The Income Distribution Threat in Latin America[*]

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Materials prepared for Summer Institute 2000
Robarts Centre for Canadian Studies

Chapter 1

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Introduction

Latin America has long been noted for the extreme inequality of incomes and opportunities characteristic of nearly all countries of the region. The urgency of dealing with this region's unnecessary poverty--unnecessary because average incomes are generally high enough to imply that there would be little poverty if the income share of the bottom few deciles were not so low--has naturally been heightened by the economic crisis of the 1980s and the sharp declines in per capita income observed in many countries.

This chapter focuses on how labour market outcomes, and especially the distribution of income, have been related to economic events and to policy changes in Latin America and the Caribbean, with a view to predicting the distribution of the benefits from expected future growth. Its immediate raison d'être is the accumulating evidence that the market-friendly policy shift has been systematically associated with an abrupt and important deterioration in income distribution. The pivotal question is whether this association is or is not a causal one. If so, it is urgent to ascertain which components of the typical policy package are most responsible for this outcome; hopefully it is not those same ones as are most important to a strong growth performance. If not, it is nevertheless crucial to understand the source of worsening, and to plan remedial steps.

The chapter does not dwell on the implications of the end of the debt crisis and the above mentioned policy shifts for economic growth. Whether growth will or will not be rapid (say 5% per year for the region) is tremendously important, of course, since even a fairly severe worsening of income distribution over the medium term might not be too difficult to weather if average incomes were rising fast enough to spread some of the fruits of growth accruing to those at and near the bottom of the income pyramid. At this time, however, it would be foolhardy to assume that growth will be rapid enough to push distributional concerns into the background. One reason is that most of the impressive growth performances in the Third World have taken place in less market-friendly contexts, with Hong Kong and post-1985 Chile perhaps the only very notable

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[***] I thank Albert Fishlow, Gustavo Indart, Adriana Marshall and Samuel Morley for comments on an earlier version of this paper.

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exceptions. Another is the obvious problem which a number of LAC countries have been suffering in the management of their exchange rates, the continuing proclivity towards overvaluation and the resulting sluggish growth (Helleiner, 1994). Finally, in spite of the new-found access to foreign capital, gross domestic investment has not yet approached its pre-crisis level of about 25%. All of these problems might be substantially resolved within five years or so, but the grounds for such an expectation are not overly strong, so the prudent response is to "be worried" about the possible implications of any sharp deterioration in distribution, along with the other unwelcome evidence--that temporary jobs, part-time jobs, and more generally job insecurity are a growing feature of labour markets in the region.

Before turning to a look at the empirical evidence on recent income distribution trends in Latin American and Caribbean (LAC) countries, in which the focus is on the timing of changes in distribution and the hypotheses suggested by that timing, we review some of the interpretations put forward to explain the generally negative trends in distribution and/or other worrisome aspects of labour market outcomes.

1. Possible Explanations for Negative Distributional Trends

There is little by way of verified theory to explain levels and trends in inequality in Latin America or in developing countries generally; deficient data bases and limited quantitative analysis have conspired against a better understanding. The Kuznets (1955) hypothesis that distribution typically worsens then improves over the course of development has received a great deal of discussion, but remains controversial. Limited discussion has also revolved around the distributional implications of the Lewis labour surplus model and the proposition that as a country's labour market begins to tighten up the distribution of income may be expected to improve (Berry, 1983). Among structural features, the distribution of agricultural land as well as of other productive assets (Loehr and Powelson, 1981), the distribution of education (Ram, 1989), the size structure of firms and the degree of openness to international markets have all received some attention either in a static sense and/or as features whose change over time may be predicted to contribute to distributional trends over time (Bourguinon and Morrisson, 1989; Fields, 1984). It is well recognized that the speed and pattern of technological change could have a significant effect on distribution. There has been less analysis than in developed countries of the impact of the economic or business cycle, partly because the sort of cycle so prevalent in the industrialized countries has not been generally present in a similar form in the LDCs, but Morley's recent work (1994) advances this line of research for LAC.

Our central concern here is with the impact of the market-friendly policies adopted in varying degree by most LAC countries over the last decade or so, including trade and foreign investment liberalization, privatization and general downsizing of the public sector, labour market reforms, etc. It is useful to specify some of the major ideas on the table.

1988	4.4	8.2	12.6	20.0	54.9	100.0
1978	5.2	9.3	13.6	21.0	51.0	100.0
1969	7.6	11.8	15.6	20.6	44.5	100.0
Quintile	1	2	3	4	5	Total

1992	Gini & Psuedo Gini	0.4705466610363532084 29	
	Share of Total Income	100.045.58.47.34.526.1	
1989	Gini & Psuedo Gini	0.4609430634620325074 55 0.4503410	0.5109499442
	Share of Total Income	100.046.410.26.54.922.6	
1984	Gini & Psuedo Gini	0.4209440446842073905390 0.4007403	0.488
	Share of Total Income	100.046.97.14.710.421.2	
		TotalWagesProfitsServicesAgric./LivestockNon-monetaryUrbanRural	TotalUrbanRural

Country	Main Period of Worsening	Degree of Worsening, main period	Degree of worsening, to present	Characteristics of main Period of Worsening
Argentina (Greater Buenos Aires)	1976-78	8 points, followed by some easing	8 points	Liberalization, labour repression, no net growth
Chile (Greater Santiago)	1974-76	7-9 points	7-9 points	Liberalization, labour repression, sharp recession
Uruguay (Monte-video)	1976-79 or 1982-84	9 points or 7 points	not available	Liberalization, labour repression, growth or recession,increa-sed exports, transition towards democracy
Mexico	late 1980s	3-5 points	3-5 points	Liberalization, some labour reform, slow growth
Dominican Republic	In period 1984-89	8 points	not available	May have coincided with adjustment
Colombia (three major cities)	1990-92	4-7 points	4-7 points	Liberalization, labour market reforms, moderate growth
Ecuador (Urban)	1989-91	5 points	5 points	Liberalization, labour reforms, slow growth
Costa Rica	1985-87 (?)	0-4 points (?)	-1 to +3 points	Liberalization, mild labour reforms (?), moderate growth