This report is presented as received by IDRC from project recipient(s). It has not been subjected to peer review or other review processes.

This work is used with the permission of University of Toronto, Centre for International Studies.

© 1996, University of Toronto, Centre for International Studies.

FOCAL/CIS DISCUSSION PAPERS

FC1996-5

THE MACROECONOMIC CONTEXT FOR POLICIES, PROJECTS AND PROGRAMMES TO PROMOTE SOCIAL DEVELOPMENT AND COMBAT POVERTY IN LATIN AMERICA AND THE CARIBBEAN

by

Albert Berry

Centre for International Studies
170 Bloor Street West
Suite 500
Toronto, Ontario
M5S 1T9
(416) 978-3350

Not to be reprinted without the permission of the author.
Copyright 1996

1 This paper was prepared for the UNDP as part of the project "Poverty Alleviation and Social Development" (RLA/92/009). The opinions expressed in this document do not necessarily reflect the official position of the UNDP. A Spanish version of this paper is available from CORDES, Suecia 277 esq. Avenida de Los Shyris, Quito, Ecuador.

2 Department of Economics, University of Toronto, 150 St. George Street, Toronto, Ontario M5S 1A1.
# TABLE OF CONTENTS

I. INTRODUCTION ................................................................. 1

II. THE ECONOMY OF LATIN AMERICA SINCE 1970: PERFORMANCE, CRISIS AND POLICY CHANGE ................................................. 2
   A. The 1980s crisis ......................................................... 5
   B. In pursuit adjustment .................................................... 11
   C. The recovery phase ...................................................... 12

III. GROWTH, DISTRIBUTION AND POVERTY EFFECTS OF THE MARKET-FRIENDLY ECONOMIC REFORMS ........................................... 14
   A. Growth impacts: lessons from the empirical record ............. 15
   B. The employment and distribution impacts of the reforms ....... 19
   C. Distribution impacts: the empirical record ......................... 21
   D. The new fiscal constraints on social policy ......................... 28

IV. LESSONS AND IMPLICATIONS FOR POVERTY ALLEVIATION ............. 31
   A. The growth implications of the reforms are unclear at this time .... 31
   B. Distribution has worsened significantly, if not dramatically, in most countries undertaking market-friendly economic reforms ........... 32
   C. The possibility that the market-friendly economic reforms have caused the accentuation of inequality warrants serious concern ....... 32
   D. Neither theory nor the record has provided much evidence on how lasting the negative distributional shifts will turn out to be .............. 34
   E. It is urgent to achieve better combinations of growth and distribution than those of the last two decades ....................... 34
   F. Some recent trends in labour force structure may have major consequences on welfare ................................................. 35

V. CURRENT CHALLENGES AND CONCERNS FOR ANTI-POVERTY POLICY ... 35
   A. Education and training .................................................. 36
   B. Technological change .................................................... 36
   C. Small and medium enterprise (SME) .................................. 38
   D. Labour market institutions and policies .............................. 38
   E. The need to build capacity for planning and monitoring in key areas, including SME and human capital policy .................. 42

VI. SUMMARY AND CONCLUSIONS .................................................. 43

BIBLIOGRAPHY ........................................................................... 47
THE MACROECONOMIC CONTEXT FOR POLICIES, PROJECTS AND PROGRAMMES TO PROMOTE SOCIAL DEVELOPMENT AND COMBAT POVERTY IN LATIN AMERICA AND THE CARIBBEAN
by
Albert Berry

I. INTRODUCTION

The macroeconomic context must be taken into account in the design and implementation of poverty policies for several reasons. To begin with, poverty alleviation is one outcome of healthy growth, so the rate and pattern of growth are a major determinant of the size of the poverty challenge and the task left to be carried out by direct anti-poverty programmes. Up to a point, therefore, healthy growth and direct anti-poverty programmes are substitutes for each other. Second, however, the macro context and performance also determine where direct anti-poverty efforts need to be focused; even healthy growth creates strains and hurts some people at least in the short run, so policy should respond to such threats. Finally, there are certain dimensions of poverty in most Latin American countries which will not in the foreseeable future be resolved by economic growth, so these problems must be approached in a different and more direct way.

Though economic growth is in most cases essential to long-run poverty alleviation, the increase in productive, stable and increasingly well remunerated employment—the direct source of most poverty alleviation, may or may not be closely correlated with growth. When labour displacing technological change is an important source of economic growth, the expansion of productive employment may be significantly less than that of output. Links between growth and poverty reduction may occur primarily either through creation of productive employment or through wage increases at the lower end of the earnings spectrum. In "labour surplus" economies whose large populations tend to "flood" the labour market, the benefits of growth will mainly take the form of increased employment but may have little impact on the basic wage rate; after this "surplus labour" condition has disappeared (i.e. when the labour market tightens up) growth will pull the basic wage up while simultaneously expanding the level of employment.

In this review and analysis of Latin America's post-1970 economic performance, we

---

1 Albert Berry is Professor of Economics at the University of Toronto, Toronto, Canada.

2 The growth vs. equity debate which peaked a couple of decades ago involved inter alia the idea that new (modern) technologies were more efficient than traditional ones and that, since they were characterized by either capital intensity or skill-intensity or both, their use would imply a relatively concentrated distribution of income at least at the outset. This growth-equity "tradeoff" issue was discussed widely before much evidence from the contemporary experience of the developing world came in. In the event, no such pessimistic conclusion could be drawn, since (i) smaller, more labour intensive units were often as or more efficient that their larger, more capital intensive counterparts and (ii) several of the very fastest growing countries, most notably Taiwan, were also characterized by high levels of equity.

3 The labour surplus "model" was put forward by Lewis (1955) and further developed by Fei and Ranis (1964).
focus extensively on the distribution of income\textsuperscript{4} and the rate of growth, since these two variables essentially determine the effects of economic performance on the rate of poverty alleviation, when poverty is defined by income level.\textsuperscript{5} A highly unequal distribution of income means that the number of jobs paying somewhere close to the average income in the economy is low relative to the size of the labour force. Other indicators, like the rate of open unemployment, the level of underemployment, and job stability are also relevant to social welfare, as are the various direct and indirect poverty redressal programmes.

The paper first reviews the evolution of the economies of the region since 1970--from growth to crisis to adjustment and, in some cases, to hopefully stable growth again. It then summarizes the evidence on income distribution trends and the factors behind them, including the market reforms put in place since 1975 in nearly all the countries of the region. Finally, it attempts to identify the policy areas and instruments which are most important in terms of their potential impact on poverty alleviation at this time.

II. THE ECONOMY OF LATIN AMERICA SINCE 1970: PERFORMANCE, CRISIS AND POLICY CHANGE

The Latin American style or "model" of development has involved a set of special characteristics which distinguish the region, in varying degree both from the "average" LDC and from the historical experience of North America, Japan and most of the countries of Europe. It is useful to have these in mind when considering policy options to relieve poverty.

1. The distribution of land as the process of structural change began was atypically unequal. That original inequality of land led to extreme income inequality both because it implied that the land/capital income was concentrated in a few families rather than distributed widely, but also because it limited the demand for labour and hence the level of productive employment. The initial inequality with roots in the distribution of land was then passed on from one stage of development to the next.

2. As growth shifted the fulcrum of the Latin American and the Caribbean (LAC) economies toward urban and non-agricultural activities, the creation of adequate employment opportunities came to depend less on how agriculture functioned and more on the non-agricultural sector. Though the modern or formal sector did create increasing levels of

\textsuperscript{4} It is useful to distinguish between "primary income"--that income received by persons or families as a result of their participation in economic activity, whether as workers getting a wage, land owners getting rent or capital holders getting profits, and "secondary income", which takes the form of transfers (gifts, pensions, etc) from other people or the state. The figures used in most of the discussion are something of a mix between the two, but mainly reflect primary income.

\textsuperscript{5} Poverty can be measured in a variety of ways. The main alternative to the use of a measure of income (or consumption) involves focusing on the extent to which basic needs have been met.
productive employment over time, the path of development during the growth phase (prior to the crisis of the 1980s) was less labour intensive than in the economies of Southeast Asia and less labour intensive than it could have been.

3. Over time the urban informal sector became substantial, though its size may not be out of line with the level of development of these economies. The claim that overurbanization was related to an undue expansion of this sector has frequently been made but is difficult to demonstrate, beyond the obvious point that with more labour-intensive agrarian systems the rural areas would have retained more workers; given the absence of such systems the distribution of labour between rural and urban areas may have been reasonably efficient.

4. Through a combination of lack of fiscal conservatism, high inflation and overvaluation, LAC countries frequently discouraged exports, encouraged overuse of imported inputs and suffered from stop-go cycles associated with periodic balance of payments crises. Still, most countries of the region have evolved away from their previously high dependence on primary exports to a greater focus on manufactures and some degree of service exports. On balance these exports have been less labour intensive than in the East Asian experience. In most countries policy biases worked against labour intensive goods like garments, leather products, furniture, etc.

The post-1970 economic evolution of Latin America breaks naturally into three phases, both for the region as a whole and, with some differences in dates, for most of the individual countries as well. The period of growth under the import substituting industrialization (ISI) strategy, which in some cases evolved substantially toward a "mixed" strategy of fostering exports as well as import substitutes, continued into or through the 1970s; it was followed by macroeconomic crisis, in most cases associated with the international debt crisis; and finally the post-crisis phase bringing a return of modest growth to the region as a whole.

Over the period 1950-80 GDP growth, averaging 5.5% per year, was "not significantly surpassed by any other group of countries, either developed or developing." (Teitel, 1992, 356). In none of these decades did average growth for the region fall significantly short of 5%. Some countries did especially well, Brazil and Mexico among them, while others performed poorly. That many of the smaller countries did less well than the two large ones suggests that the ISI strategy was better suited to the latter. In the 1970s, though growth continued to be strong (at nearly 6% per year), it relied more on foreign borrowing than previously. The oil shocks and associated changes in international capital markets during the 1970s led many LAC countries, through varying mechanisms, into levels of international debt which eventually proved their downfall. The ability to borrow allowed Brazil, among others, to continue to grow fast on the basis of balance of payments deficits. Oil exporters grew on the basis of the booms and

---

6 Peru was an exception in pursuing a more outward looking strategy into the 1960s, but was less successful in relation to the goals of growth and equity --see Hunt, 1971).
typically used their new-found credit access to borrow beyond their real needs. This heavy borrowing laid the groundwork for the debt crisis when real interest rates rose abruptly in the early 1980s and the industrial countries moved into recession. When the crisis came, the indebted countries lost much of their policy independence.

The growth decades saw considerable generation of productive employment, enough to raise the share of the labour force in the modern, relatively high labour-productivity sector, and to bring about a continuous decrease (for the region as a whole) in the share of the population living in conditions of poverty. For most countries of the region income distribution did not change markedly over this period; to the extent that there was some worsening (e.g. Brazil in the 1960s) it was not large enough to significantly offset the positive effects of growth. Over the period 1950-80 the region’s per capita income rose by about 3% per year. With the poverty line applied by Altimir (1982), poverty incidence was probably about 65% (of households) in 1950, about 38% in 1970 and around 25% by 1980. The decades leading up to 1980 clearly saw an important degree of "trickle down". Further, evidence from countries like Brazil (especially) and Colombia suggests that their labour markets may have been starting to tighten up when the crisis came. Had per capita income growth continued over the last two decades of the century at 3% per year, poverty incidence would probably have fallen to about 10-15%; with reasonably effective poverty redressal policies (targeted employment schemes, food schemes, etc.) of the sort which can more easily reach a large share of the poor when the incidence of poverty gets down to this relatively low level, it would have been realistic to think that no more than a few percent would have been critically poor. Thus the interruption of the pervious growth process was extremely costly in terms of the prolongation of avoidable poverty; the same is true of delays in returning the economies of the region to a solid growth path with a significant amount of "trickle down."

The evolution of earnings, employment, unemployment and poverty during the pre-crisis period depended both on the demand for labour—which was expanding with the generally satisfactory output growth—and on its supply. Latin America is in the midst of an important demographic transition towards the age structure of developed countries and the associated dependency rates. Population growth has decelerated decade by decade since the 1950s (Table 1). Urban population growth slowed to 3.1% per year over 1965-89 (Turnham, 1993, 136), while the rural population continued to grow at something over 1%; by now these rates will have slowed further. Growth of the labour force has responded with the usual lag reflecting the changes in age structure associated with the deceleration of population growth, and has also been affected by changes in participation rates. The net impact of these two factors has been to keep

---

7 The (current price) investment ratio for the region climbed from 21-23% in the first half of the decade to 24-25% in the second half. Gross domestic savings also rose but less than investment, and the current account deficit rose from an average of 2.2% of GDP over 1970-74 to 3.5% over 1975-80 and then to 5.5% in 1981-82.

8 Labour force participation rates (PRs) have tended to fall in recent decades for younger cohorts, reflecting increasing attendance at educational institutions, and for older males, reflecting some combination of feasibility of earlier retirement and greater difficulty in retaining employment (partly due to the shift out of agriculture). For
the labour force growing a little faster than population, and to exert a considerable downward pressure on wages.

Table 1

Average annual rate of population growth, subperiods of 1970-91

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Latin America &amp; Caribbean</td>
<td>1.81</td>
<td>1.78</td>
<td>1.57</td>
<td>1.53</td>
</tr>
<tr>
<td>Argentina</td>
<td>1.67</td>
<td>1.48</td>
<td>1.31</td>
<td>1.22</td>
</tr>
<tr>
<td>Bolivia</td>
<td>2.59</td>
<td>2.61</td>
<td>2.51</td>
<td>2.45</td>
</tr>
<tr>
<td>Brazil</td>
<td>2.38</td>
<td>2.29</td>
<td>1.99</td>
<td>1.69</td>
</tr>
<tr>
<td>Chile</td>
<td>1.58</td>
<td>1.66</td>
<td>1.69</td>
<td>1.63</td>
</tr>
<tr>
<td>Colombia</td>
<td>2.16</td>
<td>2.17</td>
<td>1.90</td>
<td>1.71</td>
</tr>
<tr>
<td>Costa Rica</td>
<td>2.79</td>
<td>3.01</td>
<td>2.61</td>
<td>2.37</td>
</tr>
<tr>
<td>Jamaica</td>
<td>1.34</td>
<td>1.18</td>
<td>0.90</td>
<td>0.79</td>
</tr>
<tr>
<td>Mexico</td>
<td>2.29</td>
<td>2.30</td>
<td>1.84</td>
<td>1.85</td>
</tr>
<tr>
<td>Peru</td>
<td>2.76</td>
<td>2.37</td>
<td>2.14</td>
<td>2.03</td>
</tr>
<tr>
<td>Venezuela</td>
<td>3.49</td>
<td>2.85</td>
<td>2.56</td>
<td>2.40</td>
</tr>
</tbody>
</table>

Sources: World Bank, World Tables 1993; ILO Statistical Yearbook, various years.

A. The 1980s crisis

The early 1980s brought serious setbacks to most countries; in a few cases (the Southern Cone countries and Jamaica) downturns had already occurred in the 1970s (Table 2). By the early 1980s GDP growth had turned negative for the region as a whole, and averaged only a little over 1% for the decade.

The crisis involved macroeconomic imbalance, hyperinflation and the resulting need to
stabilize; international payments imbalance calling for structural adjustment away from production of non-tradables to that of tradables; output losses associated with both the need to stabilize and the need to curtail imports; and, due to the above combination of events, rapidly falling absorption, real wages, and living standards. In an extreme case like Peru, per capita income fell by 21% over 1974-85 and real wages fell by over 50% (Verdera, 1994; Cox Edwards, 1992). During the 1980s GDP per capita fell by over 20% in Argentina, Venezuela, Peru, Bolivia and Nicaragua (though the first two regained some of that ground in 1991-92). Regional per capita output in 1990 was about 8% below the 1980 level and per capita income about 15% due to the negative shift in the terms of trade over that decade.

Table 2

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>2.81</td>
<td>-1.06</td>
<td>-0.70</td>
<td>7.84</td>
<td>0.95</td>
<td>1.82</td>
</tr>
<tr>
<td>Bolivia</td>
<td>4.56</td>
<td>-1.58</td>
<td>1.08</td>
<td>3.51</td>
<td>2.02</td>
<td>2.21</td>
</tr>
<tr>
<td>Brazil</td>
<td>8.51</td>
<td>1.46</td>
<td>4.46</td>
<td>1.51</td>
<td>5.70</td>
<td>5.14</td>
</tr>
<tr>
<td>Chile</td>
<td>2.24</td>
<td>0.96</td>
<td>6.22</td>
<td>7.32</td>
<td>2.68</td>
<td>3.27</td>
</tr>
<tr>
<td>Colombia</td>
<td>5.64</td>
<td>2.48</td>
<td>4.46</td>
<td>3.32</td>
<td>4.55</td>
<td>4.39</td>
</tr>
<tr>
<td>Costa Rica</td>
<td>6.18</td>
<td>0.40</td>
<td>4.06</td>
<td>4.98</td>
<td>4.18</td>
<td>4.28</td>
</tr>
<tr>
<td>Jamaica</td>
<td>-0.34</td>
<td>-0.38</td>
<td>2.34</td>
<td>1.22</td>
<td>0.31</td>
<td>0.43</td>
</tr>
<tr>
<td>Mexico</td>
<td>6.40</td>
<td>3.22</td>
<td>1.04</td>
<td>2.34</td>
<td>4.24</td>
<td>3.99</td>
</tr>
<tr>
<td>Peru</td>
<td>3.67</td>
<td>0.68</td>
<td>-0.14</td>
<td>1.90</td>
<td>1.96</td>
<td>1.95</td>
</tr>
<tr>
<td>Venezuela</td>
<td>3.57</td>
<td>-1.86</td>
<td>1.44</td>
<td>5.25</td>
<td>1.66</td>
<td>2.12</td>
</tr>
<tr>
<td>Latin America</td>
<td>4.64</td>
<td>0.49</td>
<td>2.22</td>
<td>3.33</td>
<td>2.97</td>
<td>3.02</td>
</tr>
</tbody>
</table>


Within the generally weak economic performance of Latin America over the 1980s or even over the period since 1970, there has thus been a considerable range of experiences. For the full period 1970-93 Brazil stands well ahead of the field in average growth at about 5.1%, with Colombia and Costa Rica coming next at a little over 4%. In Mexico and Chile GDP rose enough to outpace the growth of population. In per capita national income growth, Colombia and Brazil (among the larger countries) led the way at around 2% growth per year, Mexico achieved 1.3%, Costa Rica 1.2%, and Chile 0.7%; nearly all of the other countries lost ground, Peru being the least successful with an annual decrease of 1.1%.
The underlying sources of the disastrous turndown in the 1980s were the sudden unfavourable shift in the net resource flow (due to the near cessation of capital inflow, the serious capital flight, and the higher interest rate) and, later in the decade, an important negative shift in the terms of trade. As of 1980 foreign savings outweighed factor payments to abroad by 1.7% of GDP, but in 1983 the figure went the other way by 4% of GDP, and was still negative by 3-4% of GDP in 1989 and 1990 before reversing again in the 1990s. Between 1980 and 1990 the region's trade deficit of 4% of GDP changed to a surplus of comparable size. Such a huge adjustment was called for because the bulk of the accumulated debt was with commercial banks and their loans carried flexible interest rates which dramatically increased the burden of the debt after 1982. The banks were not a dependable source of long-run finance and the international agencies had little success in dealing with the crisis or in searching for new sources of funds. Most countries asked for relief but until the Brady plan of 1989 got little.

The cost of the adjustment undertaken was high. Most countries applied the orthodox medicine of real devaluation and fiscal deficit reduction, with contractionary recessions helping to produce trade surpluses. But devaluation tended to be inflationary, so falling per capita income was typically accompanied by rising inflation. Argentina, Brazil, Bolivia and Peru had violent hyperinflations with annual rates approaching or exceeding 2000%.

An important impediment to easy adjustment was the unfavourable world markets for the region's exports. In the early 1980s most of the industrial world was mired in a severe recession which depressed commodity demand. In the second half of the decade the terms of trade moved strongly against the LAC region so that the "terms of trade effect" (defined with 1980 as the base year) was costing it close to 3% of GDP vis à vis the 1970s situation. Average export prices (excluding petroleum) in early 1992 were not much more than half of their 1960-80 level. This factor contributed to the regions' sluggish growth performance in the second half of the decade (Linden, 1993, 4). Over 1986-90 the region lost a total of US$90 billion vis à vis the 1960-80 price benchmark (ibid, 8).

These impediments notwithstanding, the ratio of exports to GDP (constant prices) rose from 15-15.5% in the 1970s through 1982 up to over 22% by 1993 (Table 3). The import ratio, meanwhile, plunged from an average of 14.4 over 1971-80 and 16.0% in 1981 to a low of 10.5 in 1983-5, after which it climbed back up to 17.5% in 1993 (all figures in 1980 prices).

While the underlying cause of the crisis for most countries, and for the region as a whole, was the instability of the international capital market, the proximate cause of the growth crisis was the sharp decline in investment rates. ECLAC figures (Table 3) reveal a fall in the gross fixed investment to GNP ratio from about 23% in 1971-81 to 16.9% in 1985-89 and 17.3% in 1990-93. The domestic savings rate fell by a little under 4% over this period, a little less than the 5% decline of the investment rate. Foreign direct investment fluctuated in the individual countries according to their macroeconomic situations; by 1990-91 it had, with the
striking exception of Brazil, risen considerably from earlier lows in the 1970s or early 1980s.

Table 3

Latin America and the Caribbean: relative shares of components of gross domestic product and of gross national income at market prices (GDP = 100)

<table>
<thead>
<tr>
<th>Years</th>
<th>Total final consumption expenditure</th>
<th>Gross fixed capital formation</th>
<th>Domestic domestic demand</th>
<th>Exports of goods and services</th>
<th>Imports of goods and services</th>
<th>Terms of trade effect</th>
<th>Net factor payments to rest of world</th>
<th>Real gross national income</th>
</tr>
</thead>
<tbody>
<tr>
<td>1971-80</td>
<td>76.2</td>
<td>22.9</td>
<td>99.1</td>
<td>15.3</td>
<td>14.4</td>
<td>-2.2</td>
<td>2.1</td>
<td>95.8</td>
</tr>
<tr>
<td>1981</td>
<td>78.0</td>
<td>23.1</td>
<td>101.0</td>
<td>15.0</td>
<td>16.0</td>
<td>-0.8</td>
<td>3.7</td>
<td>95.6</td>
</tr>
<tr>
<td>1982</td>
<td>77.2</td>
<td>20.6</td>
<td>97.8</td>
<td>15.4</td>
<td>13.2</td>
<td>-2.4</td>
<td>5.1</td>
<td>92.5</td>
</tr>
<tr>
<td>1983</td>
<td>76.1</td>
<td>17.2</td>
<td>93.3</td>
<td>17.1</td>
<td>10.4</td>
<td>-2.8</td>
<td>5.0</td>
<td>92.4</td>
</tr>
<tr>
<td>1984</td>
<td>76.1</td>
<td>16.6</td>
<td>92.7</td>
<td>17.9</td>
<td>10.6</td>
<td>-2.3</td>
<td>5.2</td>
<td>92.6</td>
</tr>
<tr>
<td>1985</td>
<td>76.2</td>
<td>16.6</td>
<td>92.8</td>
<td>17.6</td>
<td>10.4</td>
<td>-3.0</td>
<td>4.9</td>
<td>92.3</td>
</tr>
<tr>
<td>1986</td>
<td>76.7</td>
<td>17.2</td>
<td>94.0</td>
<td>16.8</td>
<td>10.8</td>
<td>-4.1</td>
<td>4.5</td>
<td>91.6</td>
</tr>
<tr>
<td>1987</td>
<td>76.2</td>
<td>17.3</td>
<td>93.5</td>
<td>17.5</td>
<td>11.0</td>
<td>-4.2</td>
<td>4.0</td>
<td>92.1</td>
</tr>
<tr>
<td>1988</td>
<td>75.8</td>
<td>17.2</td>
<td>93.0</td>
<td>18.9</td>
<td>12.0</td>
<td>-4.4</td>
<td>4.1</td>
<td>91.8</td>
</tr>
<tr>
<td>1989</td>
<td>75.8</td>
<td>16.4</td>
<td>92.2</td>
<td>19.7</td>
<td>12.0</td>
<td>-4.8</td>
<td>4.2</td>
<td>91.5</td>
</tr>
<tr>
<td>1990</td>
<td>76.2</td>
<td>16.2</td>
<td>92.4</td>
<td>20.8</td>
<td>13.2</td>
<td>-5.1</td>
<td>3.6</td>
<td>91.9</td>
</tr>
<tr>
<td>1991</td>
<td>77.0</td>
<td>16.6</td>
<td>93.7</td>
<td>20.9</td>
<td>14.5</td>
<td>-5.7</td>
<td>3.2</td>
<td>91.8</td>
</tr>
<tr>
<td>1992</td>
<td>77.1</td>
<td>17.9</td>
<td>95.0</td>
<td>21.7</td>
<td>16.7</td>
<td>-6.1</td>
<td>2.8</td>
<td>91.8</td>
</tr>
<tr>
<td>1993c</td>
<td>76.6</td>
<td>18.5</td>
<td>95.1</td>
<td>22.3</td>
<td>17.5</td>
<td>-6.6</td>
<td>3.0</td>
<td>91.1</td>
</tr>
</tbody>
</table>

Source: Economic Commission for Latin America and the Caribbean, 1993, Volume 1, p. 87, on the basis of official figures converted into dollars at constant 1980 prices.

* Nineteen countries.
* Includes variation in stocks.
* Preliminary figures.

The crisis naturally affected labour market outcomes and some aspects of employment structure. For example, it raised the employment share of the informal sector. It did not seem to affect participation rates or income distribution significantly, however. The most important effect, of course, was on wage rates, whose trajectories (at least for manufacturing or non-agricultural workers, depending on the series available--Table 4) are broadly consistent with the

---

9 ECLAC data on both total and fixed investment (Tables 2.3 and 2.5 respectively) show a starker picture, with the LAC average for the former slipping from 22.6% over 1971-80 to 15.9% in 1983; from that point there had been only a marginal increase by 1991. These figures are in constant prices, converted to 1980 U.S. dollars. In general they show less recovery than the World Bank figures on gross investment.
Table 4
Real Wages (Index 1980=100)

A.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>79</td>
<td>78</td>
<td>90</td>
<td>100</td>
<td>89</td>
<td>80</td>
<td>101</td>
<td>127</td>
<td>108</td>
<td>110</td>
<td>103</td>
<td>97</td>
<td>83</td>
<td>79</td>
</tr>
<tr>
<td>Brazil:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rio de Janeiro</td>
<td>89</td>
<td>94</td>
<td>95</td>
<td>100</td>
<td>109</td>
<td>122</td>
<td>113</td>
<td>105</td>
<td>113</td>
<td>122</td>
<td>102</td>
<td>107</td>
<td>107</td>
<td>106</td>
</tr>
<tr>
<td>Sao Paulo</td>
<td>76</td>
<td>86</td>
<td>92</td>
<td>100</td>
<td>105</td>
<td>107</td>
<td>94</td>
<td>97</td>
<td>120</td>
<td>151</td>
<td>143</td>
<td>152</td>
<td>152</td>
<td>165</td>
</tr>
<tr>
<td>Colombia</td>
<td>84</td>
<td>93</td>
<td>99</td>
<td>100</td>
<td>101</td>
<td>105</td>
<td>110</td>
<td>118</td>
<td>115</td>
<td>120</td>
<td>119</td>
<td>118</td>
<td>119</td>
<td>116</td>
</tr>
<tr>
<td>Costa Rica</td>
<td>87</td>
<td>95</td>
<td>99</td>
<td>100</td>
<td>88</td>
<td>71</td>
<td>79</td>
<td>85</td>
<td>92</td>
<td>98</td>
<td>89</td>
<td>85</td>
<td>86</td>
<td>87</td>
</tr>
<tr>
<td>Chile</td>
<td>80</td>
<td>85</td>
<td>92</td>
<td>100</td>
<td>109</td>
<td>109</td>
<td>97</td>
<td>97</td>
<td>94</td>
<td>95</td>
<td>95</td>
<td>101</td>
<td>103</td>
<td>105</td>
</tr>
<tr>
<td>Guatemala</td>
<td>100</td>
<td>100</td>
<td>118</td>
<td>125</td>
<td>126</td>
<td>115</td>
<td>99</td>
<td>81</td>
<td>87</td>
<td>91</td>
<td>96</td>
<td>79</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mexico</td>
<td>107</td>
<td>104</td>
<td>103</td>
<td>100</td>
<td>104</td>
<td>102</td>
<td>81</td>
<td>75</td>
<td>77</td>
<td>72</td>
<td>73</td>
<td>72</td>
<td>75</td>
<td>73</td>
</tr>
<tr>
<td>Nicaragua</td>
<td>123</td>
<td>100</td>
<td>91</td>
<td>96</td>
<td>83</td>
<td>79</td>
<td>55</td>
<td>20</td>
<td>14</td>
<td>5</td>
<td>9</td>
<td>15</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Panama</td>
<td>105</td>
<td>100</td>
<td>99</td>
<td>100</td>
<td>109</td>
<td>109</td>
<td>97</td>
<td>97</td>
<td>94</td>
<td>95</td>
<td>95</td>
<td>101</td>
<td>103</td>
<td>105</td>
</tr>
<tr>
<td>Paraguay</td>
<td>99</td>
<td>100</td>
<td>105</td>
<td>102</td>
<td>95</td>
<td>92</td>
<td>90</td>
<td>86</td>
<td>97</td>
<td>104</td>
<td>110</td>
<td>104</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Peru</td>
<td>109</td>
<td>95</td>
<td>89</td>
<td>100</td>
<td>98</td>
<td>110</td>
<td>93</td>
<td>87</td>
<td>78</td>
<td>98</td>
<td>101</td>
<td>76</td>
<td>42</td>
<td>39</td>
</tr>
<tr>
<td>Uruguay</td>
<td>113</td>
<td>109</td>
<td>100</td>
<td>100</td>
<td>108</td>
<td>107</td>
<td>85</td>
<td>71</td>
<td>68</td>
<td>72</td>
<td>75</td>
<td>76</td>
<td>76</td>
<td>70</td>
</tr>
<tr>
<td>Venezuela</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Cox, Edward, 1992, Table 1, based on CEPAL, Estudio Económico de América Latina y El Caribe, various years.

B.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>107.5</td>
<td>96.9</td>
<td>93.7</td>
<td>75.8</td>
<td>79.4</td>
<td>80.5</td>
<td>81.6</td>
<td>80.3</td>
<td>85.7</td>
</tr>
<tr>
<td>Brazil:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rio de Janeiro</td>
<td>122.9</td>
<td>101.5</td>
<td>105.7</td>
<td>108.2</td>
<td>87.0</td>
<td>92.2</td>
<td>115.3</td>
<td>119.5</td>
<td>109.2</td>
</tr>
<tr>
<td>Sao Paulo</td>
<td>137.3</td>
<td>127.7</td>
<td>138.3</td>
<td>149.1</td>
<td>130.8</td>
<td>125.4</td>
<td>138.1</td>
<td>151.9</td>
<td>162.7</td>
</tr>
<tr>
<td>Chile</td>
<td>95.1</td>
<td>94.8</td>
<td>101.1</td>
<td>103.0</td>
<td>104.8</td>
<td>110.1</td>
<td>115.1</td>
<td>118.6</td>
<td>124.6</td>
</tr>
<tr>
<td>Colombia</td>
<td>120.1</td>
<td>119.2</td>
<td>117.7</td>
<td>119.5</td>
<td>116.0</td>
<td>115.3</td>
<td>117.3</td>
<td>122.8</td>
<td>122.2</td>
</tr>
<tr>
<td>Costa Rica</td>
<td>98.0</td>
<td>88.5</td>
<td>84.5</td>
<td>85.1</td>
<td>86.5</td>
<td>82.5</td>
<td>85.9</td>
<td>94.7</td>
<td>****</td>
</tr>
<tr>
<td>Mexico</td>
<td>73.2</td>
<td>72.0</td>
<td>71.3</td>
<td>77.8</td>
<td>79.4</td>
<td>84.7</td>
<td>92.9</td>
<td>100.2</td>
<td>99.4</td>
</tr>
<tr>
<td>Peru</td>
<td>101.1</td>
<td>108.9</td>
<td>82.1</td>
<td>44.8</td>
<td>39.1</td>
<td>42.1</td>
<td>41.6</td>
<td>41.3</td>
<td>47.4</td>
</tr>
<tr>
<td>Uruguay</td>
<td>71.7</td>
<td>75.0</td>
<td>76.0</td>
<td>75.8</td>
<td>70.4</td>
<td>73.0</td>
<td>74.6</td>
<td>78.2</td>
<td>79.2</td>
</tr>
</tbody>
</table>

Source: ECLAC on the basis of official figures, 1994, p. 42.

Notes:
- A Preliminary figures.
- C Average wages in manufacturing deflated by the CPI for Rio de Janeiro; 1994: January-August average.
- F Average remuneration declares by persons covered by the social security system.
- I Index of average real wages. 1994: January-October average.
macro trends. Thus for Chile, Colombia and Brazil wages were higher in 1990 (and in 1993) than in 1980, while for the other major countries this was not the case. The biggest real wage declines occurred in Peru, which had the worst macro performance. De Janvry et al. (1989, 718) conclude that the movements of the agricultural wage during the earlier period from the mid-1960s to 1980 also tended to reflect rather closely the macroeconomic performance of the countries, with overall rather than agricultural growth the key determinant; this, like other evidence they adduce, suggests that the agricultural-rural labour market in most countries has been rather well integrated with the rest of that market. PREALC (1990) judges that the fall in earnings over 1980-89 was a great deal sharper in the informal sector (42%) than in the public or small scale (30%) or the medium and large scale (just 7%). Though these figures may exaggerate the difference in earnings trends, they probably do indicate that the informal sector workers suffered more than those of the formal sector.

Turnham (1993, 68) concludes that the main impact of the 1980s recession in the LAC region was the shift of workers into the informal sector, rather than into unemployment. This was an important form of labour market adjustment in Bolivia, for example (Horton, et al. 1991, 15). In Brazil the main shift was into the unprotected employee category (those without signed contracts) rather than into self-employment.

Levels of open unemployment rose significantly during the country crises. The regional average (urban areas) rose from 7 to 11% between 1980 and 1985. The main burden of

---

10 And they do not seem to square well with the evidence that income distribution did not worsen systematically in most countries.

11 The urban informal segment of the labour force has been and remains important; including the self-employed and employees in quite small establishments (but excepting those in professional activities) Garcia and Tokman (1984) estimate that from 1950 to 1980 its share of regional non-agricultural employment declined slightly from 30.7% to 28.7%. Using a narrower definition (independent workers and domestic servants) PREALC estimates that the share rose from 25.6% to 30.8% in the 1980s (Barrera, 1994, 22), in the process accounting for nearly half of the new jobs created during the decade. In the early 1980s during the heart of the crisis informal employment grew at 6.8% per year (Table 2), while public sector employment was expanding at 4.6% and that of small modern firms at 6.6%, but large modern firms were shrinking their labour force at -0.5%.

Income levels are on average significantly lower in the informal than in the formal sector. When the former is defined to include establishments of less than 5 workers, but excluding self-employed professionals, studies often report that average income is about twice as high in the formal as in the informal sector (Kugler, Reyes and Gómez, 1979; Bourguignon, 1979; ILO-PREALC, 1989; Gindling, 1989). When measurable differences in human capital are allowed for (usually only education and years of work can be conveniently taken into account) the gap has in most LAC countries (including among others Colombia, Costa Rica, probably Paraguay, Dominican Republic, and El Salvador) been found to fall more in the 20-50% range. That part of the formal-informal sector earnings gap which is not associated with differences in human capital plays only a modest role in the overall income inequality of most LAC countries.
unemployment fell on poorer families. Since the mid-1980s the general trend of unemployment rates has been downward. As of 1993 only Panama registered a rate above 10% and only Argentina among the larger countries had a rate above 9%. The recent crisis in Mexico and the slowdown in Argentina have, however, seen rates move sharply up again.

The distributional effects of the economic crisis per se have been somewhat controversial, and are hard to distinguish from those of other contemporary phenomena. Morley (1994) argues that inequality was strongly cyclical, worsening in recession and improving in expansion. Others, including this author, are less persuaded that this relationship was a general one, though it seems to have been particularly characteristic of cases involving very high rates of inflation. One reason that distributions may not have systematically worsened could be the large income declines that the middle income salaried class suffered in quite a few countries. In any case, the poverty implications were undeniably very negative, again especially in those high inflation cases.

B. In pursuit of adjustment

In most countries of Latin America the new, harsher conditions of the 1980s required adjustment, to deal simultaneously with a large balance of payments disequilibrium and a frequently large fiscal imbalance, the latter accentuated by the facts that foreign capital was no longer a resource for governments to draw on and that government revenues fell with the decline in imports and with the recessions. A combined boom in exportables and import substitutes could in principle have offset the recessionary effects of the contraction of domestic demand that countries felt obliged to achieve. But this did not often happen so the adjustment process proved quite painful and usually slow. It was simpler in countries that started with little debt and a large traded goods sector; thus Colombia and Paraguay had a relatively easy time of it. Still, country economic performance during the 1980s was not very closely associated with the initial debt load; Chile, Brazil and Costa Rica did relatively well despite high initial debt. Peru did very badly despite a modest initial debt burden and a positive shift in the terms of trade; there the problem was incompetent policy. Brazil, Colombia and Mexico, countries in which borrowed capital helped finance the creation of export capacity in the 1970s, were all able to adjust more easily than those in which it financed consumption or capital flight.

Venezuela, Mexico, Argentina, Peru, Bolivia and Ecuador have had long and painful adjustments. Most countries’ traditional export bundle was heavily based on natural resources; the shift to a broader base of tradables took some time and involved considerable costs (Morley, 1993, 8). In Brazil and in Peru the process was delayed by populist policies which led to massive deficits and inflation. In Argentina, Brazil and Venezuela adjustment was interrupted by a short-term recovery before the necessary fiscal and balance of payments equilibrium had been achieved; as a result these countries had two recessions. One disastrous policy combination

---

12 Tenjo (1985) for Colombia and a recent Interamerican Development Bank report (1987) for cities in five Latin countries (including Sao Paulo and Panama City) have shown that the average rate of unemployment is much larger for poorer families in the urban areas than for better off families.
was to devalue and at the same time raise the nominal minimum wage while maintaining the level of domestic demand; it led to hyperinflation in Brazil, Argentina and to a lesser extent Venezuela after 1986 (Morley, 1993).

The Costa Rican experience is of special interest for the relative success achieved in the initial adjustment; (menacing fiscal and balance of payments disequilibria reappeared in 1994). The crisis was precipitated by a 25% decline in the terms of trade and the adjustment was one of the most abrupt experienced in the region (Morley, 1993, 132). The public sector, cut off from international sources of finance, was forced quickly to reduce its deficit from 8% of GDP to 2%. Though poverty rose sharply the recovery was impressive, and the burden of the foreign debt was reduced by the growth in exports and by the concessions associated with the Brady bill in 1990.

A natural expectation in light of the fiscal crisis might be a systematic decline in public sector employment, though the political pressure from high levels of unemployment works in the opposite direction. PREALC estimates that this group's share of non-agricultural employment rose from 15.7% in 1980 to 16.6% in 1985 (as expansion of public employment was a frequent initial response to the crisis), before falling back to 15.5% in 1990 (Barrera, 1994, 21). Thus for the decade as a whole public employment grew at almost exactly the same rate as the total labour force. Public sector wages have been much more flexible downward than has public employment (Fallon and Riveros, 1989). The eventual need to shed labour has been a very difficult challenge, though it has accelerated notably in some countries in the last few years.

C. The recovery phase

The 1990s have promised better things. Though 1995 per capita output was still a bit below that of 1980 and per capita income nearly 10% below, the regional growth rate over 1990-95 was close to 3% range, hardly dramatic but enough to begin the recovery of per capita incomes-- up by about 5% over 1990-95 (CEPAL, 1995, 49). A few really strong performers-- especially Chile and for a period Argentina--have created the hope that others should be able to follow and that the region as a whole might be able to get back to the healthy growth rates of the 1960s and 1970s. Some of the return of optimism is based simply on the better growth performance of the early 1990s; some on the dramatic return of capital, both flight capital which had previously left, and new foreign capital coming in (Culpeper, 1993); some on the entry of Mexico and the planned entry of Chile into NAFTA and the expectation that other Latin countries will benefit either from entry into a trading block or the closer integration of countries in the block; and some on the widespread more general belief that the currently more market-friendly economic policies have been a change for the better vis a vis those of the pre-crisis period.

It is to be expected in a region as large and diverse as Latin America that, even as the policies tend to converge towards a common-looking market-friendly package, there will still be some variance in growth rates and other indicators of short-run economic performance. This
is evident in the figures (Table 2). Average regional growth is, as always, heavily affected by that of Brazil, and the gradual acceleration over 1992 to 1994 for the region (from 3.0% to 3.7%) reflects the major improvement in its performance; excluding Brazil and Cuba, the growth in 1994 (3.4%) was well below that of 1991 and 1992 (both in the neighbourhood of 5%). There is no clear association between income level and growth. Of the poorest 11 countries with population over 2 million, most (including Bolivia, Ecuador Paraguay, the Dominican Republic, Guatemala and Honduras) grew at not far from the average regional rate of 3.3% over 1990-94. The only ones to exceed this were Guyana (7.3%), El Salvador (4.6%) and Peru (4.3%), while Nicaragua (at about zero) and Haiti (-8.2%) did less well.

As more countries achieve acceptable levels of stabilization on the monetary-fiscal front and convert their trade policies to more open markets there will presumably be less cases of recessions which result from the need to achieve these balances and the regional growth performance will more accurately reflect the potential of the new model under more "normal" circumstances. It seems reasonable to expect that the regional average should be at least 4% when that phase is reached and hence per capita output and incomes (assuming no major shifts in the terms of trade) should be growing at a little over 2%, figures somewhat below those prior to the crisis. The major reason that the regional average might not return even to this level has to do with countries' inability to avoid severe cycles related to capital flow, trade shocks and problems related to international indebtedness. At the other extreme, optimists expect growth to be much better than this, say up to 7-8% per year, implying per capita growth of 5-6% per year.

From a poverty perspective, this range of possible outcomes at the aggregate level highlights a number of concerns. The most basic worry is that the combination of regional growth and distribution trends will not produce a reasonable rate of income growth for the poor. In the absence of distribution changes income growth of the poor occurs at the same rate as for the population as a whole. If say, 3% per year is considered adequate, then national income per capita must also increase at 3% and national income at 3% plus the rate of population growth, i.e. about 4.5% for the region but as much as 5.5% for some of the poorest countries whose population growth is still very high. If the income share of the poor (whatever number of deciles might be categorized this way in a given country) is falling, as it has in many countries, then overall growth must be correspondingly faster. Recent experiences of Colombia and Chile provide guidelines as to how fast national income might have to grow under worsening distribution. Over 1990-93, the share of the bottom decile (quintile) in Colombia fell by 17% (14.4%). Just to offset this loss within a decade would require national income growth to be nearly 2% per year faster (1.6% faster) than otherwise. In Colombia's case, with population growing at say 1.8%, total national income would have to grow at 6.8% to raise incomes of the bottom decile at 3% per year. In Chile the loss (in consumption share) by the bottom quintile over 1969-78 totalled 32%; to recoup this over just a decade would require per capita income growth of 3.9% faster than otherwise, and to raise the incomes of this quintile at 3% per year an overall national income growth rate of between 8 and 9% per year. As the period of recouped distributional loss is stretched out the required growth rate becomes lower. A country which does particularly badly on either the growth and/or the distributional front will face a
difficult situation. Small countries are the most vulnerable to fluctuation in growth because of terms of trade changes but all countries can suffer to some degree through exogenous shocks, through what turn out ex post to be bad policy choices, and so on.

An additional concern relates to trends in the distribution of after tax and transfer income (as opposed to primary income, the concept used in the above discussion and in section 3 below). Since the various changes making up the policy reforms have made the tax and transfer system less progressive in some respects (though not in others) and have generally tended to shrink government expenditure capacity, there is the possibility that they will weaken capacity to offset poverty. Efficiency of resource utilization in poverty alleviation efforts is always of very high priority, but becomes especially so under such circumstances. It is important that the current rethinking of many issues of poverty policy be very competent and that subsequent implementation be very effective.

III. GROWTH, DISTRIBUTION AND POVERTY EFFECTS OF THE MARKET-FRIENDLY ECONOMIC REFORMS

The debt crisis provided the push to induce and/or oblige the region to jettison its import-substitution strategy for a more liberalized trading system and to adopt other elements of what is now a standard package of reforms to labour markets, financial markets and the public sector. Some countries (especially Colombia and Brazil) had already taken significant steps away from the traditional combination of protectionism and overvalued exchange rates and the resulting bias against trade. These approaches were qualitatively similar to the East Asian practice of encouraging exports while continuing to protect against imports. Chile went much farther as the Pinochet regime introduced the most free-trade free-market system in the region, including a real import liberalization bringing tariff rates down to 10% by 1980; though they were raised somewhat in the mid-1980s the average was back down to 15% as the decade came to a close (UNCTAD, 1992, 44). Argentina had an important liberalization episode between 1976 and 1982, in which the average effective rate of protection fell from 158% to 54% (Gelbard, 1990, 46). In the second half of the 1980s most of the countries of the region initiated significant reforms, varying in detail and in timing, and having few if any close precedents in the developing (or the developed) world. The remaining countries followed suit in the early 1990s.

Labour and capital market reforms have also been widely undertaken as has public sector downsizing. Many aspects of the traditional set of labour practices and institutions have been weakened. In the area of financial markets the reforms have focused on increasing the share of the private sector at the expense of state institutions, and diminishing the extent of credit subsidization in favour of market-determined interest rates. Downsizing of the state has involved both the privatization of parastatals and an attempt to cut back on employment and the wage bill in the more narrowly defined or "core" part of the public sector.

By now, in short, the LAC countries are launched in a different, more outward-oriented and less interventionist economic model. This model shows signs of working well in some
countries, but has been slower than hoped in bringing the region as a whole back to its former growth and has also either caused or coincided with a marked deterioration of income distribution. Unless growth accelerates quickly in the next few years, and in some countries even if it does, such growth will not provide an adequate antidote to poverty.

At a first level of analysis, it is useful to break the impact of the policy reforms into those on growth and those on income distribution, since these two impacts determine the rate of change of primary income for each group, including those in or near the poverty range. Although these impacts of the reforms are hard to sort out from those of the many other determinants likely to be at play, the evidence thus far provides only limited reassurance that the speed and pattern of growth will by itself resolve most of the poverty within a reasonable period of time. Beyond that, it is important both to (i) consider what factors contributed to the disastrous outcomes of the crisis period and (ii) consider independent (e.g. more micro type) evidence on the likely growth and distribution implications of the various components of the reforms. Also of relevance are any effects of the reforms on the extent and quality of direct anti-poverty policy.

A. Growth impacts: lessons from the empirical record

The more general and important lessons/conclusions we draw with respect to growth are the following.

1. The final impact of the reforms on growth remains to be seen. Some evidence is reassuring, but the still modest growth rate of the region as a whole argues for caution and points to a number of possible threats to stable rapid growth in the future.

2. The economic crisis demonstrated, above all, that heavy foreign borrowing is dangerous. It is probable that the macroeconomic performance and employment generation would have been at least reasonably successful in the 1980s had the debt crisis not hamstrung the countries’ economies. Whether the debt per se or the habits developed as it accumulated was the more serious problem is hard to say, and probably varied from country to country. In any case the combination, together with a lack of competence and understanding on the part of the international community in responding to the crisis, was lethal.

Current policy involves a high degree of integration into international capital markets, a prominent place for foreign capital in the growth process, and the corresponding degree of vulnerability to exogenous shocks in that market.

3. Overvaluation of the exchange rate is a major threat to successful export and overall growth; systematic undervaluation may be desirable but may not be feasible. Exchange rate management has proven to be perhaps the most important policy determinant of growth performance in LAC and other countries. Most successful experiences of overall growth and of growth of manufactured exports have come with appropriate (i.e. not overvalued) and stable real exchange rates (Helleiner, 1994). Colombia, with its stable and satisfactory growth record,
has managed the exchange rate relatively well since adopting a floating exchange rate in 1967. Chile’s economic downturn around 1980 was closely associated with overvaluation of the exchange rate, and the export boom of the 1980s was mainly the result of a lower real rate. Brazil was able to recover growth in the late 1980s and generate a strong trade surplus, but by 1990 the real exchange rate had seriously appreciated and growth slowed.

In addition to its negative impact on overall performance, overvaluation appears to be particularly prejudicial to smaller exporting and import substituting firms, since these have less reserves, credit access and the like to cushion the impacts of fluctuations. Small and medium manufacturing exporters in Colombia indicated in a recent survey that exchange rate fluctuations were one of the main problems they faced (Berry and Escandon, 1994). Since, among all exporters and import substitutors, small and medium firms are the most successful at creating employment, the poverty implications of their difficulties are important.

Avoiding overvaluation is often difficult. One important reason to keep clear of a macro policy which might produce serious inflation is that it is tempting to use the exchange rate as an anti-inflation instrument, which use creates a serious likelihood of overvaluation, as well as guaranteeing that the exchange rate will not be stable. When overvaluation cannot be avoided, it is important that export incentives be maintained and that domestic industry not be unduly damaged by a transitory influx of imports. Keeping incentives strong for exports via a not overpriced exchange rate means that the incentive system has an important "across-the-board" component to it, one which does not discriminate against less well-placed firms, as many other incentives tend to do (like special financial incentives, tax incentives, duty drawbacks and so on).

The main threats to overvaluation under the new policy regime appear to be the uncontrolled capital inflows which have been frequent in LAC in recent years, and the in itself laudable desire to control inflation which leads to the use of the exchange rate as an instrument to that end.

4. International flows of short term capital can be dangerous either by leading to periodic overvaluation or by fostering fiscal and monetary irresponsibility by temporarily removing the need for prudence. Thus, while more open capital accounts than in the past will bring benefits to LAC countries (access to needed foreign capital), they also bring challenges and threats. The LAC countries, having already suffered considerable damage from such openness thus far, need to learn how to sidestep such effects. The capital inflows in Mexico during the 1980s have probably impacted manufactured exports negatively. The large capital inflow in response to domestic stabilization and adjustment and the relatively favourable interest rates failed to stimulate domestic Mexican investment or associated productivity gains to growth (Helleiner, 1994). It seems rather to have crowded out domestic savings, worsened the trade deficit, and forced continued macroeconomic restraint.

5. Unlike exchange rate management, which seems to have been closely related to good overall economic performance as well as export growth, the impact of trade policy per se is much less clear. Within a fairly wide range of the relevant policy space, the impacts of trade policy on growth and employment creation appear to be considerably less important than those
of exchange rate management and other aspects of macro policy. When policy gets outside that range, as it may have done in Peru, Bolivia and perhaps Chile, the costs of ISI can be serious, though even in such cases they appear to be less than those of exchange rate overvaluation. Growth under the post-war LAC trade regimes, most of which were initially ISI-oriented but gradually shifted attention towards export promotion, was generally good as long as countries did not overvalue their currencies. It was especially rapid in Brazil, Mexico, and Colombia, all of which had moved to mixed ISI-export promotion models by the 1970s. All developed considerable manufacturing export capacity under this regime, though except for Mexico’s maquiladora sector, few of the manufactured exports from these three countries were very labour intensive. That the other countries of the region generally fared less well than those just mentioned was due to less successful management of the real exchange rate, and probably also to trade regimes either less well designed in some general sense or less appropriate to the particular conditions of the country. Taking the region’s experience as a whole, however, there are no solid empirical grounds for arguing that the trade strategy per se was a major hindrance to healthy growth. Where especially badly designed or applied, or where it was least appropriate to start with, the negative effects were no doubt greater.

Fostering strong export growth has been important to overall economic success, with avoidance of an overvalued exchange rate the common feature among countries achieving that goal. When the exchange rate does not constitute adequate inducement to export activities its role has often been substituted by export subsidies, import duty drawbacks, special credit schemes and the like. While the need for adequate incentives to exports is clear, the record throws limited light on how much it matters how those incentives are provided.

Where manufacturing exports have grown significantly after adjustment to the crisis, the creation of new industrial capacity does not appear to have played a very large role as a source of that expansion. Among Colombia, Chile, and Mexico, with the exception of new resource-intensive exports from Chile, the exports came mainly from redirected capacity from industries (and firms—often foreign owned) that had previously substituted for imports and benefited from significant import protection (Helleiner, 1994, 11). Maintenance of the booms will clearly require new investment at some point.

The new more outward-oriented policy framework of the LAC countries calls for the development of a new set of policy instruments for use within that framework, including anti-dumping mechanisms, GATT-consistent export promotion schemes, permissible forms of infant industry protection, and so on. Most countries have not advanced too far in the development of these new instruments.13

---

13 Chudnovsky et al (1992, 36) discuss these issues in the Argentine context, noting that the government had recently sent to Congress a law on anti-dumping mechanisms to put Argentine legislation in line with the GATT, but any effective use of these instruments would require adequate technical bodies to implement them (like those which Chile has) to protect domestic industry against the unfair competition which is present in many segments of the world markets.
6. The style, stability, and technical quality of policy making matters. Fast growth and healthy employment generation provide the ultimate test of what is good policy, but allowance must be made both for exogenous factors which influence the outcomes and for the management capacity available to administer the policy, including both the level of technical skills and the professionalism (freedom from corruption) which characterize the bureaucracy. The evidence suggests that both administrative capacity (sometimes hard to distinguish from policy-making capacity) and policy stability are significant pluses.

Three of the four best performers since 1970 from a growth point of view (Colombia, Costa Rica and Chile) show the benefits of policy stability in different ways and at different times. For the period as a whole, Colombia has been the standout in this respect. In a comparative analysis with Peru, Thorp (1991, 158) characterizes the response of the Colombian state to booms and crises as "pragmatic interventionism", complemented by reform of the public sector to make interventions more effective and a good level of cooperation with the private sector. Inflation and foreign borrowing were on the whole controlled, export windfalls were partly sterilized by inducing savings, and local productive sectors were provided some protection when under severe pressure. Peru's record stands in stark contrast. When industrial policies were finally introduced in Peru and actively pursued in the 1960s, their design and implementation was marked by incoherence and obedience to narrow elite interests. In their efforts to correct the structural defects of the economy and to encourage growth Peruvian governments have oscillated, with disastrous economic and political consequences, between forceful state intervention and reliance on the market. Past errors were repeated since neither the state nor the private sector had accumulated entrepreneurial and macro management experience, or institutionalized channels of cooperation with each other.

Chile's record since the mid 1980s has been the region's best, and has also been characterized by notable continuity and by a high level of technical capacity on the part of the administration. Policy reversals were violent in the early 1970s, and macroeconomic policy had not yet found a solid footing; thus the outcomes over this period were inferior.

Costa Rica has benefitted from a different form of stability, a general confidence in the political system, at least as represented by the Carazo administration which had to deal with the challenge of the macroeconomic crisis of 1980-82. Although major steps had to be taken (a sharp devaluation, tax reform, and others) and real wages went down sharply in the short run, confidence seems to have remained impressively high. (It must be granted that an unusual amount of foreign assistance was available at the time of the crisis.) The economy rebounded well, under the circumstances, and without great social conflict.

Among the potential advantages of the new policy package is that it reduces state involvement in some of the policy areas where such involvement can be destabilizing, and that it diminishes the incentive for rent-seeking behaviour and the associated waste of resources. Whether on balance it does generate net benefits of policy stability and professionalism depends on the situation and the pragmatism and care with which policies are designed and executed. It is important that the destabilizing influence of common elements of the previous policy
regimes such as excessive spending (hence budget deficits) not be matched with the destabilizing influence of free capital flows, characteristic of the new regime.

7. Though the impact of public sector downsizing is hard to assess, if done well it should have positive growth impact. Public sector employment in LAC countries typically falls within the range 10-20% of total employment. In most cases it would be hard to label more than perhaps a quarter of this as really unproductive, since a high share is in education, health, etc. Privatization is diminishing employment levels in former state enterprises, some famous for the degree of feather-bedding. In a few countries (e.g. Argentina) the total impact may be significant, but in most it will not be comparable to possible cuts in the public sector itself, partly because many public enterprises are already relatively capital intensive. Cline (1992, 8) notes that, including state enterprise, 17% of employment was in the public sector in Argentina and nearly 20% in Venezuela as of the late 1980s. Public sector spending on wages and salaries was nearly 10% of GDP in Argentina (as of 1988) and 5.4% in Chile, with 8-10% likely a fairly frequent range in the LAC region. He suspects that a desirable scaling back may be 2-3% of GDP; this would create a considerable investment fund or a cushion against inflation, depending on the existing state of the public accounts.

8. Several important areas of continuing ambiguity with respect to the growth impacts of the reforms are worth mentioning. The growth impacts of labour market and financial market reforms have been virtually unstudied to date and are hence a matter of uncertainty. Although they have been studied a little, the same goes pretty much for the impact of the reforms in general on the growth and distribution impacts of technical change, especially over the medium and longer run.

B. The employment and distribution impacts of the reforms

The employment and distributional impacts of the market-friendly economic reforms are especially important to the evolution of poverty incidence and the design of poverty policy in the LAC countries. Expectations have varied widely, especially with respect to the most-discussed component of the reforms, the liberalization of trade. Several bodies of research bear, in different ways, on this issue. Simple two (or perhaps three) factor trade models tend to suggest that trade liberalization should have a positive effect on labour demand and on income distribution, as long as labour is considered to be an abundant factor. But it is not obvious that the countries of Latin America are relatively labour abundant within the global context; in a world involving only them and the industrialized countries this would clearly be the case, but in the presence of huge low income countries which are mounting trade offensives the picture becomes murky.

A set of country studies directed by Krueger (see Krueger, et al, 1981) addressed one aspect of this issue; manufactured exports were found to be more labour intensive than domestically produced import substitutes in all cases except Korea. For the nine countries excluding Korea (Brazil, Chile and Colombia were the LAC countries included) the average employment per dollar of export value added was 49% higher for the exports. The
measurements were based on industry-wide average factor proportions and did not take account of the fact that in any given industry (at least at that time in the LAC countries) exports tended to come from the larger more capital intensive firms; this created some degree of bias in favour of the conclusion reached. Note also the extensive evidence that import substitute and export production is often carried out by the same firms (Diaz-Alejandro, 1976 for Colombia; Gindling for Costa Rica). The main implication of this research, however, is that the static effect of even a fairly large shift from import substituting to exporting sectors would produce only a quite modest total increase in the demand for labour. The main employment benefits from experiences like those of the East Asian NICs came from the rapid growth of exports and of the economy as a whole.

The employment implications of mineral exports are, as is well known, very limited. Those from agriculture are less so but it is probable that the average labour content of agricultural exports is in many cases low and will get lower in future. A number of observers have, however, expressed optimism with impacts of outward orientation through an expanding agricultural sector, on the grounds that this sector has tended to be disfavoured by ISI policies. But here, as in manufacturing, liberalization has recently coincided with difficult times for important agricultural groups (Colombia and Mexico); models which treated agriculture as homogenous in relation to trade policy were seriously over-simplified. Many of the newer agricultural exports appear to be produced in relatively capital intensive ways (one factor in this is the inegalitarian agrarian structure), though some (e.g. flowers in Colombia) are strong exceptions to this. For crops like oil palm, coffee and cocoa, export pessimism seems largely justified as demand is inelastic, so even when they are labour intensive this feature may not show up in expanding demand for labour. All this said, in fairness to the export-employment optimism view, it may be that the longer run effects of outward orientation on employment will be substantially more favourable than the short run ones. More detailed analysis of trends in the rural and overall labour markets of the region could help to identify such trends without waiting for the full history to unfold.

Based on factor proportions arguments it would seem unlikely that trade policy has had a major direct impact on income distribution (i.e. an impact independent of that occurring through its impact on growth), judging from the modest size of the trading sectors in relation to the economy, and the fact that many exports are not very labour intensive. It is nevertheless important to encourage labour intensive exports and import substitutes through the selection of policy instruments, but it appears unrealistic to expect this to be the normal outcome. For most LAC countries comparative advantage is likely to be more in middle and upper skill areas.

The ultimate test of the employment/distribution impact of a more open system must of course come from the empirical record; though, as discussed below, it is hard to sort out which causal factors have been dominant, the record of widespread deterioration of income distribution around the time of the policy reforms is very worrisome. Exports have for the most part not
been particularly labour intensive and import liberalization seems usually to have been accompanied by worsening income distribution. The Chilean experience, plus less complete evidence from Argentina and Colombia, hints that export-fuelled growth may widen the earnings differentials between highly educated people and others. Rama's (1994) analysis for Uruguay suggests a negative employment effect. Accordingly, any optimism to the effect that policy reforms in this area would have positive distributional effects as well as accelerating growth, should be shelved until there is some empirical evidence to support it. In place of that optimism should be a realistic recognition that the reforms may have a generalized negative effect on distribution in both the short and the medium run, and that carefully planned policy, especially in the areas of education/training may be needed to counteract those effects. In particular the hope that opening up of trade would fairly directly raise the relative incomes of the poorer agricultural workers on the grounds that the old protectionist system disfavoured them should be abandoned. It is increasingly clear that in such countries there is a major part of the agricultural sector which cannot compete easily with an onslaught of imports, and whose labour resources are unlikely to be quickly mobile to other sectors.

C. Distribution impacts: the empirical record

Although considerable uncertainty still surrounds the precise evolution of income distribution during the crisis and adjustment periods in many of the countries of Latin America, and it is difficult to sort out the effects of policy changes from those of the crisis itself and of longer run structural trends dating back to the pre-crisis years, analysis of the record is nevertheless quite revealing. There has been a clear preponderance of negative shifts in distribution around the time of the introduction of policy reforms, an impact not readily explicable by other obvious candidates like stage of the cycle, rate of inflation, etc. Such shifts have occurred in Argentina, Chile, Colombia, the Dominican Republic, Ecuador, Mexico, and Uruguay. In no case with satisfactory quality data is there clear evidence of the opposite pattern. Costa Rica is a special and important case since distribution appears to have remained

---

14 A long term trend toward capabilities to export manufactures beyond the region is noticeable—even in product lines involving fairly advanced stages of value added, skills and technology (Teitel, 1991). These exports have two basic origins: the processing of agricultural and other raw materials (which accounts for the bulk of Chile’s manufactured exports in recent years) and goods originally produced for the domestic market under the ISI policies, including intermediate products (steel, petrochemicals, metalworking products, industrial machinery, etc.)—this category is currently quite important in Brazil, Argentina, Mexico and Venezuela. Traditional labour intensive products such as textiles, clothing and footwear are also important (especially for Colombia and several smaller countries of the region), though less so that at a similar point in the development of the NICs of East Asia.

15 A significant feature of the 1984-89 period in Mexico was the contribution of a widening gap between urban and rural incomes to the overall increase in inequality, and of the sharp decline in income from agriculture and livestock as a share of rural income (Alarcón, 1993, 139, 148). In Colombia an unprecedented increase in the gap between urban and rural incomes has appeared within the last two years, coincident with the process of liberalization.

16 This section draws on Berry, 1995, which presents background details and discussion.
roughly constant during the relevant period.\textsuperscript{17} (The record for these countries is summarized in Table 5.)

Table 5
Summary of the relationships between economic reforms and distribution
(Countries for which data are available)

<table>
<thead>
<tr>
<th>Country</th>
<th>Main period of worsening</th>
<th>Degree of worsening, main period</th>
<th>Degree of worsening, to present</th>
<th>Characteristics of main period of worsening</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina (Greater Buenos Aires)</td>
<td>1976 - 1978</td>
<td>8 points followed by some easing</td>
<td>8 points</td>
<td>Liberalization, labour repression, no net growth</td>
</tr>
<tr>
<td>Chile (Greater Santiago)</td>
<td>1974 - 1976</td>
<td>7-9 points</td>
<td>7-9 points</td>
<td>Liberalization, labour repression, sharp recession</td>
</tr>
<tr>
<td>Uruguay (Montevideo)</td>
<td>1976 - 1979 or 1982 - 1984</td>
<td>9 points or 7 points</td>
<td>not available</td>
<td>Liberalization, labour repression, growth or recession, increased exports, transition towards democracy</td>
</tr>
<tr>
<td>Mexico</td>
<td>late 1980s</td>
<td>3-5 points</td>
<td>3-5 points</td>
<td>Liberalization, some labour reform, slow growth</td>
</tr>
<tr>
<td>Dominican Republic</td>
<td>In period 1984 - 1989</td>
<td>8 points</td>
<td>not available</td>
<td>May have coincided with adjustment</td>
</tr>
<tr>
<td>Colombia (Three major cities)</td>
<td>1990 - 1992</td>
<td>4-7 points</td>
<td>4-7 points</td>
<td>Liberalization, labour market reforms, moderate growth</td>
</tr>
<tr>
<td>Ecuador (Urban)</td>
<td>1989-1991</td>
<td>5 points</td>
<td>5 points</td>
<td>Liberalization, labour reform, slow growth</td>
</tr>
<tr>
<td>Costa Rica</td>
<td>1985 - 1987 (?)</td>
<td>0-4 points (?)</td>
<td>-1 to +3 points</td>
<td>Liberalization, mild labour reforms (?) moderate growth</td>
</tr>
</tbody>
</table>

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

\textsuperscript{17} Preliminary analysis for Jamaica indicates that expenditure distribution improved over 1991-1993 as major trade liberalization was being initiated, so it may enter the categories of "exceptions" as well. Several other countries have not undertaken the reform package far enough back in time to generate useful data by now, and for others the data are of too questionable quality.
The three Southern Cone countries, Chile, Argentina and Uruguay, differ from the rest of the LAC nations in that all introduced significant liberalizing economic reforms in the early or mid-1970s, before such efforts were undertaken elsewhere.\textsuperscript{18} These cases thus offer a longer period during which possible impacts of the reforms might have been felt. Argentina and Chile suffered unusual worsening of income distribution, with high unemployment an aspect of the period in question in Chile, and falling labour incomes for the lower deciles the dominant feature in Argentina. Uruguay also appears to have suffered a major deterioration of distribution.

Chile's experience is the most important in terms of the lessons it may provide, since the policy experiments date well back in time and, despite some vacillation, their basic direction has been maintained subsequently. Since 1973, during which period there have been two severe recessions, the economy has undergone the most radical policy "reforms" of any nation in the region. As of the late 1960s inequality was a little less severe than in most other Latin countries. Data on the distribution of consumption among greater Santiago households show one of the largest deteriorations ever recorded statistically in a developing country, occurring primarily between 1969 and 1978 but also over the decade which followed (Table 6). Since distribution at the end of the Allende years was almost certainly better than that of 1969 (to which the first data point refers), it would appear that the worsening was dramatic over the first 5 post-Allende years. If the national trend in consumption distribution were like that of Santiago, the consumption decline in the bottom quintile of households over 1969-78 would have been 40%.\textsuperscript{19} Poverty naturally increased sharply.\textsuperscript{20} A combination of make-work policies for low income groups and targeted poverty redressal seems to have helped to limit the most serious poverty impacts of the negative income trends.

A number of the policy steps taken by the Pinochet regime would be expected to contribute to rising inequality. The extensive privatization, mainly carried out during the severe recession of 1972-74, led to acute concentration of ownership and the formation of large conglomerates (Meller, 1992, 27). Curtailment of agricultural credit to small farmers led to land concentration as well. Preferential financing to small entrepreneurs was cut back. Perhaps most important was the reform of the labour legislation, which relaxed worker dismissal regulations, suspended unions (to 1979, when they were again authorized to operate, but with many

\textsuperscript{18} As noted above, Brazil and Colombia had already taken serious steps to encourage exports by the late 1960s, but had not (at this time) undertaken an important liberalization of imports, nor imposed changes on the institutions governing the labour and financial markets.

\textsuperscript{19} Over that period average private consumption per person fell by about 13% and the share of the bottom quintile by 32%.

\textsuperscript{20} Meller reports an increase in poverty incidence from 17% in 1970 to 45% in 1985 with poverty lines not more than 6% apart (Meller, 1992, 23). This may somewhat exaggerate the trend. The high incidence of television sets (over 70%), refrigerators (49%), radios (83%) and bathrooms (74%) even in the lowest quintile throws some question on the 45% figure. Some of these items probably became much more prevalent due to the low prices which came with the import liberalization around 1980.
restrictions), greatly reduced the social security tax paid by the employers and reduced other non-wage costs as well. After the second crisis (1981-1983) wage indexation was abolished, replaced by a real wage "floor", specified to be the real wage prevailing in 1979. Wealth and capital gains taxes were eliminated, profit tax rates substantially reduced, and public employment greatly cut back. Unemployment rates (for greater Santiago) rose to unprecedented levels in the neighbourhood of 20-25% (depending on the definition used). Only in 1989 did this rate fall below 10% but since then the fall has been continuous, to just 5% in 1992 (ECLAC, 1992, 42). The coverage of the minimum wage was restricted considerably and its level fell in the 1980s. Fringe benefits had been greatly reduced from their 1970 level and public expenditure per capita in health care, education and housing had also decreased.

Table 6

(percent of total consumption)

<table>
<thead>
<tr>
<th>Quintile</th>
<th>1969</th>
<th>1978</th>
<th>1988</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>7.6</td>
<td>5.2</td>
<td>4.4</td>
</tr>
<tr>
<td>2</td>
<td>11.8</td>
<td>9.3</td>
<td>8.2</td>
</tr>
<tr>
<td>3</td>
<td>15.6</td>
<td>13.6</td>
<td>12.6</td>
</tr>
<tr>
<td>4</td>
<td>20.6</td>
<td>21.0</td>
<td>20.0</td>
</tr>
<tr>
<td>5</td>
<td>44.5</td>
<td>51.0</td>
<td>54.9</td>
</tr>
<tr>
<td>Total</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: Ffrench-Davis, 1992, 16.

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

Until the early 1980s, Argentina had a long period of very slow growth-- only a total of 4% between 1974 and 1988. Accompanying this macroeconomic failure was an unusually sudden and large increase in inequality, the Gini coefficient among income earners in greater Buenos Aires rising from about 0.36 over 1974-76 to somewhere within the range 0.41-0.46 from 1978 on (Marshall, forthcoming, Tables 4A and 4B). It is plausible, given the prominence of wage goods among Argentina's exports, that an increase in the real exchange rate (through devaluation, for example) would, ceteris paribus, lead to a decrease in the real wage rate and a worsening of the distribution of income. And in fact this rate (Argentine currency per dollar) does bear a short run inverse relationship, over 1970-87 at least, with both the real wage and
the ratio of the real wage to per capita income (Berry, 1990, 31). But it is clear that the longer-run worsening of the income distribution cannot be fully explained by this link with the real exchange rate, since significant net worsening occurred over periods when there was no net increase in the real exchange rate. Possibly structural changes wrought by the change in trade policy worsened inequality; a liberalization episode (1976-82) led not only to a fall of 11% in manufacturing output, but to an employment reduction of 37%, as output per worker rose by a striking 41% (Gelbard, 1990, 54). Many small and medium firms exited, while many large firms cut employment, increased capital stock and improved technology. Changes in labour policy almost certainly played a significant role as well; the bulk of the increase in inequality occurred between 1976 and 1978, when the new military government fixed wages, repressed trade unions, eliminated collective bargaining and the right to strike, and reformed the labour code to the detriment of workers (Cortés and Marshall, 1993).

Though the tearing down of labour market institutions would not perhaps be an obvious source of worsening in countries with small "protected" segments of the labour force and large unprotected ones, in relatively advanced and highly urbanized countries like Chile and Argentina such an effect is quite plausible. It might be especially strong in an economy where large rents come from a high productivity mining sector (Chile) or agricultural sector (Argentina) and where the public sector and other service activities have been living off those rents. When the public sector shrinks and wages are more closely linked to the marginal product of labour in the private sector, one might expect wages to fall more than in many other types of economy.

In Uruguay protectionism and monetary mismanagement have prevailed over most of the post-war period, and average growth has been very slow. Economic stagnation and high inflation gradually engendered social and political instability in the 1960s, leading eventually to a military coup in 1973. The new economic team installed in 1974 introduced a program of price stability, relaxed some of the existing controls on foreign trade and capital movements, and liberalized labour markets (Allen and Labadie, 1994, 10). Neither the union movement nor collective bargaining played any visible role for the next 10 years. Average growth over 1974-78 of about 4% per year was led by export-oriented industrial activities and the investment rate rose sharply, but the deficit remained high due to increased spending on the military and on public investment projects.

Most of the evidence for the 1970s, when the key policy changes were introduced, points to a substantial increase in inequality, including a sharp fall in wages and an apparently sharp widening in the earnings differentials across educational levels. Favaro and Bension (1993, 276) suggest that the opening of the economy, the reduction in the relative size of the government, and the prohibition of labour union activity all contributed to increasing inequality. They believe that the behaviour of the labour market during previous decades was greatly influenced both by the unions and by the state’s participation in the wage boards, in the determination of wage levels, and as employer of a significant share of the labour force. These factors, they feel, weighed in favour of a more uniform wage structure than would have resulted from market forces, created disincentives for more skilled workers, and led to considerable emigration by this group.
Since the military handed the reins back to the civil society in the early 1980s, the new union movement has proved about as militant as the old. A couple of years of fast recovery were once again followed by stagflation. Williamson (1990) cites the lack of deregulation in the labour market, where firing was again almost impossible, payroll taxes heavy and trade unions still strong, as a possible source of the still sluggish growth performance.

Mexico grew rapidly during the 1970s (second only to Brazil among major LAC countries), but then ran afoul of its debt build-up and has achieved an average growth of only about 2% since 1980, with the 1990s performance little better than that of the previous decade in spite of the major policy reforms of the late 1980s. Over the long period of rapid growth up to the debt crisis in the early 1980s it appears that most wages rose substantially (Gregory, 1986) and that inequality either fell, as argued by Hernández-Laos and Cordoba (1982) or stayed about constant. Since 1984, however, it has risen significantly. Alarcón and McKinley (1994) report that the Gini coefficient of total household income (grouped data) rose from 0.43 in 1984 to 0.475 in 1992, most of the increase having occurred by 1989. The main winners were the top decile, whose share in total household distribution rose from 32.8% in 1984 to 37.9% in 1989 (Alarcón, 1994, 87). What is unusual about the Mexican case is the dramatically increased concentration among wage and salary earners, whose Gini coefficient rose moderately from 0.419 in 1984 to 0.443 in 1989, then leapt to 0.519 in 1992 (Alarcón and McKinley, 1994, Table 4), probably one of the highest Gini coefficients of wage income observed anywhere. The variance within virtually all groups exploded over 1989-92 (Alarcón and McKinley, 1994, Table 3), but most especially at higher levels of education, in the border states, in urban areas, in export manufacturing industries and, surprisingly, among union workers. While there was no increase in income variance among "poor" workers, including domestic service, helpers and unskilled labourers in industry, street vendors and urban agricultural workers (Alarcón and McKinley, 1994, 18), for the "elite" occupations (professionals, managers, supervisors, etc) at the other extreme the Theil L indexes more than doubled. The group most clearly achieving a relative gain over the two periods were those with higher education (Alarcón and McKinley, 1994, Table 6).

Colombia and Ecuador are among the relative late-comers to the market-friendly policy package, pushing it vigorously only in the early 1990s. Since the late 1960s Colombia's macroeconomic performance has also been among the best in the region, and the economy was least affected by the debt crisis and accompanying recession. This creditable performance, which dates from the late 1960s, has been based on generally good exchange rate management since the switch to a flexible rate in 1967, a trade regime offering incentives both for import substitutes and for exports, and a relatively prudent fiscal and monetary policy, under which fiscal deficits never reached the unsustainable levels of a number of other LAC countries and monetary growth was accordingly more modest.

Colombia was perhaps the only Latin country to adopt the market-friendly policy package when not under severe pressure of circumstance to do so. Its adoption coincided with the sharp reversal of a previous (and perhaps unique) equalizing trend in the urban distribution of income between the early 1970s and the 1980s (Londoño, 1989). An important part of that earlier story
was the unusually marked decline in earnings differentials across educational levels and between genders (Tenjo, 1993). Inequality bottomed out in 1990, after which it has increased sharply; this reversal mainly reflects the increasing concentration of business income and coincided with both the main phase of import liberalization and with a significant labour market reform.21

Ecuador experienced rapid economic growth during the 1970s, when the country became an oil exporter. During the late 1970s, as those exports stagnated, growth was achieved at the cost of foreign borrowing, but as the external situation deteriorated, this growth strategy became unsustainable. Adjustment was pursued haltingly in the 1980s and the export quantum grew at a creditable 6.3% per year between 1980 and 1993, but two natural disasters and a sharp decline in the terms of trade slowed economic growth. The implementation of structural adjustment policies from 1981 onwards was gradual, slow, selective, and conflictive. A stable political consensus on economic policies was never reached, and social conflict resulted in frequent setbacks. In spite of its lacklustre performance, however, the country did not experience hyperinflation of, say, over 100% (though prices did rise by 60% or more at the peak), a dramatic income decline, or violent social unrest, as in the cases of Peru, Bolivia and other countries of the region.

The implementation of structural adjustment speeded up and became more consistent from 1988 onwards. Although trade barriers were reduced from 1984 on, the most important step was adopted in 1990, when most import tariffs were reduced to somewhere within the range 5 to 30%. Labour deregulation was pursued continuously during the period; real minimum wages declined and labour legislation was reformed to "increase flexibility and eliminate rigidities unattractive to foreign investors" (de Janvry et al., 1993, p.79). The reduction of the state apparatus was also pursued throughout the 1980s (except for a right-wing "populist experience" between 1986 and 1988) and speeded up in the early 1990s. Public expenditure plunged dramatically from 21.6% of GDP (current prices) in 1981 to 11% in 1992 (Larrea, 1995, Table 6).

The evolution of functional income distribution22 points strongly toward increases in inequality over 1980-84 and over 1987-91 (Larrea, 1995, Table 9). Since 1980 the (paid) wage share of value added fell dramatically from about 30% to less than 15%. Between 1982 and 1992 the total wage bill declined by 43.4% in real terms while net business income rose by 53%. Urban household survey data available since 1987 also point to a sharp increase in income concentration, both among earners and among households, around 1990: the Gini coefficient

---

21 The economy had earlier gone through a brief episode of liberalization (early 1980s), then a sharp reduction in openness followed by a gradual re-opening through the rest of the 1980s and the abrupt aperture of the early 1990s. Labour market reforms, oriented mainly towards reducing worker security and diminishing the cost to firms of firing workers, occurred mainly around 1990, though union power was already weakened by the recession of the early 1980s.

22 The functional distribution of income refers to the division of income among the factors of production--land, labour, and capital, or subfactors (e.g. categories of workers), rather than among families or individuals.
among earners jumped from an average of 0.431 in 1988-1990 to an average of 0.483 in 1992-1993 (Larrea, 1995, Tables 10 and 11). There was a severe deterioration for the poorest half of the population, exceeding 25% for the bottom quintile, an unstable or slightly declining situation for the next 45%, and a sharp improvement (of 25%) for the richest 5% (Larrea, 1995, Table 10).

On the evidence available to date, Costa Rica appears to be the only LAC country to undertake significant market-friendly reforms without suffering a large widening of income differentials--an increase in the Gini coefficient of say five percentage points or more. This nation brought a tradition of social and political stability to the trials of the 1980s, and came off a strong post-war economic performance in which average GDP growth exceeded 6% over 1950-80. A good social service system gave it the highest life expectancy in Latin America, with the exception of Cuba, and the absence of an army allowed it to allocate more resources to civilian uses.

The second oil price hike, rising interest rates and the world recession brought a sharp 14% decline in GDP over 1980-82, a 23% fall in income per capita and a 25% cut in real wages. Over the next few years an adjustment program was put in place, including tax increases, weakening of the power of unions (union strength had lain mainly in the public sector), privatization, and new incentives for exports, especially non-traditional ones. It has been relatively successful in reestablishing a decent growth performance, about 4.5% per year (through 1994) after returning to its pre-crisis GDP level in 1985. Policy changes were less extreme, more gradual and less erratic than in Chile. Real wages did not long remain low, as the indexing mechanism which linked nominal wage increases to past inflation was left in place with only mild modification so that when tightened monetary and fiscal policy brought inflation quickly to heel real wages moved back to or near their previous peak in only three or four years.

Though some qualifications are necessitated by the uncertain quality of the Costa Rican data, the best guess at this time is that there was no significant, lasting negative impact of the post-1986 reforms on the level of inequality in Costa Rica.23

D. The new fiscal constraints on social policy

One of the essential reforms pursued in LAC countries is that of the public sector, with the twin objectives of cutting the fiscal deficit--thereby reducing the sector's destabilizing effect on the macroeconomy, and of raising its efficiency by improving the tax and expenditure system. Since a strong set of projects and programmes to combat poverty costs money and human resources, there is a natural concern that the pressure to achieve fiscal balance, partly by expenditure reduction, will curtail the poverty-alleviation effort carried out through these programmes. The concern is the greater if there is reason to suspect that many "social" expenditures tend to be vulnerable politically and hence among the first candidates to be cut.

---

when fiscal discipline is the order of the day. The space for manoeuvre is limited by the relatively low tax burdens which have been traditional in Latin America, compared to LDCs in general (Carciofi et al, 1994, 352).

The design and execution of fiscal reforms affects countries' potential for social development and poverty alleviation in several distinct ways. First, the changes in the levels of taxes and transfers will influence the distributional impact of the public sector and hence the secondary (post tax and transfer) income distribution. Second, the success in curtailing inflation may have a separate impact on distribution and poverty. Finally, the availability of funds for public spending (other than transfers) and the way they are spent will determine the focus on poverty-alleviating projects and programmes. It is impossible at this time to come to an overall evaluation of the past and ongoing fiscal reforms which would take account of these various effects. Their nature, and the overall public finance setting, clearly gives grounds for worry; but a positive outcome is not impossible and the events in this area warrant careful monitoring.

The magnitude of the fiscal challenge is highlighted by the fact that, in spite of several significant tax reforms during the 1980s, the share of current government revenue in GDP was about the same in 1991 as in 1980--around 20% for the eight richest countries listed in Table 7 and about 12% for the poorest seven. Total expenditures rose by a couple of percent of GDP for the former group, but the interest charges on the public debt appear to have risen by more than this (Berry et al, 1994, Table 2.7) so non-interest expenditures fell somewhat. For the lower income countries total expenditures fell by 2.5-4.0% of GDP (depending on whether Bolivia is excluded or included--its 1980 figure is suspiciously high), and the non-interest expenditures by even more. The gap in the ratios of revenues and expenditures to GDP between the lower and higher income countries reflects the weaker tax capacity of the former. These countries will clearly have a more difficult time in financing needed expenditures.

Concern is also warranted by the fact that the structure of the reforms undertaken in most countries gives the appearance of being regressive in character, in that they diminish the role of such theoretically progressive levies as the income and corporate taxes and increase the weight of indirect taxes, in particular the value added tax (VAT).24 The 1980s saw an emphasis on maintaining fiscal revenues even if at the expense of redistributive effects, with the preoccupation with equity increasingly focused on the expenditure side of the budget (Carciofi et al, 1994, 355). As Bird (1992, 29) puts it "The day when one could consider the tax system to be the 'supreme equalizer' of the economic system (OAS, 1973), the main means of

24 In their review of LAC tax trends during the 1980s Carciofi et al (1994, 351-3) highlight the focus on the value added tax as the chief instrument of consumption taxation, the exhaustive revision of the income tax to lower its formal progressivity and to simplify it (less income categories, less special taxes, etc.), and the reduction of the tax on retained profits in order to encourage savings.

In his review Bird notes that there is now much greater awareness of the significant constraints imposed by the administrative dimension of tax reform. Although some reformers are still tempted by tax gimmicks which promise reform "without requiring the slow and painful process of creating an adequate system of public administration" (Bird, 1992, 29) this is less frequent now than before.
<table>
<thead>
<tr>
<th>Country</th>
<th>Total current revenue</th>
<th>Total expenditure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>17.4</td>
<td>13.7</td>
</tr>
<tr>
<td>Brazil</td>
<td>23.4</td>
<td>21.6a</td>
</tr>
<tr>
<td>Chile</td>
<td>33.2</td>
<td>24.4b</td>
</tr>
<tr>
<td>Colombia</td>
<td>12.1</td>
<td>13.4</td>
</tr>
<tr>
<td>Costa Rica</td>
<td>18.7</td>
<td>24.6</td>
</tr>
<tr>
<td>Mexico</td>
<td>15.6</td>
<td>14.7</td>
</tr>
<tr>
<td>Uruguay</td>
<td>23.1</td>
<td>27.8</td>
</tr>
<tr>
<td>Venezuela</td>
<td>22.2</td>
<td>24.3</td>
</tr>
<tr>
<td>Eight richest</td>
<td>20.7</td>
<td>20.6</td>
</tr>
<tr>
<td>Bolivia</td>
<td>16.6</td>
<td></td>
</tr>
<tr>
<td>Dominican Republic</td>
<td>14.7</td>
<td>12.7</td>
</tr>
<tr>
<td>Ecuador</td>
<td>13.5</td>
<td>18.1</td>
</tr>
<tr>
<td>El Salvador</td>
<td>11.7</td>
<td>9.1</td>
</tr>
<tr>
<td>Guatemala</td>
<td>11.3</td>
<td>9.7</td>
</tr>
<tr>
<td>Paraguay</td>
<td>10.6</td>
<td>12.3</td>
</tr>
<tr>
<td>Peru</td>
<td>17.9</td>
<td>8.3</td>
</tr>
<tr>
<td>Seven poorest (including Bolivia)</td>
<td>n.a.</td>
<td>12.4</td>
</tr>
<tr>
<td>Seven poorest (excluding Bolivia)</td>
<td>13.3</td>
<td>11.7</td>
</tr>
</tbody>
</table>


Notes: (i) the fact that these data refer only to the central government implies that they understate total revenues and expenditures, by an amount which varies according to the country. In general, however, they appear to give a reasonable feel for differences in the overall importance of the public sector across the countries. (ii) A few figures refer to a year other than (but near) that specified.

* Figure refers to 1992. The 1991 figure for revenue given in the source is an anomaly, apparently reflecting the effects of the rapid changes in the rate of inflation at the time.
* Figures refer to 1992. Those for 1991 were not available.
* Inflates by the unusually high figure for Bolivia.
correcting inequalities in income and wealth, has passed. This shift in Latin America is part of a more general drift away from the use of progressive income taxes. One major reason behind it is "the heightened perception of the severe constraint that administrative factors impose on redistributive taxation" (Bird, 1992, 30).

Though the current batch of reforms may or may not have actually made the tax systems less progressive than before, what they do make clear, in removing the formal progressivity which characterized the previous system, is that the existing system has limited progressivity.

The main basis for hope that the contribution of the public sector to poverty alleviation need not diminish in spite of the fiscal constraints just cited is the fact that in the past the poverty-alleviating effects of social expenditures have often been far below their potential, either because they were not designed with the poor particularly in mind and/or because they were not effectively targeted towards that group. Thus the challenge of the post-adjustment era is to achieve greater poverty-alleviating effects with fewer resources. While it is not inherently impossible, neither can it be taken for granted. Too little evidence is in for Latin America and other parts of the Third World to give grounds for particular optimism or pessimism.25

IV. LESSONS AND IMPLICATIONS FOR POVERTY ALLEVIATION

A. The growth implications of the reforms are unclear at this time

Though modest growth has returned to the region it has been slower than hoped for. It is expected to increase as more countries put the crisis and adjustment problems behind them, but the various setbacks suffered to date suggest that this remains a somewhat uncertain prospect. Regional growth will likely settle somewhere between 4% and 8% per year, possibly not far from the middle of this range in which case it will be about the same as before the crisis. Recovering the pre-crisis rate of poverty reduction will require a combination of growth somewhat above the lower limit of the range just cited together with not much if any deterioration in the distribution of income. The challenges to be met under the new more market friendly model of development will be somewhat different from those of the earlier ISI phase of development, and countries which do not learn to deal effectively with them may be losers from the policy shift.

25 A useful review of the experience with targeting in Latin America is Grosh (1996)
B. Distribution has worsened significantly, if not dramatically, in most countries undertaking market-friendly economic reforms

The economic reforms have been systematically associated with severe accentuation of (primary) income inequality; among LAC countries for which the statistical evidence is adequate to reach any conclusions on this issue, the only probable exception to this generalization is Costa Rica--Jamaica and Peru may turn out to be as well but this remains to be seen. Insufficient data are available to judge whether the distribution of secondary income (after allowing for taxes, transfers, public provision of goods) has moved differently from the primary distribution or not. Effective targeting has made a positive impact in some cases, but the reduction of government activity may have had a regressive effect, as may the changes in tax systems toward the greater use of indirect taxes.

The country experiences reviewed above suggest that the "normal" observed increase in inequality accompanying reforms is 5-10 percentage points as measured by the Gini coefficient of primary income (Table 5). This increase is frequently associated with a jump in the share of the top decile, most of this accruing to the top 5% or perhaps even the top 1% (as in the cases of Colombia and Ecuador households) while most of the bottom deciles lose. In the three Colombian cities analyzed by Berry and Tenjo, the ratio of the income of the top 5% of households to the bottom decile rose from 13 fold to 20 fold, and the income share of the latter decile fell from 1.74% to 1.45% (Berry and Tenjo, 1995, Table 3B). At a moderate GDP per capita growth rate of 2% per year, it would require nearly 10 years of distribution-neutral growth to recover the "lost ground" implicit in this drop in the income share of the bottom decile. If per capita income growth could be accelerated to, say, 5%, the recovery period would be only four years. In Ecuador, where the percentage decline for the bottom decile was sharper (from 2.2% in 1988-89 to 1.5% in 1993)\(^{26}\), nearly 20 years of distribution-neutral growth at 2% per year per capita would be needed and about eight years at 5%.

It appears probable that some components of the new policy package have contributed to the widespread worsening of income distribution, but neither the overall degree of that impact nor which elements of the model might be primarily responsible is clear at this time. Better understanding of the causation is necessary, along with careful monitoring of distributional outcomes from now on. The impact of the deterioration which has occurred to date is to very substantially increase the challenge of poverty reduction.

C. The possibility that the market-friendly economic reforms have caused the accentuation of inequality warrants serious concern

No definitive conclusions on the origins of the observed increases in inequality can be derived from the comparison of country experiences and the limited microeconomic evidence on the various elements of the reform package. We tentatively suggest that technological

\(^{26}\) Based on calculations undertaken by Carlos Larrea as part of Larrea, 1995.
change, more open trade regimes, the dismantling of labour institutions, and the "socialization" of debts (whereby the state makes itself responsible for certain private debts which might otherwise threaten macroeconomic or financial stability) have all had negative impacts on distribution. The effect of the scaling down of the public sector (directly and via the privatization of public enterprise) is less likely to have been negative. Increasing foreign investment has also been proposed as a source of worsening (in Mexico, for example), but judgment should probably be reserved on this point also. Many questions remain with respect to how these various factors interact among themselves and/or complement each other, both in terms of their growth effects and their implications for income distribution.

Trade and labour market reforms have been consistent elements of the reform packages instituted in the LAC countries where distribution has worsened significantly. In each case it is easy to see mechanisms whereby their effects on distribution might be negative, and in each case there is at least some empirical evidence suggesting that those mechanisms are at work. It seems unlikely that the comparative advantage of the region lies in unskilled labour-intensive products and it appears that import liberalization shifts the price vector in favour of better-off families. Recent evidence contradicts the hope that agricultural workers would be significant beneficiaries. Meanwhile, labour market reforms appear to open the way for wider wage and salary differentials among individuals. A tentative guess would be that these two elements of reform packages may underlie most of the observed negative trends in distribution.

The "socialization" of international and other debts in order to save teetering financial and other enterprises has doubtless had a significantly negative impact on distribution, as shown in the case of Chile by Meller (1992). This was, however, a crisis-response policy, less germane to our present concerns than the now ongoing financial liberalizations (assuming that such liberalization does not henceforth lead to financial crises as they sometimes did during the 1970s and 1980s--see Diaz-Alejandro, 1985). Solid evidence has yet to come in as to their distribution impacts, but there are plenty of reasons to suspect that these could be negative27, and that the supporters of reform will here, as in the area of trade policy, prove to have been excessively optimistic.

The possible role of technological change in the increasing inequality observed is hard to assess since it is very difficult to get a quantitative reading of its speed and the extent to which it has been labour saving. Technology affects, through the shape of the demand curve(s) for labour, both the amount of productive employment and the distribution of income between labour and capital. For any given total capital stock in the economy, the demand for labour also

---

27 The reforms tend to diminish the role of the institutions whose main role is to provide credit to the smaller firms, and may also tend to decrease pressure on private and other banks to allocate loans in that direction. In many countries a significant share of the private part of the system is made up of banks which are part of large conglomerates and whose main function is to service the non-financial members of those conglomerates. Although there is also hope that since the reforms discourage subsidization of credit this may improve the access of smaller firms otherwise viewed with disfavour by the banks, the strength of this effect remains to be seen. Financial markets are notorious for their degree of oligopoly, making it very hard to judge the outcome of the reforms now under way.
depends on the distribution of capital, an outcome related to the fact that technology choice depends on the size of the productive unit, with smaller units typically being more labour intensive. When the bulk of the capital stock is in the hands of large firms while many small firms get by with meagre amounts of capital, total output is likely to be less than if capital were more equally distributed and the equilibrium wage is relatively low since it is determined by the firms which have little capital and hence low labour productivity. Given the generally significant level of technological change in the last couple of decades and the concentration of technological catching-up in the post crisis period, it is would not be surprising if this factor has played a significant role in the observed deterioration.

D. Neither theory nor the record has provided much evidence on how lasting the negative distributional shifts will turn out to be

Since many of the economic reform episodes are recent, it might be hoped that many of the accompanying negative effects are temporary, associated with the transition to a new model, and likely to peter out with time and the adjustment of economic actors to the new reality. The only ray of hope in this regard comes from Chile, where distribution has improved noticeably in the last five years. But the period between initial worsening and beginning of improvement was a lengthy 15 years, and it is not clear whether the recent improvement is best understood as the reversal of the initial impacts of the new model or simply the result of other, independent processes, such as the tightening of the labour market predicted by labour surplus theory.

Even if the latter is the case, the declining inequality in Chile is certainly reassuring, since it suggests that distributional losses from the economic reforms may be offset within the foreseeable future by other aspects of the growth process; though distribution may remain less equal than it would have been without the reforms, it will not permanently remain more unequal in absolute terms.

What does not appear likely is that simple recovery from the recessions which have racked the LAC countries will reverse the increases in inequality. Morley (1994) is certainly right in concluding that for economies mired in stagnation and underutilization of capacity the best way to cut poverty is to get the economy moving. And it may be true, as he argues, that economic downturns were the main factor underlying the increases in inequality observed in some LAC countries during the 1980s. But the evidence presented above suggests that most of the observed worsening has other origins.

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

The experiences of Chile, Colombia and Costa Rica are perhaps the most interesting from the perspective of learning how to guide policy more effectively in the future. Costa Rica is the one country which may have come through a reform process without a major deterioration of distribution. Colombia appears to have achieved the most significant pre-reform improvement in distribution, at least in the urban areas. And Chile undertook the reforms earliest, suffered
high social costs thereafter, but has also pioneered a number of impressive policy experiments of relevance to other countries.

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

F. Some recent trends in labour force structure may have major consequences on welfare

There has been considerable evolution both in the structure of the labour force (e.g. more temporary work) and of the societies (e.g. smaller families, more female-headed households) over the last couple of decades. Some of the changes may have been in response to the needs of the more market-oriented model but much appears to have different causes. The welfare implications of these changes are also not well understood at this time. Among the striking trends are:

(i) the rising female participation rate and the generally increasing shares of economic activity undertaken by women and of total income earned by them. Related phenomena in most countries have been a decrease in average family size, an increase in the share of female headed households and a continuation of the normal trend towards urbanization;

(ii) the increasing importance of temporary work and part-time work, and the apparently associated decrease in the security of employment (though this is not clear since the trends in the share of workers in the modern sector has a major impact on this latter).

V. CURRENT CHALLENGES AND CONCERNS FOR ANTI-POVERTY POLICY

A number of challenges confront effective anti-poverty policy at any time; the set is somewhat different in Latin America today than it was a couple of decades ago, both because of the evolution of the economies, the polities and the administrative systems over the interim and because of the policy changes which have occurred.

Several background trends should be noted. In the political/administrative realm there have been (related) trends towards democracy and more decentralized decision-making and administration. In some countries the economic crisis reduced decision-making capacity on many issues, though it is probably on the rise again in many countries and in some is clearly
superior to that of a couple of decades ago.

In the area of poverty policy there is a trend towards targeting and towards more market-based approaches. Pension plans are increasingly being privatized, and the role of the private sector in health and educational systems is on the rise, in some countries at least. The results are yet to be clarified by empirical studies.

Among the specific challenges at this time the following appear to be especially important.

A. Education and training

There are both positive and negative reasons to put much weight on improving the distribution of education and human capital. On the positive side, it appears that the character and rapidity of technological change has raised the payoff to skills, or perhaps better put, it has changed the set of skills on which the economic payoff is high and increased the advantages of training-for-flexibility and general training. On the negative side, there is evidence from several LAC countries (e.g. Mexico, Chile at times) that earnings differentials by level of education have widened in recent years, often in the wake of changed economic policies or greater outward orientation. Since unequal distribution of human capital is now perhaps the main single source of inequality in LAC countries, it is obviously important to avoid outcomes in which either earnings differentials by level of human capital become even wider or the distribution of that capital becomes even more unequal. The most straightforward way to avoid such outcomes is to diminish the inequality of such capital. In the context of most of the poorer LAC countries, this means assuring that as few people as possible are stuck with low levels of education or poor quality education. In some countries making sure that everyone completes primary may be the highest priority aspect of this response, in others the quality of primary, especially in rural and poorer urban areas is central. Adult education may also be very important in some cases. The objective of such policy is to diminish the size of the lower tail of the income distribution when the factor underlying the low incomes of the people found there is their lack of human capital.

B. Technological change

Technological change may have been a significant factor in the recent increases in inequality in LAC countries. And it is probable that the speed and character of technological change will directly and indirectly be a major, and perhaps the dominant, determinant of the evolution of productive employment and income distribution in the LAC countries over the coming decades. While bringing benefits in the form of growth, such change holds also the threat of increased income inequality. At present governments tend to have little understanding and even less access to policy instruments which could give them some direct control over the process and the effects of technological change. Support for small farms and for microenterprise and SME, discussed in the next section, can influence these outcomes indirectly, since these units tend to choose less capital intensive technologies than do larger ones. And one of the issues in the assessment of the relative merits of alternative trade policies is the way they affect
the evolution of technology.

The relationship between technology and labour demand/income distribution involves at least three aspects: (i) the changing range of available technologies and the appropriate role of the LAC countries in building up their own capacity to develop and adapt new technology; (ii) choice of technology and the problem of inappropriate technology resulting from distorted factor prices; and (iii) the role of the size distribution of enterprises as a determinant of technology choice and factor proportions.

Technological change has long been suspect as a key factor in the inability of Latin America's growth to generate enough increase in the demand for labour to lead to an improvement in income distribution. The main argument was that technology developed in DCs was not suited to the factor proportions of the region, and that it tended to be transferred with little adaptation. Tokman (1989) suggests that the prevalence of foreign technology may have played a role in falling real wages of unskilled workers in a number of LAC countries, though others feel that this view is too pessimistic. The "appropriate technology" question is an especially tricky one for LAC, since the region is less labour abundant than the Asian countries so its comparative advantage in labour is less obvious. Technological change is essential but if it is either too fast28 or of the wrong type its distributional effects are likely to be negative and even its growth effects uncertain. It is this "double-edged sword" character which makes the policy decisions around technology so tricky.29 We are still searching for adequate inducement mechanisms to generate the "right" rate. When well complemented by a high investment rate, a strong human capital formation policy, and a strong SME technology policy, the risks associated with fast technological adoption may be reduced. It is likely that exchange rate and trade policies have impacts on the pattern (as well as the rate) of technology change, but these have not been well identified thus far. But logic dictates that Northern technology will sometimes be inappropriate. Empirically about all that can be said so far is that, if the extensive technological contact with the North over the Post-War period as a whole has had negative effects on employment and distribution, these were not strong enough to produce a generalized worsening in the region prior to the crisis. It is possible that the transfer occurring after the crisis has played a role on the observed worsening of distribution in many developed countries of the region, since the more liberalized trade and investment arrangements permit a freer flow of Northern technology.

---

28 There is some danger of inducing overly capital intensive technologies by either or both of a low or negative interest rate or an overvalued exchange rate. Large firms have been the usual beneficiaries of low interest rates and of cheap rationed foreign exchange when the exchange rate is overvalued. The continuing very high level of income inequality in Brazil and other LAC countries, while it does not demonstrate that these phenomena have played a significant role, is consistent with that conclusion.

29 While the recent export performance testifies to the competitive potential of industries fostered under the old policy regime, Teitel (1992, 374) notes that a substantial technological discontinuity seems to have occurred in LAC around 1975-80; for the industrial applications required in the new fields, the learning embodied in the stock of human capital acquired during ISI is of limited use. He feels that to boost the region out of its current stagnation an enhanced role on the part of the public sector may be needed.
C. Small and medium enterprise (SME)

Few informed observers doubt that SME has a major role to play in a healthy development process and that this role has been grievously neglected in the past. Neither macroeconomic nor microeconomic policies have taken its needs and potential into account. The export and import competing potential of SME is an increasingly important issue as the LAC economies turn outward. In Colombia the share of manufactured exports coming from SME has risen significantly over the 1980s, for reasons still not established (Escandon and Berry, 1994). Although many SME face serious problems in breaking into export markets, these problems are now somewhat better understood and it is not unreasonable to believe that well designed policies could appear in some LAC countries over the course of the next five years. However, though many SME can be significantly affected by macroeconomic, trade and exchange rate policy, in most countries the sector has virtually no voice in the making of such policy, and policy-makers typically know almost anything about the sector and its needs. The increasing dominance of policy by macro specialists unfamiliar with the economics of major sectors of the economy (agriculture and SME come immediately to mind) has created the danger that the criteria for policy-making will be unduly simplistic.

The experience of many counties, including Japan and some of its Asian neighbours, illustrates the potential importance of linkages between efficient modern industry and smaller firms. Though the evidence is scanty from Latin America, it suggests that such mutually beneficial synergies are significantly less frequent, a situation attributed by some to the ISI history, the lack of competition in local markets, and the daunting initial gap between the large and the small in productivity, technology, and even culture. The contribution of effective linkages of this sort is likely to be more important in the open economy than in the closed one; where it is the larger firms which do most of the exporting (as in Brazil, for example), export success may bring little productive employment in its wake unless smaller subcontractors are hooked into the process.

D. Labour market institutions and policies

Labour market functioning may be particularly important to overall economic performance in situations of macroeconomic stress and of major structural or policy change requiring the shifting of labour sectors, decreases in labour costs, or changes in relative wages. Just how much it matters and exactly how the outcomes are related to labour market functioning and to labour market policy is less clear. Labour resistance to mobility or to reduced wages may have different impacts according to what adjustments are needed to improve economic functioning. Sometimes considerable shifting of output composition occurs with very little labour movement, as noted in the cases of Costa Rica (Gindling and Berry, 1992), Brazil (Urani, 1994) or earlier in Colombia (Diaz-Alejandro, 1983). Of particular importance to poverty issues is the extent to which wages will fall when not "protected" by such institutions as the minimum wage and the welfare costs of job insecurity.

Among the labour market institutions under serious debate (and frequently attack) in the
current labour market "reform" processes are the level of job security built into the labour codes, the high level of non-wage costs, the mobility reducing non-transferability of some pension plans/systems, and the management of the minimum wage (including the way it is indexed for inflation). The appropriate role and structure of the unions and of union bargaining naturally lie behind these more specific concerns, with the distinction frequently made between public and private sector unions.

Given the inequalities so manifestly present in most LAC countries, the important potential role of unions as a defense of the worker is obvious, and their contribution along these lines may have been considerable. As in many other developing countries, however, the unions and much of the legislation have been criticized as protecting the interests of a labour elite at the expense of both the capitalist class and the rest of workers, contributing to microeconomic inefficiency and macroeconomic instability and, of particular relevance here, pushing down the earnings of the poorer, unprotected workers by reducing labour demand in the formal sector of the economy.

The authors of the World Bank's "Labor Markets in an Era of Adjustment" studies of the experiences in Argentina and Brazil conclude that the unions impeded adjustment and labour mobility, while the author of the Chile study concludes that they contributed to the painful nature of the recession and the ensuing high unemployment (Horton et al, 1991, 39). In Costa Rica the institutions remained more or less in place without apparent damage and in Bolivia were dismantled without apparent positive effect thus far (ibid, 40). Private sector unions in Costa Rica are relatively weak, especially since the collapse of the banana union after a major strike in the early 1980s. Labour legislation, on the other hand, is quite detailed and appears to be systematically implemented. An interesting hypothesis is that this combination played a role in Costa Rica’s relatively successful passage through the 1980s crisis.

Less analysis has focused on the income distribution implications of labour legislation and union power. It has been widely noted that some of the more egalitarian countries of the developing world are found in East Asia where unions and labour legislation are less powerful than in LAC. Within Latin America, however, there appears to have been a positive association between equality and the strength of labour legislation and unions; Argentina had both the lowest level of inequality (prior to the late 1970s) and the strongest legislation/unions.

The traditionally strong barriers to firing in the medium and large private firms in most LAC countries and in the public sector were a natural outcome of labour's bargaining demands in a situation in which (i) there was no general unemployment insurance system to act as a safety net against the welfare losses associated with loss of job, and (ii) because of labour market segmentation, the earnings associated with a "protected" modern sector job were likely to be well above what one would expect to get in an alternative job. The widespread presence of severance payments developed as a partial substitute from the worker's perspective for the existence of a publicly funded unemployment insurance scheme. But it is clear that tight strong regulations against worker dismissal contribute to the reluctance of firms to expand employment, and lie behind some firms' deliberate rotation of workers after they have completed the probation

39
period after which employment becomes permanent; such rotation may impede the accumulation of human capital. When actually applied with some rigour, these rules are seen to be particularly prejudicial to many SME which are likely to need to vary their labour forces according to their market situations. Riveros (1992, 19) concludes that Latin America got into a vicious circle of policies and pressures around labour issues and ended up with a highly inefficient and in many ways counterproductive system.

Most countries have recently introduced or are introducing major labour market reforms. Though many of the criticisms levelled at the previous set of institutions are likely to be valid, at least up to a point, it must be noted that there is little persuasive empirical evidence to help guide the policy maker as to how the reforms have affected or will affect performance. It is hard to sort out any growth effects from those of other factors at work at the same time, including the other components of the reform packages. And it has not been possible to demonstrate convincingly that they have led to raised "productive mobility" of labour, reduced firms' reticence to hire, or raised human capital accumulation. If they have had an impact on distribution it has almost certainly been negative.

The impact of minimum wages on employment, wages and income distribution also remains controversial in the LAC countries, partly because enforcement is variable and not always well-known, and partly because the effects are neither easily predictable nor detectable even when enforcement is systematic.

Riveros (1989) has established that non-wage costs have been very high relative to wage costs in most countries of LAC (often in the range 60-80%), much higher for example than those observed in most Asian countries (more often 20-30% or so). He believes that such non-wage benefits unrelated to productivity considerations may be dangerous to the success of export drives. Though there seems to have been little analysis of the degree to which the presence of such mandated costs raises total labour costs, it probably has some effect in this direction. It also clearly stretches out the time profile of expenditures on the labour whose product occurs at any given point of time (since some of these costs accrue later--e.g. the severance payment); this might be of benefit to a young struggling firm, but it would also reduce the firm's flexibility to lower labour costs at a time of crisis.

Given the major dislocations in the labour market due to the crises and structural adjustment programs, the value of effective labour adjustment support programs has not been

---

30 Cortés, Berry and Ishaq (1987) report that in a sample of SMI firm-level employment showed much fluctuation over the histories of the firms.

31 Panama and Peru were examples of very strict security regulations and labour market segmentation has been quite important. Job security legislation was earlier an important obstacle to mobility in Brazil but the creation in 1964 of a fund to provide severance pay eased the problem (Horton et al, 1991, 40). In Bolivia (latter 1980s) job tenure was ended and job security reduced, and the government stepped out of the previously centralized bargaining. In Chile the public sector labour force was reduced by a third and regulations greatly simplified; that country now has a particularly liberal labour market regime.
lost on the LAC governments. Some have initiated new schemes, some of them adaptations of systems in use in developed countries. They have shown reasonable promise and deserve to be retained as one instrument in the tool kit. A number of LAC countries, including Brazil, Bolivia, Chile and Peru, have introduced emergency employment policies in response to the labour market crises of the 1970s and 1980s. They appear to have been effective for these emergency situations, can be implemented quickly and at low cost, and can be quite selective and hence help the poorest. Their impact is more on raising income of lower income families than on lowering unemployment; 70-90% of the beneficiaries were women (Tokman, 1989, 168). To avoid mismatches, it is important to take account of the characteristics of the persons to be helped and take this into account in the sort of jobs provided.

It is easy to conclude both from microeconomic theory and from observation of distortions and some of their direct costs that the reforms pursued have been and are important to the labour regulatory systems of many LAC countries. But research has not gone far in clarifying the details of a really good system or of how to proceed from an inferior to a better one. Chile has had the most complete reform; there the question is whether/how much the changes adopted contributed to the long and costly adjustment, whether they continue to have a negative impact on income distribution, and whether they have contributed to the strong growth since the mid-1980s. Horton et al (1991, 42) deduce from the comparison of the experiences of Bolivia and Costa Rica that the wholesale dismantling of labour institutions is neither necessary nor sufficient to economic success. But they suggest, and in this we concur, that strong unions are likely to be associated with labour market inefficiencies (though the causation may go in both directions). In East Asia strong growth and equity have been associated with weak unions.

Labour market regulation is a different story; some common instruments seem innocuous and basically positive, others do not. There appears to be little serious evidence that minimum wages have been per se a cause of significant distortion, even when a system (e.g. that of Costa Rica) seems cumbersome and complicated; the experience of that country suggests that together with such benefits as minimum wages are expected to provide in the form of control of monopsonistic behaviour by employers, the institution probably helped the country through its macroeconomic crisis by providing reasonable stability of the wage relative to other prices. On the other hand, the costs of job security regulations may be high; the benefits may also be significant (less evidence is available on this) but it is clear that the criticism of this institution has substance.

---

32 Experience in Mexico and Chile indicates that training courses of 2-3 months duration and costing about $600 per trainee can contribute to worker reemployment; greater success is expected when the program is closely tied to the private sector, with intermittent periods of on-the-job training (Cline, 1992, 17). Mexico’s Labour Retraining Program began in 1984, enrolment peaking at 546,000 in 1984.
E. The need to build capacity for planning and monitoring in key areas, including SME and human capital policy

Most LAC countries have given less serious attention to policy in the social areas (health, education, labour) or in SME than to macroeconomic policy, trade policy, etc. Yet it is clear that the quality of policy making in these areas will be pivotal to the rate of poverty alleviation in the coming years. In most countries some appropriate and needed policy changes or foci have been identified. In the education/training systems of most LAC countries, for example, such goals as substantial improvements to the quality of primary education, a more flexible and effective vocational training system, better quality-control at the higher level, and an increased in-firm training capacity are in principle uncontroversial. The desirability of continued rapid expansion of secondary is arguable, but not self-evident. The question of how the relationship between academic and technical education should handled is not clear nor, typically, is the way in which primary and secondary curricula should ideally be changed.

On the SME front, improvements in credit access, credit guarantee systems, technological transfer and relevant courses and training are all clearly desirable. Policies to foster productive small-small and small-large linkages may have a good payoff but at this time little is known about what, if anything, would work in practice.

In short, there are a number of important policy questions to which the answer is not clear at this time. Further, the best feasible means to achieving such agreed-upon goals as quality improvement in primary, or technical transfers to small enterprises are not clear, and will certainly require not only solid up-front analysis but, probably even more important, a system with the monitoring capacity to allow for the early correction of mistakes in the making. As countries consider significant policy changes in areas like these it is shocking how little clear evidence is brought to bear on what works better than what.

The analysis and monitoring system needed to help guide countries towards an effective and efficient education/training system or a well designed and performing support system for SME will not be easy to attain, since it involves several features which are almost complete the opposite of past practices. It needs to produce solid analyses on the key controversial issues, to greatly improve administrative and implementation capacity, and to mount a solid information/monitoring/analysis system to keep track of progress in those areas where policies are undertaken on what should be considered an experimental basis.

Many LAC countries suffer a grave shortage of top-notch personnel in their social sector ministries and a correspondingly inadequate planning/analysis/monitoring capacity in these areas. In the SME area the problem is partly that no clear institutional home acts as the focus of policy considerations, etc. There is no organized and up-to-date compilation of policy-relevant information which could be effectively used by policy-makers. In both these areas and others like them, there must be high quality, adequate quantity and good continuity of personnel, together with reliable data. None of these conditions is at present close to being met. To meet them require, at the least, the development of "policy analysis units" and "information units".
VI. SUMMARY AND CONCLUSIONS

The macroeconomic context must be taken into account in the design and implementation of poverty policies, partly because that context is a major determinant of the size of the poverty challenge (healthy equitable growth can by itself reduce poverty considerably), and partly because it defines where direct anti-poverty efforts need to be focused. Though economic growth is in most cases essential to long-run poverty alleviation, it does not automatically lead to a satisfactory growth of productive, stable and increasingly well remunerated employment—the direct source of most poverty alleviation. In particular, when labour displacing technological change is an important source of growth, the expansion of productive employment may be significantly less than that of output. When operative, the link between growth and poverty reduction may occur primarily through creation of productive employment (especially when the labour market has an overabundance of low-skill workers and the task is just to get them employed) or through wage increases at the lower end of the earnings spectrum.

The background to the 1980s crisis which afflicted most LAC countries included an unfortunate legacy of extremely high levels of inequality—which made poverty more severe than it would normally be for countries with the average incomes of the region, and of macroeconomic instability. The latter was the result of exogenous fluctuations in international markets, together with a combination of fiscal deficits and monetary expansion which, in a context of fixed exchange rates, produced bouts of very high inflation and stop-go cycles. These problems notwithstanding, the region as a whole grew relatively rapidly over 1950-80, at an average of 5.5% per year, some countries exceeding this rate and others doing substantially less well. The 1980s, however, saw severe downturns in most countries and average growth of under 1.5% for the decade.

The unsuccessful performance of the LAC economies in the 1980s contributed to a reconsideration of the traditional import-substituting focus of trade-industrial policy and its replacement by a more outward-oriented strategy, accompanied by market-oriented reforms in the areas of labour policy and financial markets and by a downsizing of the public sector. The full results of this policy switch remain to be seen. Chile’s fast growth during the last decade is the most promising sign, but the region’s overall growth performance, at an annual average of under 3% for 1990-1995 remains well below that of the pre-crisis period. This continuing sluggishness reflects the aftermath of the crisis (low investment rates, lack of confidence, etc) and a still unsatisfactory capacity to operate effectively under the conditions of free or nearly free movement of capital internationally; in several countries excessive inflows have led to exchange rate appreciation, export stagnation and sluggish growth. More generally, the basic potential of this relatively untried model for the LAC region will only be confirmed by events. East Asian miracle countries like Taiwan and Korea retained considerable trade barriers and control on capital flows during their main growth surges.

While the region’s modest growth rate does provide some grounds for optimism, the frequency of increases in inequality around the time of the reforms is quite worrisome. The poverty challenge associated with the combination of modest growth and increased inequality is
a serious one. In some cases other factors have no doubt been involved but only infrequently do they appear to explain the bulk of the increase in inequality. We tentatively suggest that technological change and economic downturns have played a role, along with more open trade regimes, the dismantling of labour institutions, and the "socialization" of debts (whereby the state makes itself responsible for certain private debts which might otherwise threaten macroeconomic or financial stability). The effects of the scaling down of the public sector (directly and via the privatization of public enterprise) and of increasing foreign investment are less clear.

Growth rates may be expected to increase as more countries put the crisis and adjustment problems behind them, though the setbacks suffered to date carry the clear message that this cannot be taken for granted. Regional growth will likely settle somewhere between 4% and 7% per year, possibly not far from the middle of this range, i.e. about the same as before the crisis. Recovering the pre-crisis rate of poverty reduction will require a combination of growth somewhat above the lower limit of the range just cited, together with little if any deterioration in the distribution of income. The challenges to be met under the new more market-friendly model of development will be somewhat different from those of the earlier ISI phase of development, and countries which do not learn to deal effectively with them may on balance be losers from the policy shift.

Under the conditions described it is urgent to achieve better combinations of growth and distribution than those of the last two decades. The experiences of Chile, Colombia and Costa Rica are perhaps the most interesting from the perspective of learning how to guide policy more effectively in the future. Costa Rica is one country which seems to have emerged from the reform process without a major deterioration of distribution. Colombia appears to have achieved the most significant pre-reform improvement in distribution, at least in the urban areas. And Chile undertook the reforms earliest, suffered high social costs thereafter, but eventually achieved a high growth path and also pioneered a number of impressive policy experiments of relevance to other countries.

Some priority policy areas in confronting the poverty challenge seem clear: education/training systems—clearly important in light of the danger that low skilled persons are being left behind; small and medium enterprise policy, important given the major role this sector plays in the creation of productive employment; poverty redressal, whether through better targeting or otherwise, in light of evidence that considerable social spending has not in the past been very efficiently carried out, and the fact that under conditions of rapid economic change such systems must be unusually adept in order to do their job well. While their general importance is evident, the precise policy formula most likely to bear fruit in each of these areas is much less clear. Designing it effectively has high priority.

The need to **improve levels and broaden access to education and training** is rooted, in part, in the character and rapidity of technological change, which alters the set of high-payoff skills. In some countries making sure that everyone completes primary may be the key item, in others, especially in rural and poorer urban areas, it may be the quality of primary. A major
objective is to diminish the size of the lower tail of the income distribution when the factor underlying the low incomes in question is the lack of human capital.

Since the speed and character of technological change will directly and indirectly be a major, and perhaps the dominant, determinant of the evolution of productive employment and income distribution in the LAC countries over the coming decades, it is worrisome that neither a good understanding of the processes involved nor access to policy instruments which could help to channel the effects of technological change in socially desirable directions are on the horizon. Technological change is essential to growth, but if it is too fast or of the wrong type its distributional effects can be quite negative and even its growth effects uncertain; this "double-edged sword" character makes technology policy a very tricky area. Prosperous small farms, microenterprise and SME can diminish the risks inherent in technology change, since these units tend to choose less capital intensive technologies than do their larger counterparts.

Small and medium enterprise has a major role to play in a healthy development process, a role which has been seriously neglected in most LAC countries. Its export and import competing potential is an increasingly important issue as the LAC economies turn outward. The experience of many counties, including Japan and some of its Asian neighbours, illustrates the importance of linkages between efficient modern industry and smaller firms; effective linkages of this sort are likely to be more important in open than in closed economies; where it is the larger firms which do most of the exporting (as in Brazil, for example), export success may bring little productive employment in its wake unless smaller subcontractors are hooked into the process. As for policy, improvements in credit access, credit guarantee systems, technological transfer and relevant courses and training are all clearly desirable. Policies to foster productive small-small and small-large linkages may have a good payoff but at this time little is known about what, if anything, works in practice.

Labour market issues of particular importance at this time are the extent to which wages will fall when not "protected" by such institutions as the minimum wage, and the welfare costs of job insecurity. The level of job security built into the labour codes is among the labour market institutions being weakened by the current labour market reforms, on the grounds that it discourages the hiring of workers in the first place and diminishes mobility below its optimal level. The high level of non-wage costs, the mobility reducing non-transferability of some pension plans/systems, and the management of the minimum wage (including the way it is indexed for inflation) are also under attack. Though many of the criticisms levelled at the traditional labour market institutions of the LAC countries are probably valid, their wholesale dismantling is neither necessary nor desirable. Though it does appear that strong unions are often associated with labour market inefficiencies and that the costs of extreme job security may be high, some common instruments of labour market regulation seem innocuous and/or positive. Costa Rica's minimum wage system, though apparently cumbersome and complicated, probably helped the country through its macroeconomic crisis by providing reasonable stability of the wage relative to other prices.

Most LAC countries have given less serious attention to policy in the social areas (health,
education, labour) or in SME than to macroeconomic policy, trade policy, etc. Yet it is clear that the quality of policy making in these areas will be pivotal to the rate of poverty alleviation in the coming years. In a number of important policy areas there is serious ambiguity either about the general direction of policy, or about the best feasible means of achieving agreed-upon goals such as quality improvement in primary education or technical assistance to small enterprises. Such situations will require not only solid up-front analysis but, probably even more important, a system with the monitoring capacity to allow for the early correction of mistakes in the making. Many LAC countries suffer a grave shortage of top-notch personnel in their social sector ministries and a correspondingly inadequate planning/analysis/monitoring capacity in these areas.
BIBLIOGRAPHY

Alarcón, Diana

Alarcón, Diana and Terry McKinley

Allen, Steven G. and Gaston J. Labadie
1994 Labor market flexibility and economic performance in Uruguay and Chile. Report to the Tinker Foundation.

Berry, Albert

Berry, Albert and José Escandón

Berry, Albert, María Teresa Méndez and Jaime Tenjo

Bird, Richard M.

Cline, William

Cortés, Mariluz, Albert Berry and Ashfaq Ishaq
Cortés, Rosalía and Adriana Marshall

Cox Edwards, Alejandra

Culpepper, Roy

De Janvry, Alain, Elisabeth Sadoulet and André Fargeix
1993 *The political feasibility of adjustment in Ecuador and Venezuela.* Paris: OECD.

Díaz-Alejandro, Carlos F.

Economic Commission for Latin America and the Caribbean
1994 *Estudio económico de América Latina y el Caribe 1993, Volumen 1.* Santiago de Chile: CEPALC.

Fallon, Peter R. and Luis A. Riveros

Favaro, Edgardo, and Alberto Bension

Fei, John C. H. and Gustav Ranis
Ffrench-Davis, Ricardo

García, N. and V.E. Tokman
1985 Acumulación, empleo y crisis (Series investigaciones sobre empleo/25). Santiago: PREALC.

Gelbard, Enrique A.

Gindling, Timothy H., and Albert Berry

Gregory, Peter

Grosh, Margaret E.

Hernández-Laos, Enrique and Jorge Cordoba

Horton, Susan, Ravi Kanbur and Dipak Mazumdar

Hunt, Shane J.

Krueger, Anne O., Hal B. Gary, Terry Monson, and Narongchai Akrasane
1984 Trade and employment in the developing countries: 1, individual studies. Chicago: University of Chicago Press.
Larrea, Carlos

Lewis, W. Arthur

Linden, Gary
1993 Depressed commodity prices: implications for Latin America's economic Growth (Staff Working Paper, no. 6). USAID, Bureau for Latin America and the Caribbean

Londoño, Juan Luis

Lora, Eduardo and Ana María Herrera
1993 *Tax incidence in Colombia: a general equilibrium analysis* (Paper presented to the Seminar on Tax Reform in Developing Countries). Delhi, India.

Marshall, Adriana

Meller, Patricio
1992 *Adjustment and equity in Chile*. OECD Development Centre.

Organization of American States (OAS)

PREALC

Rama, Martín

Riveros, Luis
Robbins, Donald J.

Tenjo, Jaime

Teitel, Simón

Thorp, Rosemary

Tokman, Victor E.

Trejos, Juan Diego and Pablo Sauma

Turnham, David

Verdera, Francisco

Williamson, John