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DISTRIBUTION AND GROWTH IN LATIN AMERICA IN AN ERA OF STRUCTURAL REFORM: THE IMPACT OF GLOBALISATION

by

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PREFACE

Over the 1980s many developing countries recorded disappointing performances in terms of growth, development and, especially, poverty reduction. The 1990s has been the decade of globalisation — defined as both external opening and an increased role of markets domestically. Globalisation in developing countries has occurred largely as a consequence of moves towards external liberalisation, part of broader shift to more market-oriented, export-led development strategies, often in the framework of stabilisation and structural adjustment programmes with the IMF and World Bank. This simultaneous emphasis on globalisation with the unsatisfactory performance of developing countries in lowering inequality and poverty levels, has led to an intense debate over whether globalisation, and the development strategies associated with it, are part of the problem, or part of the solution. The debate has been largely about perceptions, rather than about well-defined propositions, in part because of lack of data, inadequate analysis, and insufficient attention paid to cultural differences.

In the light of this debate, on 30 November and1 December 2000 the Development Centre organised a policy dialogue to assess the impact of globalisation on poverty and income inequality in developing countries. What policies should developing countries pursue to achieve “inclusive globalisation”, supported by pro-poor growth? What policies should OECD member countries adopt to help them through, for example, bilateral development assistance and influencing international institutions? In the Development Centre’s tradition of frank policy dialogue between experts, policy makers and stakeholders, this particular event gave a voice to those countries and people in the world economy who do not normally participate in the meetings of international institutions.

This series of papers* consists of regional surveys of the impact of globalisation that the Centre commissioned as input and background for the dialogue. For each of three regions — Latin America, Southeast Asia and Sub-Saharan Africa, two contributions were commissioned. The first focused on the economic impact of globalisation, especially the effect on poverty and inequality. The second looked at the political economy of countries in the context of policy formulation in response to globalisation.

The results presented here and in the rest of the series show that globalisation is not the major cause of income inequality and poverty in developing countries, but has none the less contributed to the poor performance of a number of developing countries. What has differentiated winners from losers has been that globalisation has worked by amplifying the effects of pre-existing inequalities in the distribution of assets, especially human capital, and of access to infrastructure and other productive resources. In

countries were inequalities were high, globalisation tended to make inequality worse; similarly globalisation has tended to increase inequalities across countries.

This analysis implies two key, development policy lessons. First, for globalisation to be pro-poor, it needs to be combined with policies which create a more equal distribution of, or access to, productive assets and resources, particularly for vulnerable groups facing the increased competition which comes with globalisation. Second, the speed and sequencing of external and domestic liberalisation must be tailored to the particular circumstances of individual countries, based on their institutional capacity to transform the economy.

Jorge Braga de Macedo
President
OECD Development Centre
5 December 2001

* *Globalisation, Poverty and Inequality in Sub-Saharan Africa: A Political Economy Appraisal*, by Yvonne M. Tsikata

Distribution and Growth in Latin America in an Era of Structural Reform: The Impact of Globalisation, by Samuel A. Morley

Globalisation, Liberalisation, Poverty and Income Inequality in Southeast Asia, by K.S. Jomo

Globalisation, Growth and Income Inequality: The African Experience, by Steve Kayizzi-Mugerwa

The Social Impact of Globalisation in Southeast Asia, by Mari Pangestu

Where Does Inequality Come From? Ideas and Implications for Latin America, James A. Robinson

RÉSUMÉ

L'Amérique latine a longtemps été caractérisée par la répartition des revenus la plus inégalitaire au monde. Celle-ci résultait en particulier de la structure de la propriété foncière, des politiques de développement et d'éducation, ainsi que de la démographie qui ont gonflé l'offre de main-d'œuvre non qualifiée et la demande de compétences, creusant ainsi les inégalités. Les politiques de substitution aux importations ont créé de la croissance, mais aussi de grandes inégalités, et elles ont provoqué la crise de la dette. Toutefois, les réformes de globalisation des années 90 n'ont pas réduit ces inégalités et les ont même parfois exacerbées. Désormais, compte tenu des médiocres résultats à l'exportation, la priorité revient au problème ardu de comment relancer la croissance ? Il faudrait absorber autant que possible l'excès de main-d'œuvre non qualifiée, en particulier grâce aux secteurs du BTP et de l'agriculture. Une croissance dans l'équité devrait aussi se préoccuper d'aider les régions reculées et d'y investir. Mais la solution à long terme réside dans l'éducation, qui permettra de combler le fossé des compétences, de réduire les inégalités et de stimuler le taux de croissance.

SUMMARY

Latin America has long had the most unequally distributed income in the world because of land ownership patterns, development and education policies and demography, which have swelled the supply of unskilled labour and demand for skilled workers, leading to widening inequality. Import substitution produced high growth but also high inequality and led to a debt crisis. But globalisation reforms in the 1990s did not reduce inequality and sometimes increased it. Now, because of poor export performance, the priority is the tricky problem of how to boost the growth rate. The aim should be to absorb as much of the region's excess of unskilled labour as possible, especially through construction and agriculture. Growth with equity should also focus on supporting and investing in backward regions. But the long-term key is education, which will narrow skill differentials, reduce inequality and increase the growth rate.

I. INTRODUCTION

Globalisation in Latin America since the early 1980s has largely been a shift from import substitution to export promotion as part of structural adjustment programmes in response to the 1982 debt crisis. Greater integration into the world economy through current and capital account liberalisation was nearly always accompanied by extensive domestic reforms or, overall, by *neoliberalismo*. Both were complementary parts of an export-led growth strategy to align domestic prices with world prices and increase the market's role in allocating resources and investment to improve efficiency and drive down costs. Together these were supposed to increase competitiveness, exports and growth.

Latin America has long been the region of the world with the most unequally distributed income. The main factors have been highly unequal agricultural land distribution, government development policies (import-substitution) and educational policies, as well as demographic factors. These all produced rapid growth in the supply of unskilled labour and increased demand for university-trained workers, leading to a widening earnings gap. Import substitution, which had produced high growth as well as high inequality, also involved more and more structural imbalances, greater foreign borrowing and eventually a debt crisis. Economic reforms — globalisation and extensive domestic liberalisation — were introduced as a part of the response to the 1982 debt crisis. Inequality increased further during the economic stagnation of the "lost decade" of the 1980s. At the start of the 1990s, it was hoped reforms would bring recovery and growth that would lessen inequality. But inequality seems at best to have stayed at the high levels of 10 years ago or even worsened (Székely and Hilgert, 1999*a*). So why has recovery and growth not improved inequality, and what impact have structural reforms had on inequality performance?

II. RECENT DISTRIBUTION EVIDENCE: HIGH AND PERSISTENT INEQUALITY

Latin American countries are the most inequitable in the world. Figure 1.1 shows the most recent estimates of Gini coefficients in the region[1]. As many as 13 of the 18 countries have Ginis over 0.50, higher than the maximum in all but 14 of the 88 non-Latin American countries in the World Bank data set (see Deininger and Squire, 1996).

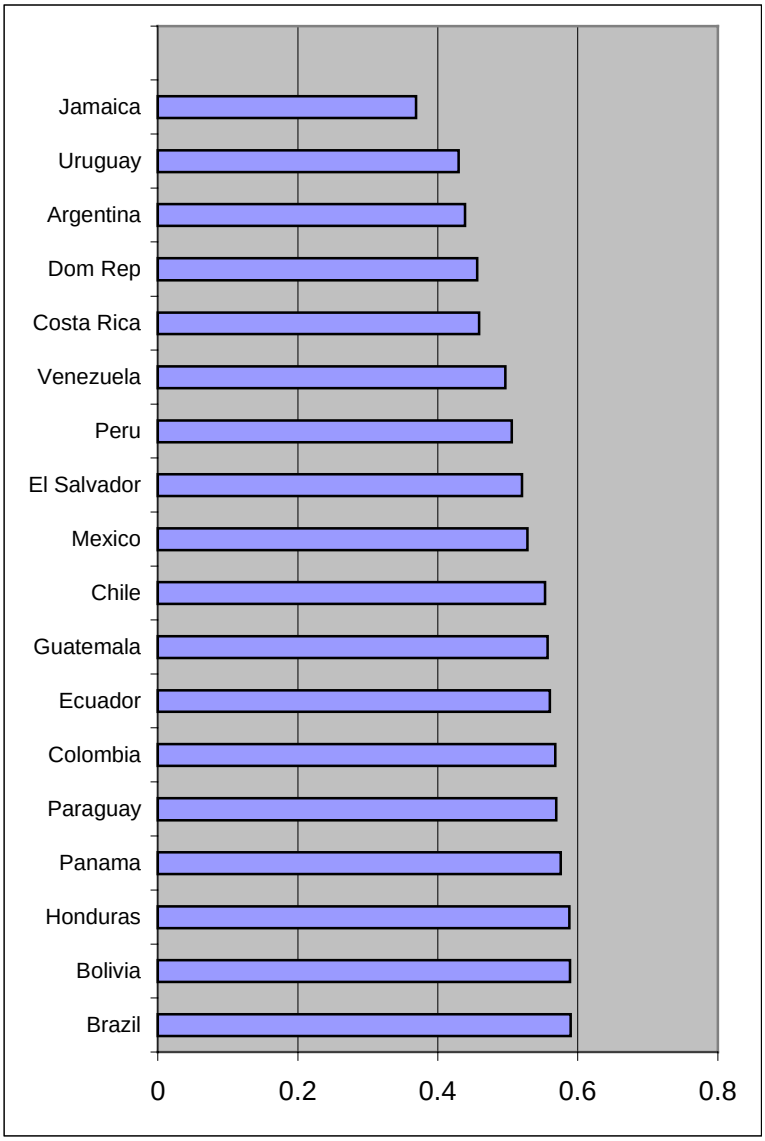
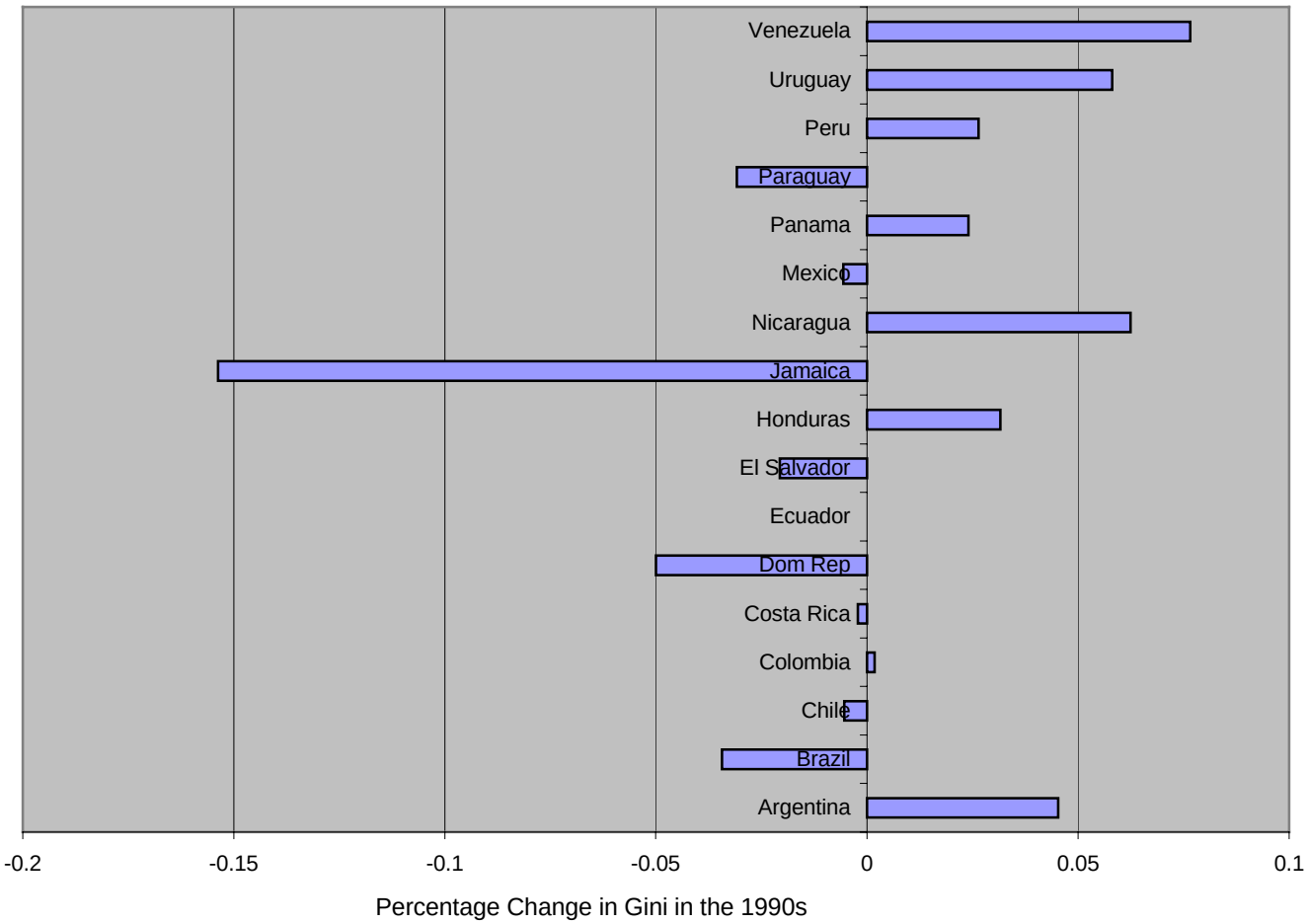


Figure 1.1. **Gini Coefficients for a Recent Year**

Source: Annex.

Figure 1.2 shows little change in inequality during the 1990s, after reforms in most countries; in Miguel Székely's words, inequality is high and persistent in the region (see also the Annex). Inequality rose in eight countries, fell in eight and was constant in one, but most changes were small and only in four are they more than 5 per cent (i.e. about 2.5 percentage points on the Gini scale)[2]. Inequality moved within a fairly narrow range for most countries.

Figure 1.2. **Percentage Changes in Distribution in the 1990s**



The aggregates do hide important details. Inequality in six countries has risen sharply in the past and now seems stuck at a very high level; two countries once had fairly small levels of inequality but saw them increase significantly in the 1990s; and in three countries, progress in the early 1990s was largely reversed after 1995[3].

However even in the positive cases, optimism must be tempered. In Costa Rica and Uruguay, inequality has fallen to levels found in developing countries, but this means it is unlikely to fall much further as there appear to be lower limits to income inequality in any society, especially when inequality is measured by income instead of consumption[4]. In three of the other countries where inequality fell (the Dominican Republic, Jamaica

and Paraguay) it tended to be the result of a severe and lengthy recession when the rich lost more than the poor.

So inequality is a serious problem in Latin America. Only three countries have either low or declining levels of inequality and adequate growth. In the other 14, either their inequality is stuck at a high level, has been rising significantly in recent years or the countries are in serious recession. This group includes more than 90 per cent of the region's population and there is little or no sign of improvement.

III. DETERMINANTS OF THE DISTRIBUTION OF INCOME

Why these developments in inequality? One of the underlying components of inequality is distribution of earnings — the primary distribution, which is most closely connected to economic influences[5]. In the short run, this is determined by the interaction of three factors: the distribution of ownership of factors of production (assets) and the interplay of supply and demand for those factors. Persistently high inequality in Latin America is largely due to unequal distribution of productive assets in the society. Of the four key productive assets — land, skilled labour, unskilled labour and capital — all but unskilled labour are distributed unequally compared with industrialised countries and other developing areas. Two of them, skilled labour and capital, are in scarce supply relative to demand in Latin America, which means their rates of return should tend to be high. This has been exacerbated by the relatively skill- and capital-intensive growth strategy of Latin America (which has raised profit rates) and the return to education.

Before looking at how factor returns have evolved in Latin America, we must examine the underlying theoretical relationship, both short and long-term, between returns and growth. Like other economic markets, prices are determined in factor markets by the interaction of the supply of each factor and the demand for factor services. On the demand side, economic growth increases the demand curve for each of the factors, which tends to raise each of their prices. What happens to relative factor demand depends on the factor-intensity of the growth process; structural reforms can change how growth affects factor demand, such as by shifting the composition of output from unskilled to skill-intensive sectors.

The supply side is critical to understanding the process. In the short run, the supply of factors is fixed so demand factors, such as growth strategy, macroeconomic conditions and structural economic reforms, have a dominant influence on relative earnings and the rate of return on capital and land. In the long run, factor supplies change in response to prices. A bigger wage gap between skilled and unskilled labour, or between university and high school graduates, will tend to increase demand for university education if the educational system can provide it and people can pay for their education. Over time, these investments will increase the supply of physical and human capital in the economy.

So there is an important distinction or ambiguity between the short run and long run meaning of a rise in the rate of return to education (skill differential) or to capital. In the short run, an increase in either is almost always regressive. But in the long run, as long as the supply side reacts positively to these changes in the rate of return, the change could be progressive either because of upward mobility or because the increase in physical capital drives down the rate of return and raises the productivity and average

wage of workers. It is a serious error of interpretation to concentrate only on the short run regressive effect of changing factor returns without taking into account progressive long run supply responses.

How have the four factors of production that together determine the earnings distribution played out in Latin America?

Physical Capital

Could Latin America's high inequality be due to a higher profit share in the region? It is well known that the household surveys used to measure inequality seriously underestimate total profit income. But they do contain some income from that source and, as expected, its distribution is far more skewed in favour of the rich than labour income. However, because of underreporting, the total income from this source is too small to significantly change the distribution. The Gini of total income including distributed profits is less than one percentage point higher than the Gini of labour income alone. This means the high reported inequality in Latin America comes mainly from inequality in labour income, not profits. Also, because most profit income is not captured in the surveys, inequality in Latin America must be a good deal higher than what is reported in the household surveys.

Land Distribution: The Interaction with Unskilled Labour

Latin America has always had the world's most unequal land distribution, and a recent study of land in developing countries showed it had the four most unequal countries and 11 of the most unequal 16. No Latin American country was in the group of low or even medium inequality. (Theisenhusen, 1995, p. 9)[6].

There have been attempts to change the situation through land reform[7], but they were largely unsuccessful as the reforms mostly did not reach a large fraction of landholdings or significantly equalise land ownership. Either the reformed land was put into collective farms, as with the *ejidos* of Mexico, or it was later sold by the new owners[8].

The relevance of this for income distribution is that countries with very unequal land distribution tend to have a low reservation wage for unskilled labour in rural areas. Because of rural-urban migration, this also means low wages for unskilled workers in the cities. In Latin America, rather than confronting the powerful landed oligarchs, the more typical solution was for the rural poor to escape by migrating to the cities. One could say the cities became the safety-valve for the poor landless peasants, just the opposite of the Turner hypothesis for the United States. That largely avoided violent confrontations but at the cost of transferring inequality and low wages for the unskilled to the cities.

To make things worse, population growth temporarily rose between 1950 and 1980 as death rates fell with improvements in health, followed by a lag caused by a reduction in the birth rate (the so-called demographic transition)[9] . This caused a big increase in the number of youngsters, who had to be either educated or absorbed into the labour force. The education system mostly did not expand enough to absorb them. Instead, most entered the labour force with meagre education, increasing the supply of

unskilled labour. Without access to land and other productive inputs, the increased supply drove down rural wages and then flooded into the cities, driving down unskilled wages there. Over the same period, most countries in the region pursued an import substitution development strategy that implied rapid growth in demand for, and returns to skilled labour and capital. The predictable overall result was a rise in informalisation, stagnation in real wages for the unskilled and a rise in the wage differential.

These land-labour market developments have important implications for the future as well. A backlog or oversupply of poorly-educated workers has been created which will have regressive effects on income inequality until the demographic transition comes to an end, providing an extra challenge to any public policy efforts to lessen inequality. This highlights the need for a combination of more rapid and labour intensive growth and investments in secondary education.

Human Capital or Education

Education is one of the keys to the distribution puzzle. Latin America has a highly unequal distribution of education and the highest skill differentials in the world. Dozens of studies have shown that a person's level of education and experience are the major determinants of where they are likely to be found in the distribution of income (See in particular Birdsall and Londoño (1997) and Londoño and Székely (1997)). So it is reasonable to expect a big part of the explanation for earnings inequality to be the educational profile of the population and the skill differential.

Another puzzle is how to explain Latin America's high and persistent education wage differentials. Surprisingly, they cannot be explained by the relative scarcity of university graduates. Compared to the typical Asian economy, the share of university graduates in the adult population is actually higher in Latin America. Yet the returns to university education are higher in Latin America than they are in Asia. The number of university graduates in the labour force in Latin America has grown rapidly since 1970, yet skill differentials have widened. These facts are a critical part of why inequality has not decreased in the region. But we have no clear explanation why this expansion of supply has not driven down education differentials and rates of return to university education.

Getting good historical or comparative data on wage differentials between skilled and unskilled labour or between different education groups is surprisingly difficult. Lora and Marquez (1998) compared white and blue collar average wages in Latin America and several other regions. Their data shows the white collar differential in Latin America in 1982 to be twice as high as in developed countries and 50 per cent higher than in the four Asian tigers. Since 1982, that differential has fallen everywhere but Latin America, despite increases in the share of college and high school graduates there. It has even risen sharply since 1988. Behrman *et al*. (2000) confirm this widening of the educational wage differential. They ran earnings regressions for a number of Latin American countries at two points in the 1990s and found that in eight of the 10 countries for which they had data, the differential between university and high school graduates and lower education groups increased. The exceptions were Costa Rica and Panama. Morley (2000) found the same pattern in the nine countries in his study, several of which were

not in the Behrman *et al.* survey. It is generally agreed that wage differentials in favour of the educated have widened in the post reform period, for whatever reason.

To try to explain trends and patterns in relative skill differentials, it is natural to ask about demand and supply. If one looks at the educational profiles of the adult population in Latin America compared to Asia, what stands out is the large proportion of university graduates in Latin America and the small number of adults with a high school education. Most Latin American countries have managed to universalise primary education, which has sharply reduced the percentage of the labour force without any education. But many young people still drop out of school after completing primary school, particularly in countries that have poor overall education levels, such as Brazil, El Salvador, Guatemala, Honduras and Bolivia. As a result, much of the progress in reducing the group with no schooling has been offset by an expansion of the group with no more than primary education.

The Latin American experience has differed most sharply from Asia since 1970 in the rapid expansion of the university component relative to secondary education. In Asia, both the secondary and university component practically doubled between 1970 and 1985. But in Latin America, university graduates expanded twice as fast as high school graduates. Asia spent a lot on eliminating the bottom tail of its educational distribution and universalising secondary education while Latin America let most of its youngsters leave school after primary, choosing instead to expand university coverage.

Latin America has expanded the supply of university graduates in the labour force faster than Asia, so rising relative wages or returns to university education in Latin America cannot be attributed to a failure to expand supply. The university-intensive education strategy in Latin America has also increased the variance in ownership of human capital, what could be called educational inequality. Trends in this variance are critical to understanding trends in earnings inequality. If there are very few university graduates in the population, the high wage differential earned by them will not be important in the distribution because overall education variance is low (Most of the population has a low education level). When a country starts upgrading education, educational inequality is likely to increase as the education level of younger people improves relative to older people. That trend will reverse as older people retire and are replaced by better and more equally educated younger people. But the Latin American educational strategy has delayed this turning point. Not only is educational inequality still increasing there, it is increasing faster than expected in view of the experience of other countries. A recent study (Londoño & Székely, 1997) shows the standard deviation of education rising along with education levels from just over three years in the 1960s to over 4.5 years in the 1990s — more than double the increase in educational inequality to be expected from the increase in average education level over the same period.

Rising educational inequality in the region is partly a result of the Latin American education strategy. There was substantial reduction in those with little or no education — the left hand tail of the distribution. That was helpful. But there was significant expansion of university graduates (the right hand tail). That increased educational inequality because of the relatively small size of the group at the beginning of the period. In other words, the expansion in educational opportunities above primary level was limited to a small minority of new entrants. The Asian strategy, however, expanded the

group in the middle, those with high school education, relative to the top, and more of the labour force was in this group to start with. Asia reduced the lower tail and expanded the middle of the distribution, equalising education over the labour force. Latin America did not. Eventually, educational inequality trends will reverse in Latin America, as they have in Asia, because intra-group inequality is now falling in almost every country in the region. But the Latin American strategy of expanding primary and university at the expense of secondary has delayed the point at which overall educational inequality begins to decline in most countries in the region.

Income distribution is related to both the return to human capital and variance in its ownership. So far, changes in the educational profile of the region's labour force have not managed to reduce income inequality and may even have increased it.

Changes in the rate of return to education or the wage differential are the main way the earnings distribution can be changed in the short run. Upgrading the labour force by investing in education is a key component of any government's social policy. But it takes a long time to have a significant effect on earnings distribution — a long time for the newly-educated to join the labour force and even longer the lower the coverage of the education system to start with. Even when these people do enter the labour force, they will add at most 2-3 per cent to the economy's stock of workers. Those changes are not big enough to alter very quickly the variance of education or the educational profile of the labour force. Costa Rica has a progressive education policy and 89 per cent of its adult population had only primary education in 1970. Fifteen years later, that percentage had only dropped by 14 per cent (Barro and Lee, 1996). The proportion of college graduates rose from 3 per cent to 11. Those are substantial improvements, among the best in the region, but are too slow to alter the ownership profile of human capital much in the short run. So for a significant change in earnings inequality to come from this source, it will have to be from changes in the rate of return to education — the wage differential.

Unfortunately, as we have seen, wage differentials are moving in favour of the more educated. The key has been returns to university education. The rise in the university group contribution to overall inequality in the Morley sample of countries was so great that it completely offset favourable trends in the rest of the population[10]. For all countries in the sample, the absolute change for the university component was higher than the absolute overall change in inequality. Rising inequality in the university group was responsible for all the increase in inequality, where there was an increase in inequality, or offset progressive trends in the non-university group where inequality was constant. So earnings inequality would have declined in every country in the region, except perhaps Argentina, had it not been for widening inequality in the university group and between it and everyone else. This suggests more demand for university skills outstripped even the growing supply and is a striking confirmation and result of increasingly skill-intensive growth in the 1990s. Growth in the new economic model strongly favoured the few in the labour force with university education. Was this the result of opening up the economy, of an increase in the market power of university graduates or of changes in technology? All we know for sure is that income differentials in favour of university graduates rose in most countries despite a rapid increase in the supply of

university graduates and that this group is the main source of whatever increase in inequality there was in the region.

Inequality and Growth

What economic forces can cause changes in the distribution of earnings? The most important is growth itself. What is the nature of the growth strategy and its effect on factor markets and distribution of income across the economy?

Economies are heterogeneous and growth is a unbalancing process that spreads unevenly across them. It always starts in a particular sector or region and then spreads out or trickles down to the rest of the economy through a series of linkages between the sector where growth begins and the other sectors and agents in the economy. If the linkages are strong, the benefits of growth will be shared widely throughout the economy and growth is likely to be more equitable. If they are not, growth will be confined to the leading sector and will probably exacerbate inequality.

Some Latin American economies have weak linkages, such as backward regions or indigenous populations that are only weakly or marginally connected to modern dynamic sectors — regions like the northeast and north of Brazil, the Andean region of Peru, or the indigenous areas of southern Mexico. The areas themselves have much of the nation's population, which means their relative income levels will have a noticeable effect on inequality. Growth in these conditions tends to be inequitable. Inequality seems likely to be lower the smaller and more homogenous the economy, as in Argentina and Uruguay, where most people live in a few interconnected urban areas[11].

Just as important is a country's growth strategy. If substantial growth comes from sectors that use a lot of unskilled labour, such as construction or agriculture, it will be equalising. The same should be true if the leading sectors are in backward regions. But if the leading sector is skilled-labour intensive or in mineral extraction — which does not employ many people directly and has weak links with the rest of the economy — growth will very probably increase the skill differential and worsen inequality, though it may be partly offset by demand from skilled workers for services provided by the less skilled.

The government can play a big role in determining the size of the linkage or spread effect of growth. It can generate much demand for the unskilled through construction, one of the two sectors that intensively uses unskilled labour. The government can also direct its spending to backward regions. So even if the basic growth dynamic comes from mineral extraction or skill-intensive exports, the government can use the tax revenues they generate to fund construction projects or other activities such as basic health care, education or direct transfers that will help the poor. The government acts as a conduit for some of the revenue from production in the leading sector to reach the poor, the unskilled or backward regions of the country.

So whether or not growth is an equaliser depends on the structure of the economy, especially how big and heterogeneous it is and how much skilled and unskilled labour it has; on the growth strategy being followed and what the leading sectors are;

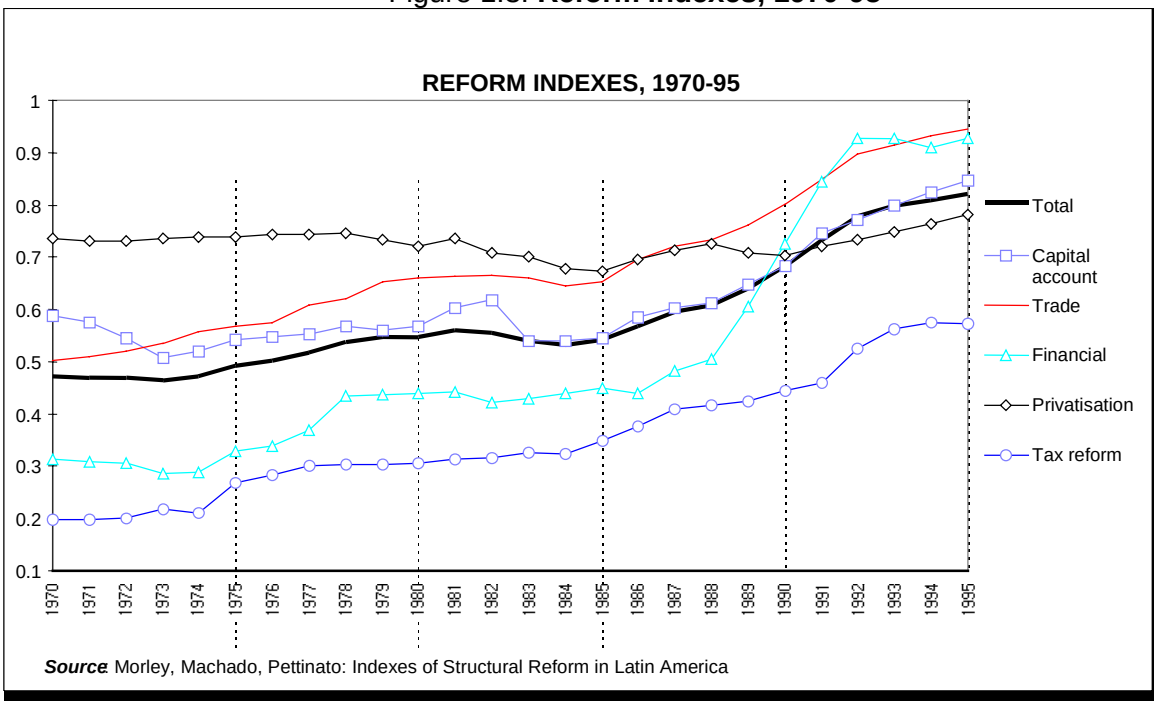
and on how much the government does to boost the spread effects of growth.

IV. EMPIRICAL EVIDENCE ON THE IMPACT OF GROWTH AND REFORM

The Impact of Structural Reform

Latin America has undergone massive structural reform in recent years. It began in the Southern Cone in the 1970s and spread through the rest of the region after 1985 (see Figure 1.3), usually as part of structural adjustment packages. The broad thrust of it has been to increase the role of the market in determining the allocation of resources. Trade reforms removed tariff protection from domestic production and financial reforms and privatisation reduced government influence over allocation of resources. Balance of payments reforms integrated foreign and domestic capital markets and reduced the government's ability to control capital movements. Labour market reform increased flexibility, in effect reducing labour's ability to defend itself against either market-driven demand fluctuations or wage reductions. Because globalisation — increasing the role of world market forces — was done fairly simultaneously with domestic reforms, it makes no sense to analyse them separately, so we shall refer to reforms taken together[12].

Figure 1.3. **Reform Indexes, 1970-95**



Source: Morley, Machado, Pettinato: Indexes of Structural Reform in Latin America

How have these changes affected equity? A key feature of neo-liberal reforms in Latin America has been reduced tariffs and greater reliance on exports. Standard trade theory says this should help unskilled labour because it is fairly abundant in the region. But as we have seen, wage differentials are growing in favour of skilled labour despite increasing supply. An increase in wage inequality does not necessarily mean an increase in total income inequality, but these results suggest caution be taken in accepting that trade reduces inequality in countries with a large supply of unskilled labour.

Understanding the impact of trade reform requires disentangling the effects of two different mechanisms. The first, on which the standard trade story is based, relies on the idea that commercial reform switches the production of tradeables away from (non-competitive) import substitutes to exportables in which countries have a comparative advantage. The connection to the distribution of income comes from the shift in factor demands due to the different relative factor intensity of these two types of products.

The second mechanism is the demand-side. The old import-substitution, inward-looking development strategy depended largely on a growing internal market, essentially a Keynesian strategy that domestic demand could grow faster than external demand. This relied on a growing middle class with increasing purchasing power based on rising real wages. The export-led growth strategy is completely different. Here, the internal market is irrelevant and the strategy relies on a rapidly-growing world market to drive demand, possibly supplemented by increased market share through efficiency gains. Rising real wages are a clear threat to growth in the export model because its success depends on controlling costs. They do not have the positive indirect effect through demand as in the inward-looking growth strategy. Countries adopting the outward-looking growth path are making their wage levels hostage to labour costs and wage levels in other countries.

Which strategy is appropriate depends on country size, growth and competition in the world economy, as well as the institutional requirements of the two models. The advantages of greater efficiency in export production over import-substitutes may outweigh the disadvantages of this wage competition so that workers are better off. But this is not immediately obvious, especially in the large economies.

What is the effect of liberalising the capital account? This integrates the local and international capital markets more closely, bringing local interest and profit rates, adjusted for risk, closer to rates in the rest of the world. Whether or not this is progressive depends on the reactions of foreign and domestic owners of capital and the effect of capital mobility on the bargaining power of capital. If foreign investors have been put off a country because of restrictions on capital flows and profit repatriation, reforms should induce a foreign capital inflow. The distributional effect is ambiguous. Wage/profit ratios should rise because of the rise in the capital/labour ratio. That is progressive. But if capital and skilled labour are complementary, the skill differential will rise, which is regressive. A similar ambiguity results from the actions of domestic owners of capital. Capital account liberalisation has usually included lifting restrictions on capital outflows by domestic savers and investors. If there was excessive demand for foreign exchange under capital controls, then reforms should cause a capital outflow, with results just the reverse of those for foreign capital inflows.

Removing barriers to capital movements seems to increase the bargaining power of capital in its negotiations with both labour and the government as capital becomes more mobile. If foreign investors are free to move from one country to another, governments will find it far more difficult to tax capital or force businesses to shoulder more of the cost of infrastructure or labour regulation and will be obliged to compete in costly ways to attract foreign capital — the so-called “race to the bottom”. The same argument goes for domestic capital. If this is correct, both government and labour will be forced to accept arrangements sufficiently generous to make domestic entrepreneurs and holders of wealth content to leave their money invested in their home country. This is one reason there has been a shift away from taxation of corporate profits and a big reduction in the top income tax rate in most Latin American countries in recent years. Both effects are likely to be regressive.

On the domestic side, the principal components of reform were financial, tax and privatisation. Financial reforms eliminated controls on interest rates, cut compulsory reserve requirements of banks and reduced the use of directed or subsidised credit. The direct effect on inequality has probably been small, but because these reforms increased private saving and investment, they were probably progressive.

Tax reform has usually comprised introduction of a value added tax (VAT) and cuts in marginal tax rates. During the 1970s and 1980s, the VAT was introduced in all 17 countries for which we have data. Reformers favoured VATs because they believed they distorted private decisions less than did tariffs or high marginal income tax rates. Enforcement is also easier than with an income tax based system. Every country in the region has reduced its top income tax rate since 1970 and average rates on personal and corporate income fell from around 50 per cent to 25 and 37 per cent to 29, respectively, between 1970 and 1995[13].

These changes shifted the tax burden away from the wealthy and towards the middle and lower classes. The introduction and later expansion of the VAT was a move away from taxation of income towards taxation of consumption, which hurts poor people more since they consume more of their income than the rich. Reductions in the top income tax rate increased the trend towards greater regressivity. The effect of all these changes is almost certainly regressive.

The impact of privatisation — a key component of most market-oriented reforms — on the distribution depended on the sale price, price of services and labour demand. If the assets of state-owned enterprises (SOEs) were sold for less than their true market value, there was a transfer from taxpayers to buyers, with buyers in effect receiving a gift from taxpayers. Many public utilities such as electricity, telephone and water companies subsidised their customers by setting prices below cost. The distributional impact depended on what happened to the price of these services to the public after privatisation. Privatising utilities normally included eliminating the subsidy, which could be either progressive or regressive, depending on who the customers were. A recent study of gasoline and electricity pricing in Venezuela and Peru concluded that these subsidies mainly benefited the middle class because they were wealthy enough to own electrical appliances and cars. (Hausmann and Rigobon, 1993).

Privatisation also affects labour demand and employment. Labour productivity in the typical SOE was low. For political reasons, many governments seemed more interested in using these enterprises to create high wage jobs than provide good service at the lowest possible cost. Argentina is perhaps the most extreme example of this. In the 1980s, aggregate output fell by 16 per cent, yet employment grew by 21 per cent. That was because the government hired surplus workers and paid them good salaries (funded by budget deficits) that averaged over 10 per cent of GDP between 1980 and 1990. This situation could not last. When the SOEs were privatised as part of the Menem reforms, there was a wave of layoffs and a dramatic increase in unemployment[14]. Government jobs were reduced by an estimated 11 per cent of total formal employment between 1990 and 1995. For Peru, the figure was 7 per cent (see Lora and Olivera, 1998). The distributional impact of this structural change depends on who the displaced employees were and what alternative jobs they found. Judging by the labour force of the typical SOE, these jobs mostly came from the middle of the earnings distribution. So privatisation probably hurt mainly the urban middle class, because they were the main users of subsidised SOE services and also the main employees of state-owned firms.

Empirical Literature on Reforms and Income Distribution

Separating the impact of the reforms on the distribution of income from all the other factors which affect it, and which have been changing as the reforms have been implemented, is extremely difficult. Simple comparisons of Ginis before and after is clearly inadequate and researchers have used econometric estimation and counterfactual exercises, which both conclude that the structural reforms have been regressive but with fairly small effect and not particularly robust or significant.

Trade reform is the area that has been most widely studied. Wood (1994) argues that the experience of East Asia in the 1960s and 1970s supports the theory that greater openness to trade tends to narrow the wage gap between skilled and unskilled workers in developing countries. But in Latin America, since the mid-1980s, increased openness has widened wage differentials. Wood (1997) thinks this is probably not because of differences between East Asia and Latin America but the result of differences in the world economic environment, such as the entry of China into the world market and perhaps the advent of new technology biased against unskilled workers.

Spilimbergo, Londoño and Székely (1997) point out that what really matters is each country's factor endowments, including land, relative to the average world effective supply of each factor. They estimate econometrically the effects of openness on inequality for a panel of countries and find trade openness is associated with higher inequality, holding endowments constant. But the size of the effect depends on the relative abundance of each factor. Inequality is higher in countries fairly well endowed with skills and lower in countries well endowed with physical capital and land. In their sample, factor endowments in Latin America are quite close to world averages. The continent does not have a high level of unskilled labour[15]. If true, that would explain why openness has not reduced the wage differential.

Behrman, Birdsall and Székely (2000) collected data on wage differentials across 18 Latin American countries for the period 1980-98. They ran panel cross-section regressions using indexes of the structural reforms as explanatory variables. They found the overall average reform index had a regressive and significant effect on wage differentials (though there is some indication this effect fades with time) and that all the regressive impact of reform came from three areas — capital account liberalisation, financial market reform and tax reform. Curiously, trade reform had no significant effect on the skill differential and privatisation tended to narrow differentials. The study was concerned with wage differentials, not the distribution of earnings or per capita income. The three may or may not move in the same direction because of structural changes in the labour supply or because of the effect of reforms on employment and transfers.

Ganuza, Paes de Barros and Vos (2000) summarised a recent set of case studies of 17 Latin American countries on the impact of trade and capital account liberalisation. These compared the observed household distribution in a recent post-reform year with what it would have been had there been no reform, using a counterfactual approach[16]. They studied 31 reform periods in 17 countries. In 15 cases inequality went up with the reforms, in 15 cases it went down and in one case it stayed the same. Most of the simulated changes in distribution in either direction were small. In 17 out of 31 cases, the change in the Gini coefficient was less than 3 per cent and in 11 it was less than 1 per cent. What changed was the wage or skill differential. That explained almost all of whatever change in distribution there was but its impact was muted by changes in occupational or education structure.

Morley (2000) tried in a recent study to relate the reforms directly to the distribution of household income by estimating an econometric model in which both the reforms and other variables were introduced as explanatory variables. He used a large panel cross-section of 261 observations in 16 countries over the period 1960-97. The sample uses observations over a long period to capture the effect of growth and adoption of the reforms. It also includes many other variables such as education structure that are thought to have a significant impact on the distribution[17]. He drew three main conclusions from the study.

There appears to be a robust and significant relationship between growth and the distribution of income. It is not linear, but an inverted U shape. This means that with other things equal, growth in low-income countries is very likely to increase inequality until they reach the income level of Colombia or Costa Rica. Only seven or eight countries in the region have high enough income for growth to drive down inequality.

Growth seems systematically less equitable than it used to be. In countries where growth is equalising, it is now less so than before and in countries where growth increases inequality, it now does so more than it used to. This appears due to the increasingly skill-intensive nature of growth in the region. Growth has widened wage differentials and boosted the rate of return to education, particularly at high school and university level.

In aggregate, the economic reforms seem to have had a regressive effect on the distribution but it is small, absolutely and relatively, compared to other factors such as growth, inflation and changes in education structure. This is because reforms in different

areas have offsetting effects on equity. Trade reform is regressive in all the specifications, but insignificant in all but the national sample. Tax reform is unambiguously regressive and opening up the capital account is unambiguously progressive.

Inertia in the Distribution

The observed distribution of income is subject to a large number of influences, many of which change quite slowly over time and have offsetting effects on the distribution. Morley (2000) concludes that when all these changes are considered together, they imply a significant inertia or stability in the level of inequality, in the absence of severe macroeconomic shocks such as the debt crisis or the hyper-inflations of the 1980s, or interventions in labour markets of the kind observed under the military dictatorships in Argentina, Brazil, Chile and Uruguay in the 1970s.

We know growth is more skill-intensive now than it used to be and has tended to raise wage differentials in most cases. That is regressive. But new people are entering the labour force and expanding the better-educated segments. That should be progressive. Morley (2000) showed in various simulations that these progressive and regressive effects seem to just about offset each other, which is one reason the overall distributions have not changed much despite substantial growth and rising wage differentials[18].

V. THE PROBLEM OF FINDING SUSTAINABLE AND RAPID GROWTH

Despite all the attention to the relationship between growth and the distribution of income, recent history in Latin America suggests the more serious question now is the growth rate itself. In most countries, growth in the 1990s was disappointing and much lower than the averages achieved in the decades before the debt crisis (1950-80) and structural reform. (See Table 1).

Table 1. **Growth and Recession in the 1990s**

	Growth Rates in GDP Per Capita			
	1950-80	1991-99	1995-99	Years of Recession 1995-99
Argentina	1.572	3.300	0.827	2
Bolivia	1.431	1.400	1.338	1
Brazil	4.016	1.000	0.734	2
Chile	2.056	4.400	3.222	1
Colombia	2.402	0.500	-0.845	2
Costa Rica	3.142	1.200	1.175	2
Ecuador	4.083	-0.200	-1.647	2
El Salvador	2.843	2.300	1.201	1
Guatemala	1.842	1.500	1.438	0
Honduras	1.375	0.200	-0.126	1
Mexico	3.388	1.300	0.895	1
Paraguay	2.637	-0.600	-1.300	4
Peru	1.864	2.900	2.576	1
Rep. Dom.	2.652	3.100	4.294	0
Uruguay	0.865	2.400	1.414	2
Venezuela	2.373	-0.300	-1.411	3
Jamaica	2.329	-0.500	-1.589	4
Trinidad and Tobago	6.774	2.300	2.781	0
Panama	2.738	2.800	1.468	0
Average L. America	2.652	1.526	0.866	0.3053
Average C. America	3.009	1.420	1.154	0.2000
Average S. America	2.330	1.644	0.545	0.4000

Source: For 1950-80, IMF and CEPAL, for 1990-98, CEPAL.

Before the Tequila Crisis in 1995, things seemed to be going well. Growth rates were much higher than in the 1980s and in some countries even higher than in the long period between World War II and the debt crisis. Things were expected to get even better in the following years since in many countries the reforms had only recently been adopted[19].

The optimistic expectations of the early 1990s have not been realised (see Table 1). Instead of accelerating, growth has declined, especially in South America[20]. Overall average per capita income growth between 1990 and 1995 was 2.9 per cent per year[21]. That fell to 0.8 per cent per year between 1995 and 1999. Only two countries (Trinidad-Tobago and the Dominican Republic) did better in the last five years than they did in the previous four and both of them are in the Caribbean.

The problem does not seem to be a decline in capital formation, except in the three oil exporters (Ecuador, Trinidad-Tobago and Venezuela), where investment and growth have fallen sharply. Of the remaining 16 countries, all but three increased their investment rate and for the region as a whole, gross investment as a percentage of GDP was slightly higher in the 1990s than in the base period. But investment is not as good at producing growth as it used to be.

What Explains the Downturn in Growth after 1995?

It is too early to tell whether the brake in growth is temporary or permanent, but there seems little doubt an exports slowdown is a big part of the problem. The export-promotion model is not working very well. Probably the biggest single change in the growth strategy in Latin America has been the shift in development strategy from import substitution to export promotion. Reforms increased the role of market forces in allocation of resources and aligned domestic relative prices with world prices. This was expected to lead to greater efficiency, competitiveness and thus greater exports, though how dramatic reductions in tariff rates and other forms of protection could increase exports is not clear.

This strategy at first seemed partly successful. Most countries' exports were the biggest source of demand growth in the first half of the 1990s, adding more than 100 per cent to the net increase of GDP in eight countries and more than 50 per cent in another six. Brazil and Honduras were significant exceptions. But critics of trade liberalisation have charged that export growth was accompanied by an aggregate rise in imports which more than offset the expansionary effect of increased exports. There seems to be some truth in this, but only for Argentina and Brazil, where highly-protected domestic manufacturing was penalised both by trade liberalisation and currency appreciation. For them, as well as Paraguay and Uruguay, the external sector was a drain on domestic production. In 11 of the remaining 13 countries this was not so. There, export growth exceeded, sometimes by a wide margin, the negative effect of rising imports.

Since 1995, there has been a serious widespread decline in exports affecting almost every country in the region except Mexico, Costa Rica and the Dominican Republic[22] (See Table 2). This has forced most economies onto a slower growth path so as to reduce the volume of imports and conserve foreign exchange. Every country in Latin America saw a reduction in exports with the exception of Colombia, where they were roughly constant. Every country in Central America increased its exports.

Table 2. **Exports and Imports 1997-99**

	total exports		total imports	
	1997	1999	1997	1999
Latin America	326862	339850	356862	359550
Costa Rica	5478	8150	5690	7540
D. Republic	7061	8110	7780	9580
Mexico	121831	148300	122424	154620
sub total	134370	164560	135894	171740
Rest of L. America	192492	175290	220968	187810
C Amer+Caribbean north of Panama	142798	173575	147282	185335
South America	184064	166275	209580	174215

Source: Balance Preliminar de las economies de America Latina y el Caribe, CEPAL (1999). In millions of current dollars.

Source: CEPAL, 1999

Most of the performance differences between Central and South America have to do with conditions in their export markets. South American exports go mainly to Asia and Europe while Central America's and the Caribbean's go to the United States. Japan and (until recently) Europe have had a period of slow growth and the United States has been in an extended boom. These trends outside the region have been strengthened by slow growth in Brazil, a major export market for Argentina, Uruguay and Paraguay. But another factor is that Latin America is losing market share. Between 1995 and 1998, its exports to industrialised countries grew by only 1.5 per cent a year.

Export promotion as a growth strategy is not working very well in South America because exports have mostly not provided the dynamic growth needed to produce very rapid income growth. South America's experience over the last few years has shown that the export-led growth model can easily become an export-led decline when external markets significantly contract. That may be partly a short run problem of cyclic downturns in raw material markets and slow growth in total demand for the sort of products Latin American countries sell. But the loss of market share indicates something else going on. Latin America could be specialising in the wrong products or the wrong countries, where the overall growth in demand is low. Or perhaps exporters have failed to modernise and cut costs to compete better against other developing countries. Whatever the cause, no export-led growth strategy will work if it cannot produce an export growth rate higher than 2-3 per cent per year.

VI. CONCLUSIONS AND POLICY IMPLICATIONS

The most recent evidence on inequality in 18 Latin American countries shows that in all but four, changes in inequality over the 1990s were insignificant. The distribution depends on the ownership and rate of return on assets, particularly human capital. In the short run, changes in these two variables tend to be offsetting — growth widens skill-differentials which is regressive, but advances in education are progressive. The two effects roughly cancel each other out in the absence of severe macroeconomic shocks or revolutionary changes in the rules of the game. Recent papers on the impact of structural reforms on inequality show that reforms associated with globalisation have had a negative but small regressive impact on inequality mainly because many individual reforms had offsetting effects. Trade and tax reform have been unambiguously regressive but opening up the capital account is progressive. There seems to have been a significant slowdown in growth, especially in South America, since 1995 because of poor export performance.

The reappearance of the growth problem and insensitivity of the distribution to feasible policies means the main problem facing the region is not how to improve the distribution but how to increase the growth rate. Unfortunately, the recent experience of Latin America suggests that achieving an adequate and sustainable growth rate will not be as easy as it might have been in the past. Globalisation offers many advantages but also raises many difficult challenges to economic management.

The most important single policy a government can adopt is a growth strategy that produces the highest and most stable growth rate possible. It must not rely excessively on borrowing since that will affect future growth. Nor must it trigger a significant increase in inflation. High but unstable growth rates do as much harm as good, and high growth rates that lead to outbreaks of inflation are sure to have a regressive effect. Stable, rapid growth is a necessary, though not sufficient condition for reducing poverty and unemployment and increasing wages for the least qualified.

A complementary goal is to make the growth strategy one where the economy will absorb as much unskilled labour as possible without undue sacrifice in the overall growth rate. The basic distribution problem facing Latin America is reducing the supply of unskilled labour and increasing the demand for it. A growth strategy that creates a lot of jobs for unskilled labour takes care of the demand side of that problem. Investment in education will help with the supply part.

Construction and agriculture are especially big users of unskilled labour and should play an important part in the equitable growth strategy, which should also favour traded goods production, because these too use a lot of unskilled labour.

Another part of an equity-increasing growth strategy is support for backward regions. Growth is almost always sparked by something that happens in a sector or region. The more heterogeneous and separated the parts of an economy or country are, the less of a multiplier the initial impetus will have in other sectors or regions. Government should try to increase the spread or linkage effects of growth, for example by improving transport and communications in backward regions and making a special effort to upgrade worker training and education there.

A very big part of Latin America's distribution problem comes from the large stock of unskilled labour relative to the demand for the services that labour can provide. Many years of high population growth and inadequate education have saddled the region with too much unskilled labour. Until that backlog is eliminated, wage differentials are unlikely to narrow and not much progress will be made on equity. Latin America is hostage to past policy failures that will take a long time to correct. Labour-intensive growth strategy will help. But more important in the long run is education strategy, whose goal should be that all those entering the labour market have at least high school education. Over a few years that will significantly lower the growth rate of unskilled labour and raise it for skilled labour. Then skill differentials will begin to narrow and equity will improve. Countries like Chile, Costa Rica and Uruguay that have made big investments in education have been able to grow and reduce poverty quite rapidly without an increase in inequality.

Education should also be an important part of equity-increasing growth strategy because raising the education level of the young reduces a colossal waste of human potential. How many would-be entrepreneurs or scientists are working in agriculture or the informal sector just because they never got enough education to unlock that potential? Human capital is increasingly the key to growth, making education as important as investment in machinery. Expanding it is likely to raise the potential growth rate.

Universalising education also makes sense because, rich or poor, parents are concerned about their children's future. If the poor see that the state provides a good high school education, they are more likely to accept an unequal distribution of their own income. They will see that inter-generational inequality is falling, even if the statistics do not show it. Inter-generational mobility matters and education is the key to increasing it.

Significant progress has been made in recent years in poverty reduction and expansion of education coverage for young people, but the distribution indexes do not reflect that. It is important to understand why this can happen and how it follows from the definitions of inequality that underlie the indexes we use. Latin America needs to keep going down the road of faster, more labour-intensive growth and broadening the coverage of high school education. That may not be immediately be reflected in lower Gini coefficients, but it will lower poverty levels and raise real wages for the unskilled. Eventually it will also bear fruit in declining inequality indexes.

ANNEX

	Changes in the Distribution of Household Income per Capita in the 1990s										Sources
	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	
Argentina		0.42		0.41		0.439				0.439	ECLAC
Bolivia								0.5877	0.589		S&H
Brazil		0.61			0.6				0.59		Neri
Brazil	0.607	0.611		0.594	0.617		0.614				L&S
Chile		0.556		0.553		0.545		0.553			Larranaga
Colombia			0.5315	0.5315	0.5231	0.5291	0.5337				Ocampo
Colombia			0.567		0.6038		0.5697		0.5758	0.5679	S&H
Costa Rica	0.4595		0.4598		0.455		0.4571		0.4589		S&H
Dom Rep				0.482						0.456	Aristy
Ecuador							0.56			0.5601	S&H
El Salvador				0.531	0.523	0.53	0.5				Mejia-Vos
El Salvador							0.505		0.5195	0.5589	S&H
Guatemala										0.5569	S&H (#409)
Honduras	0.5704			0.5489				0.5284		0.5876	S&H
Jamaica	0.436				0.382			0.369			King & Handa
Nicaragua					0.567					0.6024	S&H
Mexico	0.5309			0.5341		0.5361		0.5276			S&H
Panama			0.5625				0.5602		0.5755		S&H
Paraguay							0.6203			0.5692	S&H
Peru			0.4643			0.4832			0.5055		S&H
Peru			0.467			0.458		0.435			Saavedra&Dias
Uruguay	0.4064			0.4319			0.4209		0.43		S&H
Venezuela	0.461	0.459		0.446		0.498	0.471				L&S
Venezuela							0.4703		0.4963		S&H

Note: All the series are national household income per capita with the exception of Jamaica which is household expenditure per capita, and Argentina and Uruguay which are urban distributions, not national. Note that in Peru, the Saavedra &* Dias distribution uses the same areas for 1994 and 1996 that were surveyed in 1991. This may explain the differences with the S&H estimates. The source abbreviations are S&H-Szekely and Hilgert 1999a, L&S-Londono & Szekely, ECLAC is the Panorama CEPAL. The remaining author sourcs can be found in the bibliographic references.

NOTES

1. Except for Argentina and Uruguay all the data is national, and except for Jamaica all measure the distribution of family income per capita. A table with comparable estimates by year for each country can be found in the Annex.

2. One of these is Jamaica, where the survey is based on expenditures and the country was in recession. A second case is Uruguay for which there is a major difference between two sources (Székely and Hilgert, 1999*a*, and CEPAL, 1999) on whether inequality rose, fell or stayed constant.

3. The first group includes Brazil, Chile, Colombia, Ecuador, Nicaragua, Mexico and Panama; the second is Argentina and Venezuela, and the third includes the Dominican Republic, Jamaica and Paraguay. Finally there are two countries — Bolivia and Ecuador — for which national data is only just becoming available. They are problems too because all had very high levels of inequality at the end of the decade.

4. In every society there is a group of what could be called the hard-core poor who either cannot or will not work. They are not likely to get any increase in income when there is growth. In addition, with a distribution measure based on earned income, many of the aged are going to appear to be poor, even if they are consuming out of past savings.

5. The distribution most relevant for welfare comparisons is the distribution of income across families (or households). It combines the earnings distribution with transfers and various demographic trends affecting family size and composition.

6. The share of land ownership at the top and bottom of the distribution illustrate this even more graphically. The FAO estimated that around 1970 the biggest 7 per cent of land holdings in the region (those above 100 hectares) owned 77 per cent of the land. At the other extreme, the smallest 60 per cent had only 4 per cent. For Asia, holdings over 100 hectares were 1.6 per cent of all land, while 96 per cent of farms had less than 10 hectares and that comprised 68 per cent of the total area. (Cardoso and Helwege, 1992, App. D)

7. Mexico, Bolivia, Cuba and Nicaragua are the most extreme examples, but there were also reforms in Peru, Ecuador, Venezuela, Panama, Costa Rica, Chile, Colombia, El Salvador and the Dominican Republic. (Cardoso and Helwege, p. 261)

8. A reform will not be effective in redistributing land unless small farms have a productivity advantage that raises the reservation price above what a large landowner is willing to pay. See Carter and Coles (1998).

9. Growth of the labour force increased from 1.9 per cent in the 1950s to 2.3 per cent in the 1960s, 3.8 per cent in the 1970s and then fell to 2.9 per cent in the 1980s (Weller, 1998, p. 12). School age population (0-14) peaked as a share of the total population around 1970. (Duryea and Székely, 1998, Fig. 1).

10. For a fuller report on decomposition of changes in earnings inequality for a nine-country sample, see Morley (2000), chapter 7. The countries are Argentina, Brazil, Bolivia, Chile, Colombia, Costa Rica Jamaica, Mexico and Peru.

11. If linkages and relative homogeneity are important, one would expect urban income distributions to have less inequality than national distributions. The relationship between changes in income and changes in the distribution would also be different in the urban sector. In fact, both are true in Latin America. In a big cross-section study (Morley, 2000), urban Ginis were found to be systematically 3-5 points lower than the national Ginis. These differences are very significant and show growth tends to benefit urban people more.

12. Also, when done together they often have a synergistic effect, boosting the role of market forces much more than individual reforms would.

13. See Morley *et al.* (1999) for more details on changes in tax rates and other reform variables.

14. See Marquez and Morley (1997) and Altimir and Beccaria (1999) for more details on the employment problem in Argentina.

15. This is consistent with Wood's emphasis on the entry of China and other large Asian countries into the world trading system. So the effect of openness on inequality is modest — a rise of 10 per cent in their openness index only raises the average Gini coefficient by 0.63 of a point.

16. The counterfactual approach mimics the labour market structure and relative wages of a pre-reform year by a probabilistic reassignment of the observed labour force across sectors, occupations, employment status and wage groups so the structure of the post-reform year is identical to that of the pre-reform year.

17. A fuller description of the study and results can be found in Morley (2000*a*).

18. Paradoxically, improving the education structure of the labour force could in the short run make the distribution worse rather than better. Morley (2000) showed that in the case of Brazil, countries with a very small fraction of high school or university graduates in their labour force will find inequality goes up when they raise that fraction unless they can significantly lower the skill-differential at the same time. Reducing the proportion of poorly-educated workers helps offset this perverse effect but does not eliminate it altogether.

19. See Burki and Perry (1997) and Fernando Arias and Monteil (1997).

20. This deceleration of growth is particularly pronounced in South, as opposed to Central America. Over the entire decade (1991-99), annual growth in South America was 1.6 per cent and in Central America 1.4 per cent. But in the last five years, growth in South America has fallen to 0.5 per cent a year and in Central America and the Caribbean to 1.2 per cent. 1995-99 was for South America a period of recurrent recession (Argentina and Peru) or protracted recession (Brazil, Colombia, Paraguay, Ecuador and Venezuela, along with Jamaica). If a recession year is defined as one when per capita income declines, the South American countries were in recession 40 per cent of the time between 1995 and 1999. In Central America, the figure was 20 per cent or, excluding Jamaica, only 12 per cent of the time.

21. For the years 1991-94.

22. The good performance in Mexico, Costa Rica and the Dominican Republic hides the bad performance of the export sector elsewhere. Exports rose 22 per cent between 1997 and 1999 in those three economies but fell by 9 per cent in the rest of the region. That permitted a 26 per cent rise in imports for the three and forced a 16 per cent decline elsewhere (see Table 2).

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