico	1988–94	Consumption boom	5.5
		1994–95	Crisis and cons. Squeeze	-7.8
		1996–98	Investment recovery	8.3
14	Panama	1986–90	Crisis: private demand contraction	-5.4
		1990–94	Private demand and exports	5.7
		1994–98	Exports and private demand	4.9
15	Paraguay	1988–91	Private demand expansion	6.7
		1992–94	Private demand expansion	10.8
		1995–98	Private demand and export contraction	-0.6
16	Peru	1986–90	Collapse private demand	-1.9
		1991–97	Private demand recovery	5.6
17	Uruguay	1986–90	Export led, private demand squeeze	2.9
		1990–94	Private demand expansion	8.4
		1994–97	Private demand and exports	4.4

Source: Taylor and Vos (2001).

Table 2 Productivity growth in the 1990s

Country	Periods		Productivity growth: Overall	T	NT	Sector reallocation effects: Employment
Bolivia	1980–92	Destabilization/ stabilization	-2.8	-2.9	-3.0	Large (toward agric., inf. trade)
	1992–97	Post-liberalization	1.0	1.0	0.8	Large (toward urban inf. trade)
Brazil	1982–86	Pre-reform period	0.7	2.0	-0.4	
	1987–91	Liberalization	-4.0	-2.4	-5.1	
	1992–94	Post-Liberalization I	4.4	2.4	4.6	
	1994–97	Post-Liberalization II	0.9	4.4	-1.2	
Chile	1970–74	Demand expansion, hyperinfl.	0.8	0.1	1.3	Small
	1976–81	Liberalization	2.6	3.7	1.9	Small (-)
	1985–89	Readjustment	0.1	-1.2	0.9	Small (-)
	1990–97	Free trade agreements	3.9	4.8	3.5	Small (-)
Colombia	1992–95	Liberalization and boom	2.6	2.7	2.9	Small
	1995–98	Stagnation	2.0	2.8	1.9	Small
Costa Rica	1987–91	Trade lib.	1.5	2.3	0.9	Small
	1992–98	Further opening	0.6	3.0	-1.0	Small
Cuba	1989–93	Opening forex market	-8.3	-13.7	-5.0	0
	1994–98	Fiscal adj., ;flexibilization inf. activ.	4.1	11.1	0.1	0
Dom. Rep.	1991–96	Post-liberalization	3.5	5.7	2.3	Small
Ecuador	1992–97	Post-reform	0.1	1.3	-0.9	Large (away from NT)
El Salvador	1991–95	BoP and financial liberalization	14.3	-0.6	31.3	Large
	1995–96	Demand contract	9.6	4.4	14.0	Small
Guatemala	1987–92	BoP liberalization	0.4	-0.4	1.1	Large
	1992–97	BoP cum dom. financial lib.	0.3	-1.3	0.8	Large
Jamaica	1980–89	Pre-liberalization	3.2	1.7	0.9	Small
	1990–92	Financial liberalization	3.7	1.2	2.1	Small
	1993–98	Trade liberalization	-1.0	0.5	-1.6	Small
Mexico	1988–93	Financial liberalization	0.6	6.0	-0.5	Small
	1994–97	Peso crisis, NAFTA	-0.8	-0.2	-2.1	Small
Panama	1991–94	Stabilization and recovery	0.2	4.3	-2.0	Large (out of agriculture)
	1994–98	Trade reform	0.2	1.2	-0.5	Fair (into informal services)
Paraguay	1982–92	Trade and exchange rate reform	-0.4	1.2	-2.5	Large (away from T)
	1992–97	Mercosur & financ.	-5.7	-2.1	-8.7	Large (away from T)

Periods			Productivity growth: Overall	T	NT	Sector reallocation effects: Employment
		liberalization				
Peru	1986–90	High Inflation Period	0.7	1.1	0.6	
	1991–98	BoP liberalization	0.6	1.1	0.5	
Uruguay	1986–90	Pre-Mercosur	0.4	-0.7	0.6	
	1990–94	Mercosur (I)	3.8	0.0	2.2	
	1994–97	Mercosur (II)	2.7	6.5	2.4	

Source: Taylor and Vos (2001).
Key to variables:
Productivity growth = annual rate of change of productivity (Q/L)
T = traded goods sectors
NT = non-traded goods sectors

Table 3 Growth and Inequality in Latin America in the 1990s

Change after liberalization		INEQUALITY		
		Overall Primary incomes		
		Rising inequality	Decreasing inequality	Unchanged
GROWTH	High (>5%)	ARG (91–94, 96–98) CHI (76–81, 84–92) COL (91–95) DR (91–98) PERU(91–97)	CHI (92–97) ESV(91–97) PAN(90–94)	URY (90–97)
	Moderate (2–5%)	BOL (89–97) BRA(87–94) CRI (92–98) ECU (90–97) MEX (88–94) PAN(94–98) PRY (88–91, 92–94)	BRA(94–97) CRI (87–92) CUB (94–98)	URY (86–90)
	Low (0–2%)	COL (95–98) ECU(95–99) MEX (85–87) PRY (95–98)	JAM(89–98)	
	Negative (< 0%)	CUB (89–93) MEX (94–95)		
Change after liberalization			INEQUALITY	
		Skill differentials		
		Rising inequality	Decreasing inequality	Unchanged
GROWTH	High (>5%)	ARG (91–94, 96–98) CHI (76–81, 84–92) COL (92–95) DR (91–98) ESV (90–97) PAN(90–94) PERU (91–98) URY (90–97)	CHI (92–97)	
	Moderate (2–5%)	BOL (89–97) BRA (92–94) CRI (85–91, 92–98) ECU (90–97) MEX (88–94) PRY (88–91, 92–94)	BRA (94–97) URY (86–90)	
	Low (0–2%)	COL (95–98) JAM (90–92) MEX (85–87) PAN(94–98) PRY (95–98)		
	Negative (< 0%)	JAM(93–98) MEX (94–95)		BRA (87–91)

Source: Taylor and Vos (2001).