TRADE AND FINANCIAL LIBERALIZATION AND ITS EFFECTS ON GROWTH, EMPLOYMENT AND INCOME DISTRIBUTION IN LATIN AMERICAN COUNTRIES*

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Introduction

Strong capital inflows and comprehensive trade and financial liberalization characterized the last decade in the majority of Latin American countries. Despite some modest improvement in poverty incidence, the evolution of employment, wages and income distribution has frustrated even the most "Panglossian" of the Washington Consensus's policy maker that largely run the continent along the last years.

Considering the evolution of household income distribution along the last two decades in Latin America countries an comprehensive analysis observed an asymmetrical pattern of growth with a high income concentration during the "lost decade" of 80's and a distributive rigidity during a more expansionist phase observed in average in the region along the nineties (Sáinz, and Fuente (2001). But even this evaluation can not be assured since there is a strong underestimation of the income of the richer strata. Due to a disappearance of regular jobs in the continent a polarization process with a hollowing out of middle class and a top- driven increase in inequality seems to be happening in many countries in recent years as a social consequence of the economic and structural changes led by external opening . But unfortunately this performance is not the bottom line. Nowadays an implosive decline is taking place in Argentina with tragic consequences on poverty incidence.

Given the diversity of experiences of liberalization in the continent and the superposition of many economic and social changes to identify and even more to isolate the effects of trade and financial liberalization on income distribution it is not a simple question.

In an effort to bridge a classical/sraffian theory of income distribution with a structuralist approach to economic development and a institutionalist approach to labor markets[1], this paper tries to address to these questions considering the balance of payment constraint through its effect on interest rate, exchange rate, relative prices and in GDP growth as the dominant macroeconomic force shaping income distribution. Some routes can be singularized. From the classical/sraffian surplus approach emerges the proposition that there is an inverse relation between the rate of interest (formed

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[1] Following Medeiros and Serrano (2002)

exogenously by monetary forces) and product wage[2]. This relationship will be considered as a clue factor connecting financial liberalization and functional income distribution. From this perspective, the level of productivity in wages goods sector is essential for the determination of real wages[3].

From the classical and structuralist approach we retain the basic conception that in a surplus labor economy economic growth generates not only a reduction in poverty – an indisputable stylized fact- but trough an increase in formal employment an improvement in the distribution of labor income[4]. From both approaches we take that structural heterogeneity between sectors is a primary source of income differentiation. Thus, the impact of external liberalization on income distribution depends on whether financial and trade liberalization contributes to reduce or to increase the real rate of interest, the level of employment, and the structural heterogeneity.

The majority of studies on income distribution concentrate exclusively on personal/family income distribution with no concern on functional distribution. In general the nationals survey data only report evidences adequate to this concept. This dominant approach underreports non wage income – barely covered in household surveys- and exclude some important connections between macroeconomic forces and income distribution[5]. This data inadequacy and other pitfalls arising from the exclusive focus on labor income will be observed and explored along this position paper.

Given the high level of income concentration observed in Latin American countries, this paper will not cover the distributive social policies that in the last decade was enlarged in many countries in order to alleviate the poverty incidence, its focus will be on the forces that shape the primary income distribution[6].

Besides this introduction the main argument unfolds in four sections. In the first we briefly examine how the balance of payment constraint has historically influenced the income distribution in Latin America countries. A brief analyses of the first experiment

[2] This classical idea has been recently explored by Pivetti (1991), Serrano (1993) and UNCTAD (1997) See last section.

[3] This connection integrates nominal and real aspects of income distribution in a way not presented in the majority of the studies on income distribution. In general they are based on nominal terms, relegating to the studies about poverty the main reference to real income. Thus if there is a transference of income of a richer household to a poor one a income distribution is suppose to occur. But in real terms since there is different consumption pattern among social groups the income distribution is changing all the time according to the changes in the prices of consumption baskets that affects the majority of workers. This connection bridges the classical approach with the Latin American economic development theorists.

[4] This conclusion is very intuitive and comes from the basic idea that the relative contraction of disguised employment in agriculture and service and the relative expansion of formal employment brought about by industrialization and economic growth exerts a positive effect on labor income distribution as we will observe in the next section. For details see Lopez (1997)

[5] The use of individual or household as exclusive unit for quantitative analysis of income distribution has been affirmed in the benchmark study of Deininger and Squire . Besides the theoretical implications of this methodological option there is a strong omission of all source of incomes not related to formal wage employment. In Latin American Countries (LAC) where the income concentration is very high and polarized this omission is meaningful. As put by Székely and Hilgert, 1999, "Standard household surveys in LAC are unable to capture the incomes of the richest sectors of society; so, the inequality we are able to measure is most likely a gross underestimation." (pg 3)

[6] The social public transference in the continent expanded along the nineties in absolute terms or in proportion to total public outlays or to the GDP. Only in Chile this expansion was remarkable in real terms. (Stallings, Peres, 2000)

of external liberalization intended in the beginning of eighties in Argentina and Chile was viewed an *avant- premiére* of what happened in almost all countries in the nineties. In the second section we consider the determinants of the large capital flows and their connections with balance-of payment liberalization in the continent . We stress the major role played by external pull forces and distinguish differences on trade liberalization in Mexico (and some small countries above Panama) and in South American and the differences on financial liberalization in Chile in contrast with other countries. In the third section we analyze some evidences on growth, employment, relative prices, wages and income distribution in the continent considering two stylized situations: an "import-led consumption boon" (Taylor and Vos, 2000) based in fix or semi-fixed exchange rate and the more recent period characterized by floating exchange rate with income concentration and no growth. Some important differences are observed among countries. In the last section we conclude and explore some questions for future research.

Growth and Income Distribution in Latin America before Balance of Payment Liberalization

Despite remarkable national differences in the continent, the majority of Latin American countries historically exhibited large inequities in income distribution. As stressed by Londono and Székely(1997) there is nowadays an excess inequality between individuals, families or social classes not only in countries like Brazil or Colombia but also in countries like Chile, Mexico or Argentina (even before the recent turmoil)[7]. The unequalizing forces on income distribution are not new but have a long historical trajectory in the continent. Given a high concentration in land property, the historical pattern led by commodity export in a liberal economic order since the beginning of XX century in all countries, brought about a economic dynamic characterized by unstable growth and high unemployment. With exception of Argentina (or Uruguay) where a surplus of high quality land existed for a highly demanded international wage good that formed their main staple, the majority of continent had a pattern of growth where a kind of "commodity lottery"[8] created a succession of boom and down cycle with large swings in income favoring the land owners. In this model of growth, a "Dutch disease" was a strong tendency in many successful export economies retarding a export diversification and import substitution and forming a large surplus labor in depressed rural areas.

As a response to the international crisis of the thirties and the sharp contraction of international trade the continent was forced to create a inner dynamic based in import substitution in industry and strict control of foreign exchange. In large countries that after the II World War tried to spur an industrialization process, old and new forces contributed for a high level of income concentration. The existence of a large surplus labor in countryside and in big cities and the structural heterogeneity between wage goods sectors, specially agriculture, and industrial sectors seen to have played an important role for this distributive reality[9]. Both aspects were envisaged by structuralists

[7] Londono and Szélkely, followed a methodology of Deiniger and Squire (1996) based on household surveys for 13 countries in Latin America covering 1970-1995 period..

[8] Diaz Alessandro characterized the pattern of growth that occurred in the XIX century in Latin America countries as "commodity lottery" where the income growth was strongly influenced by the external price of commodities.

[9] A rich structuralist literature developed by Arthur Lewis, Raul Prebisch, Anibal Pinto comes from this point. "It was the combination of an increase in both volume of employment and output per head in non-

authors as central factors for the income of small rural producers and urban and rural wage earners. Again, the Argentinean and Uruguayan cases differed from the continent. In fact, in these countries the industrialization and urbanization from the thirties through the fifties brought about a real wage rate expansion while the land prices declined improving the income distribution[10]. But as soon as the balance-of-payment constraint interrupted the economic growth through increases in exchange and interest rates, inflationary pressures exerted a depressing effect on real wages. The "populist" cycle of go-and-stop in Argentina was an attempt to change income distribution in the presence of strong external constraint[11]. But this situation was not peculiar to Argentina but a more generic case in Latin America.

The balance of payment constraint that chronically accompanied the industrialization process in Latin American countries was the main macroeconomic force for the persistence of high levels of surplus labor and for structural heterogeneity. In fact, in a situation marked by small financial inflows and a high dependency of export revenues on commodities, a limited capacity to import was the main constraint for a higher rate of growth and employment.

In an " industrialization – cum - dollar shortage", pressures for exchange rate devaluation and for systematic increases in food and raw material prices brought about a persistent inflation and, in many countries, a short cycles of economic growth. No other country exceed Brazil in its effort to industrialize and no other large country exceeds Brazil in income concentration. A surplus labor with a initial shortage of "good" lands in a heterogeneous primary sector (very different situation compared to Argentina) shaped a very concentrated wealth and income distribution. A huge surplus rural labor coupled with a significant lag in food productivity for internal markets generated a high poverty level and a permanent pressure on unskilled labor. Different from Mexico, that industrialized without strict exchange control, in Brazil the balance of payment constraint exerted a bigger pressure on real rate of exchange and inflation. With a crawling peg adopted in midi sixties coupled with a rate of interest fully adjusted for inflation, the real wage rate for unskilled labor was repressed widening the income differential between capital and labor and within skilled and non-skilled labor.

Although the orthodox rhetoric emphasize the negative aspects of the "import substitution industrialization" particularly along the seventies – is better to call it as state-led industrialization[12] - the persistence of high rate of economic growth with structural changes brought about a significant reduction in poverty and in surplus labor in the majority of Latin America countries causing in consequence a decline in inequality in many of them.

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agricultural employment and the absence of a corresponding increase in food supplies that made continued inflation inevitable. It caused a persistent upward pressure in the prices of food paid by the urban consumer, and it was the rise in food prices which caused the persistent rise in urban wages and salaries...." "...the basic cause of the inflation was the disproportionality in the growth of production in different sectors of he economy, ...between wage-goods and non-wage goods" (Kaldor 1978:128)

[10] The level of personal income concentration is strongly related with the surplus labor in backward agriculture. Measured by a Gini index the income concentration in Argentina or Uruguay was in the nineties, as it was in the past, almost 50% lower than the index observed in Paraguay, Brazil, Peru or Colombia.

[11] For a classical analysis for Argentinean case see Adolfo Canitrot (1975)

[12] Cárdenas, E. Ocampo, J. A. and Thorp, R. An Economic History of Twentieth-Century Latin America Vol 3, Introduction, Palgrave, St Antony's Series, 2000

Due to the extraordinary surge in international credit supply that followed the end of Bretton Woods monetary system, the net transfer of resources grew from zero to almost 3% of real GDP in Latin American countries along the seventies[13]. A positive income effect spread all over from this *growth- cum - debt* pattern. With a negative real interest rate and a high growth of exports the debt accumulation did not arise major concerns[14]. In countries like Brazil or Mexico, where a developmental state were strong, the surge in capital inflow was accompanied by a high growth in exports and in import substitution. The strict control of financial system responded for this strategy. In many countries the dramatic end of "dollar shortage" and the beginning of a era of "dollar abundance" stimulate a surge in imports and income growth.

Many factors contributed to decline in poverty and in improved income distribution that characterized this decade in the continent, specially the reduction of rural surplus labor absorbed in modern activities. The real important exception occurred in Chile. The institutional rupture and a monetarist economic policy practiced in the second half of the decade in this country had important distributive consequences on employment, wages and in poverty levels.

The shifts in relative prices in favor of oil, raw materials, and foods stuff affected unequally the different countries. In oil exports like Mexico or Venezuela the change in prices favored a boom in exports and in economic growth, in Mexico, thanks to the social democratic policies implemented along the decade the income distribution improved. In Brazil, despite an intense reduction in poverty and a high positive income mobility, the income distribution did not change substantially. The shift in terms of trade with a stable real rate of exchange and positive real rate of interest increased the inflation rate precluding partially the transformation of the positive employment effects on higher real wages. In Brazil as well as Mexico or Argentina the role of sector public not only as investor but as employer was very important in promoting a richer and bigger urban middle class through a growing demand for skilled labor.

In fact despite the high difference in wage levels between the rural labor and the urban professionals, the urbanization and economic growth of this period brought about a significant growth of middle class job. It is important to note the dominant role of public employment amongst Latin American professionals[15].

Given the high concentration of land property it is very difficult to use the inverted Kusnetz curve in Latin America countries for the long run, but if we compare the seventies years with the two decades before, we can argue that the transformations induced by high growth and structural change with a reduction in surplus labor in countries like Brazil or Mexico were shifting the unequalizing forces toward the descendent part of a Kusnetz curve. This whole situation dramatically changed in the eigthies.

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[13] See, ECLA. 2002 We follow here the methodology used by ECLA in which the net resources transfer corresponds to the net influx of capital (including non autonomous influx) minus profits and interests from the current account (which is equal to the trade deficit including nof factor services).

[14] For data on international interest rates and relevant periods see, Table 1 in annex based in Schulmeister (2000). In Medeiros and Serrano (1999) we explore the impacts and challenges of a flexible dollar standard for peripheral countries. This analysis is further developed in Serrano (2002)

[15] See Tokman, V. and Klein, E. (2000)

During this decades, the Latin America countries experienced a low growth (1.2% in average for 18 countries), a sharp fall in regular employment, an increase of more than 3 points in GINI index (a growth of 6% in great contrast with the decline of this index during the seventies), a decline in real wages, in wage share and an increase in poverty. (Londono, Székely, 1997). The unilateral decision of American Federal Reserve to increase the interest rate and the sharp valorization of US$ against the yen and the mark brought about a real interest rate on debt of 14,5% between 1981/1985 in acute contrast with the negative rates charged in the seventies (Schulmeister, 2000). With the Mexican default in 1982 new capital ceased to flow to the continent, with partial exception of Chile (for geopolitical reasons) and Colombia. The net resources transfer became negative in more than 4% of GDP in average (ECLAC, 2002). Severed from international finance, the highly indebted countries had to promote an intense export effort. Despite this, the rate of growth exports in US$ was lower than the rate observed in Latin American countries in the seventies. The decline in the terms of trade more than compensated that bigger export effort. (ECLAC, 1995)

The high inflation and the distributive conflict that characterized this decade was a consequence of this dramatic increase on external solvency and liquidity problems that spread in the majority of the countries[16]. Before we explore with more details the consequences of this change in balance of payment constraints on income distribution , lets consider very briefly the first experience of trade and financial liberalization in the continent practiced in Chile and Argentina from 1979 through 1981.

Supported by the IMF and guided by a monetary theory of balance of payment, the Chilean government changed the previous stabilization policy based on monetary control and started a comprehensive program of trade and financial liberalization. (Díaz-Alessandro, 1984, Frenkel, 1988). A fixed rate of exchange and a liberalization of capital account were the crucial policies of this strategy. Based in the supposition that Chile was a small country that could obtain the capital influx it needed and that difference between domestic and foreign debt was not relevant, the local authorities with the IMF approval, allowed for a fast expansion of a current account deficit financed by short term debt. With a strong valorization of the real exchange rate, large spreads in the rate of interest were used to attract the internationally abundant short term capital[17]. After few years of rapid income growth and import boom with real wages increases, in few years the local banks accumulated a great stock of short term debt.[18] This experience was very similar to that occurred at this same period in Argentina. In 1982 it was over.

With a radical contraction in external loans and finance outflow to Latin American countries, the rate of exchange in Chile and Argentina was strongly devaluated, the controls of capital were introduced, the trade barriers were erected and the private debt

[16] A useful proxy for solvency is the ratio of current balance deficit and exports. A liquidity problem is accessed by the ratio of mobile capital and reserves. For an application to Brazilian experience see Medeiros and Serrano, 2001

[17] According to Díaz Alessandro, the rate of interest reached 32% annually during 1976/1982.

[18] For Díaz Alessandro, the high interest rates that prevailed in this stabilization policy did not prevent a surge in domestic indebtedness possibly because as far as the rate was high for every taker in a non regulated financial market, the borrowers expected a public redemption on private debt

was nationalized. A huge wealthy transfer from public to private hands and a capital outflow from Latin American residents were a common consequence of this episode[19].

It is important to note that the contraction of GNP in Chile – 15% between 1981/83- in Argentina – 11%- and Uruguay –14%- exceeded the contraction occurred in the rest of continent in these years, a direct macroeconomic consequence of capital account liberalization. After that *avant –à-lettre* experience (that was spread in the continent in the nineties), Argentina, Chile and Uruguay followed the same and compulsory macroeconomic policy based on the achievement of large trade surplus in order to finance the international debt service through exchange rate devaluation and contraction on internal absorption. Low and unstable growth, high inflation, high interest rate, huge decline in public investments, decrease in formal employment were common characteristics that explain the general expansion of poverty and income concentration.

Although this situation were most alike in the continent, important differences have to be noticed. In the midi of the decade the rate of interest on American Bonds fell down and the US$ devaluation against the yen and the mark yielded an important reduction on real interest rate on international debt. In addition, the world export prices and the real rate of world export growth increased. This created opportunities for indebted countries to re-launch a trajectory of economic growth. Chile and Colombia explored this opportunity. The common aspect of these two countries was the higher rate of export growth in US$ than the rate observed in the majority of Latin American countries. (ECLAC, 1995). Chile was particularly lucky in its terms of trade and more than other countries was politically supported by American hemispheric political interests. Given a well succeeded keynesian and sector developmental policies, these countries could diversify their exports (along traditional and non-traditional manufactures) preserving competitive real rate of exchange through tariffs and capital controls.

Despite a high export effort, the Brazilian economy had very low growth far behind Chile, Colombia or even Mexico. With a highly indexed price system, all the efforts for real devaluation and increases in real rate of interest were followed by nominal increases in wages and other contracts enacting a self-sustained inflationary process. In a high inflation environment the wages less protected, the non-asset holders, the less skilled and the small land producers suffered the burden of inflationary crisis. This process was partially suspend during the short periods that followed several “heterodox stabilization plans” that failed for the same reason: the lack of external finance. Some social policies established in the middle of the decade were effective in reducing the social consequences of this crisis but were not enough to interrupt this unequal path.

As we have seen the balance of payment constraint trough its impact on the rate of income growth, on the rate of interest, exchange rate and relative prices played historically a dominant role on macro forces that influenced the evolution of poverty levels and income distribution in Latin America countries. With the abundance of capital inflow that came to the continent in the nineties the balance of payment constraint has sharply reduced, but contrary of what happened in the seventies a mild, unstable and unequal growth with a high rate of unemployment predominated in the majority of the countries[20]. Before we examine how the liberalization of balance of

[19] According to a World Bank estimate the capital fugue in Latin America reached U$ 90 billions between 1980/1983, mainly from Argentina, Mexico, Venezuela, and Central America.
[20] For an analysis of how an epoch of dollar abundance was accompanied by mediocre economic growth in Brazilian case see Medeiros and Serrano (2001)

payment that spread all over in Latin America in the nineties contributed for this deceptive result lets observe briefly the macro dynamic of capital flows in Latin America countries.

Capital Flows and Balance of Payment Liberalization in Latin America: A New Financial Lottery[21]

As it happened in the seventies, the large volume of capital flows (debt, foreign direct investment, portfolio equity) that came to Latin America in the nineties, was largely autonomous from the domestic policies practiced in these peripheral countries. Deregulation and innovations in American and international financial markets, reschedule of public debts of high indebted countries along Brady' initiative (as it happened in Mexico, Venezuela, Argentina or Brazil), reduction in the international (American and Libor) interest of rate, continuous devaluation of US$ (up to 1995), and diversification of European banks to new external markets were the external push factors for the surge of capital flows in the continent. (See Table 1 and 2)

The sudden dollar abundance was the material basis for the launch of a strategy of balance of payment adjustment that intended in many Latin American countries to reach simultaneously a price stabilization and sustained economic growth. In a rather different approach from the seventies, the trade opening that started in many Latin American countries in the second half of the eighties, in the middle of dollar shortage, and the capital account opening (as it was spread with different intensities in the continent in the beginning of the nineties), were considered in Argentina or Mexico, or Brazil but not in Chile or Colombia as an industrial policy in itself in a macro strategy very similar to that implemented in Argentina and Chile in 1979.

This strategy had the same characteristics we already has observed: the use of the exchange rate as nominal anchor (in a rigid fix parity as in Argentina case, or in a semi-fixed regime as in Mexico before 1994 or Brazil before 1999) in a open and deregulated financial market brought about an appreciation in real exchange and a huge surge in imports[22]. The rate of interest was pushed in order to sterilize capital inflow and attract new capital inflow that came in seeking for high arbitrage opportunities created by the fix (or semi-fixed) exchange regime[23]. The radical shifts in current account-from surplus to deficit- and a fast increase in deficit ratio to exports stimulated speculative movements (led in general by national resident bond holders as it was evident in Mexico in 1994 or in Brazil in 1999) against the exchange regime. Increases in interest rate contributed to alter the composition of capital flux increasing the rate of short term

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[21] For a historical and comparative approach of many aspects commented in this section see Medeiros and Serrano, 1999. I am using this expression originally developed by Diaz Alessandro to describe a situation where capita-account booms generated by external changes in financial markets causes in a deregulate economy a pattern of boom-bust cycles that resembles the short cycles of growth in a commodity export small economy.

[22] The difference been that in the Southern Cone experiences in the eighties "... the turning point was reached in a relatively short time via domestic financial developments. For this reason, the real dimension of the cycle lasted longer in the Mexican and Argentine experiences in the nineties, giving rise to deeper real effects on the combination of trade opening and exchange-rate appreciation" (Frenkel, 1998:21)

[23] The simultaneous capital accounts and trade liberalization lead to a combination "of a high local interest rate and a strong exchange rate has emerged, diluting whatever benefits concomitant trade liberalization was supposed to bring and often leading to a balance of payment crisis in the medium run." (Ocampo, Taylor, 1998 pg 12,)

capital to reserves. The Mexican crisis in 1994, or Brazilian in 1999 or Argentinean in 2001 was in this sense, very similar to that happened 12 years before in Southern Cone .[24] Despite the similarity of all crisis in the age of liberalization the national meaning of balance of payment liberalization was not all alike. In the case of Mexico there was a big difference. Mexico was highly backed by IMF/US Treasury not only because Mexico was big for international markets, the common argument, but because Mexico started to be, in a context of NAFTA agreement, a huge market for U.S. exports. In fact, during the eighties the large American trade deficit with Asian countries was enlarged by Latin American exports surplus in order to finance the negative transfer of resource. In the nineties, a large American export surplus with the continent was the counterpart for a positive net resource transfer. But as a matter of fact, the contribution of South American to U.S. exports was and still is very low in contrast with the growing importance of Mexico imports.

The IMF/American Treasury rescue of Mexican economy gave more time for the survival of this exchange rate regime in the continent, not exactly in Mexico, or in Chile where it did not return since its failure in 1983, but in South American Brazil and Argentina. From 1994 until 1999 Brazil practiced the same model with the same dynamic and results ending with the exchange rate devaluation. During this period the Brazilian imports were essential for the survival of the rigid Argentinean exchange regime.

These policies grounded in free trade and liberalized finance has collapsed in the end of the decade when the net resources transfer to Latin America countries became again negative (ECLAC 2002). At the end of the decade the majority of countries adopted a fluctuating exchange regime.[25] (See Table 3 and 4 in the Annex)

In 1983, the balance of payment liberalization in Southern Cone was defeated by the high American rate of interest and the high valorization of US$. Again, that same factors and reasons were in the roots of this new failure. In fact, with the appreciation of US$ dollar in 1995 and an increase in the international rate of interest, the real interest rate on international debt increased –see Table 1- ; after 1998, the rate of import in industrial countries declined and the terms of trade and the Latin American exports revenue dropped. (See Table 5).

In times of a surge in foreign direct investment that came in great volumes in Brazil or Argentina in the last years of the nineties, the ratio of current account deficit to exports – a solvency ratio- has grown and so the external fragility. Contrary to the prompt rescue occurred in Mexican case (an north-American integrated country) and in Asia's

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[24] Despite its persistent failure , in a Report on Capital Account Liberalization the IMF still considers that there is not anything unique in external liberalization that distinguish it from domestic financial liberalization "...the mechanisms through which internal and external financial liberalization can expose threats to financial stability are largely the same. Both internal and external liberalization squeeze margins and leave less leeway for poor loan and management practices. Both give banks and other intermediaries additional access to risky investments. Both give banks gambling for redemtion access to additional sources of expensive funding. There is nothing unique or different about external financial liberalization in this context." (IMF, 1998)

[25] In 2002, Barbados, Belice, Ecuador, El Salvador, East Caribe, Panama were under a fixed, semi-fixed or dollarized exchange rate regime. Bolivia, Costa Rica, Honduras, Nicaragua, Republic Dominican and Uruguay were under a controlled wide band exchange rate, and the rest of the continent in a float regime (ECLAC, 2002)

bail out in 1997 (an American effort to impulse trade and finance liberalization in the region), the big default and crisis in Russia in 1998, inaugurated a different approach to be followed by IMF/ American Treasury. In consequence the commercial banks assumed a more conservative exposure in emergent countries resulting in a sharp contraction on external loans. The Latin American international bonds issues declined and the Brady bond spread on U.S. bond spread grown substantially ending the liberal expectation for a new survival of this model.

As we observed the external forces played a dominant role on outflow of capital from industrialized countries. These flows showed, by its turn, a pro-cyclical pattern contributing for a high volatility in economic growth in LAC. In fact, given the growing dependency on external markets and on the external rate of interest the macroeconomics policies implemented in LAC did not counter balanced the external cycle, on the contrary, it showed a pro-cycle performance, in a succession of bubbles of imports surge and private capital gains in equities followed by depressive policies aimed to "restore confidence" (Ocampo, 2002) when external cycle of investment was reversed. A remarkable aspect of this macroeconomics is a permanent pressure on domestic interest rate. In a fixed exchange regime the rate of interest was used as a major instrument to attract mobile capital, in a float system to control the exchange flotation. As we will observe in the nest section this monetary policy based in a ever-high-interest rate was specially strong in Brazil. (See Table 6 and 7)

A comprehensive financial liberalization – a free substitution of dollar and domestic assets- that characterized many Latin America countries during the nineties was not a necessary condition to obtain a positive flux of resources necessary to resume the income growth. The Chilean experience with non remunerated deposits established in 1991 did not sever the country from financial markets but was positive to protect its export competitiveness and to improve the maturity composition of net capital inflows. The same can be said about Colombia that followed a similar policy (IMF, 1998). In this sense the associated effect of capital liberalization seem to be the excess of short term capital and the volatility in income growth. The simultaneous removal of trade barriers and cut in tariffs with a overvalued rate of exchange – as was argued by Ocampo and Taylor(1998), and Taylor and Voz (2000)- amplified the destabilized effects of financial liberalization on income growth .

Although the external push factors seen to explain the boost of FDI inflow in Latin American countries, the internal deregulation and privatization in services (finance, insurance and business service) and in public utilities (telecommunications, electricity) was indeed a crucial factor pull factor for the enlargement of international presence of transnational corporations in essential sectors.

Through these routes the influence of balance of payment deregulation on income distribution was very significant and as we will argue in next section, the mechanisms of transmission include much more than its effects on wage differentials.

Growth and Income Distribution in Latin America in the Age of Balance of Payment Liberalization

We have seen from the previous analysis that the macroeconomic dynamics of Latin America in the nineties was shaped by the interactions of the surge of capital flows accompanied by internal pull factors induced by financial deregulation and trade overture. In the case of Mexico, the interactions with the American regional trade policy was dominant. From a macro perspective the main novelty observed in the nineties was

the sharp discontinuity with the 80's and the instability observed in growth, inflation, relative prices employment, and wages. Lets observe briefly some data.

First of all, it is important to notice that the rate of economic growth for the majority of Latin American countries was low by historically standards. Between 1990 and 1999 the average rate of GDP growth in Latin America was 3.2% in contrast with 1.0% observed in the eighties but far behind the 4.9% observed between 1951/80. The rate of per capita growth was 1.4% far exceeding the 1.0% negative observed in the "lost decade". But this performance was very differentiated with a high dispersion within the continent. Chile reached a GDP a high rate of 6% in sharp contrast with the Brazilian rate of 2.5%. If we exclude Brazil, the average rate of GDP growth in Latin American was 3.6% and 1.7% in per capita GDP (ECLAC, 2001). In comparison with its own history or with others Latin American countries, the Brazilian economy had in the nineties a very poor growth performance.

As already observed this low rate of GDP growth was remarkable unstable (see Table). Large discontinuities occurred in 1994, 1998 and 2001 and the pattern of growth followed the movements of net transfer of resource. Again this characteristic was differentiate between countries. Argentina and Venezuela had a "roller coasted" (O'Connell, 2002) kind of growth in contrast with Chile or Colombia where the GDP volatility was less pronounced.

In a huge contrast with the 80s, in the era of dollar abundance, the annual rate of inflation has dramatically contracted from three digits in the beginning of the decade (four digit in case of Brazil) to one digit reached in the in the middle of the nineties.

In no less impressive contrast with the precedent decade, despite the high rate of exports achieved in many countries, the deficit in balance of trade and in current account was a general aspect in the region (ECLA, 2001). The rate of import growth far exceeded the rate of exports. This rate was dispersed and important differences between Mexico and the countries below Panama affirmed in more recent years. Again the Chilean economy distinguished by its lower sustainability (deficit in current balance and exports).

As we have observed in the last section, a high real interest rate distinguished the Latin America countries along the nineties. In context of a great GDP volatility a pro-cyclical behavior of public revenues was accompanied by a high interest rate resulting in consequence a high contraction on non financial outlays with a depressive effect on growth and employment. Again this feature was very dispersed across countries. Brazil has presented the highest real rate of interest and Chile the lowest. (Table 7)

Some remarkable structural changes and transformations in labor market occurred in the nineties induced by these macro forces. In the case of Mexico and others small countries above Panama these transformation were led by the NAFTA arrangements:

- save for Chile, in most countries the last decade was accompanied by a low growth in aggregate productivity and low investment ratio but with a very high dispersion between and within sectors. In Mexico, a high growth in manufacturer sector driven to exports was in sharp contrast with the low productivity in agriculture and service sector. According to Hofman (2000) between 1991/98, Mexican's labor productivity did not increase in aggregate terms despite the large increases observed in manufacture. In Brazil, the aggregate labor productivity increased only 1% between 1991/98 (Hofman, 2000). The productivity gap between agriculture and industry has

declined, but the productivity differences within the manufacturer sector, and between the whole sector and the services sector has enlarged;

- between 1991 and 2000, the rate of unemployment has increased significantly – see Table 3 – in almost all countries principally in Argentina and Brazil and has declined in urban Mexico. The rate of employment followed the rate of economic growth with minor changes in elasticities (Stallings, Weller, 2001);

- during the nineties the Latin American countries became a source of mass immigration (legal and illegal) to the United States. This flow, highly concentrated in Mexico, Dominican Republic, Haiti, El Salvador, Jamaica and Cuba responded for 50% of American legal immigration (circa of one million people every year). (Borjas, 1999);

- between 1990 and 1998, formal employment in private enterprises and in public sector has declined in Latin America and the informal employment has increased. This downgrade in employment structure was most pronounced in Brazil but affected all countries with the only one exception occurring in Chile (Tokman and Klein (2000) based in ILO data);

- despite the general and almost universal fall in Agricultural employment, the industry contribution for employment growth was strongly differentiate among countries. In countries above Panama, the manufacturing employment has expanded in contrast with the pronounced fall occurred in southern countries. In Mexico, in sharp contrast with Brazil, the agriculture sector absorbed labor mainly in low productivity activities. In all countries the growth in employment in finance services, far exceeded the average employment creation (Stallings, Weller, 2001).

The principal findings on income distribution can be thus summarized:

- the information about functional income distribution is precarious and scanty among the countries. The share of wages in manufacturing valued added fell down in the majority of countries between 1985-1992 (UNCTAD, 1996). In Brazil and Mexico the wage share in national income has strongly contracted;

- the Gini index on personal income distribution has increased along the decade in Argentina (Frenkel, and Rozada, 2000), Bolivia, Chile, Colombia, Mexico, Peru, Venezuela and many among others (Behrman, Birdsall, Szekely, 2001) and stayed high in the same level in Brazil[26]. The incidence of poverty has increased in Argentina, Mexico and Venezuela an fallen down in the majority of others countries. (Behrman, Birdsall, Szekely, 2001);

- in general the employment of low income earners (first and second quintile) and high income earner (fifth quintile) had a faster rate than the employment of middle income earner (third and fourth quintile). (See Table 8).This hollow-out of middle earners was very intense in Brazil and reflected the de-industrialization of labor

[26] Needles to say that since "... the richest individuals are more reluctant to disclose their assets and wealth, so underreporting tends to result in an underestimation of inequality" (Székely. Hilger, 1999:11). Besides this underreporting problem, the expansion of non wage labor has enlarged problems of misreporting contributing for a bad quality in income concentration data based in standards household surveys.

force. In Mexico, the labor income concentration was essentially caused by a decline in real income of lower and middle earner and the expansion of real income of high income earner (Tookman, Klein, 2000);

- what distinguish LAC income concentration is the importance of the concentration at the top of the distribution. In the last years considering only the standard household surveys (that shows a strong underestimation of profits and interest earnings) a top-driven inequality favoring the richest 1% individuals has been into play in LAC reflecting co-movements in the structure of employment and the distribution of wages (Székely, Hilgert, 1999);

- the average real wage in formal sector has moderately grown in many countries. It showed a steady growth in Chile, and a decline in Argentina, Mexico, Peru and Venezuela (Stallings, Weller, 2001 based in ECLAC data).

- in average in Latin American countries the minimum real wage and average industrial wage have increased slowly in many countries the minimum wage has not accompanied the expansion of average wage (Tookman, Klein, 2000 on ILO data). (See Table 9).In Mexico, the real minimum wage has declined. The real minimum wages paid in 2000 were in average much lower than the wage paid in 1980. Chile and Colombia were important exeption followed by Brazil (ECLAC, 2002) ;

- the information on wage structure does not permit a detailed analysis on labor market segmentation. The conventional proxy for skilled labor is based on schooling years and the remuneration associated to it is assumed to be the premium paid to skill. In many countries the average wage of graduate professionals to workers with 7-9 years of schooling sharply increased in the nineties with the exception of Argentina that showed a moderate increase and Brazil that did not show a significant rise. (Starling, Weller, 2001). In both cases a "devaluation of human capital" seen to have appeared (Sainz, and Franco, 2001). This general trend in the wage gap between skilled and non skilled in the majority of Latin American countries is well documented in studies based on nationals data;

- even when controlling for personal characteristics the segmentation in labor market, between large and small firms and between long term and short term labor contracts was a decisive factor underling the wages differences. (Tookman, Klein, 2000).

The majority of studies on income distribution in Latin America stress the role of trade liberalization only on the distribution of labor income. Based in a "before-and-after" country narratives on balance payment liberalization covering 17 Latin American countries Taylor and Vos (2000) try to distinguish the effects of trade and finance liberalization on income distribution. They conclude that "*...the structural changes associated with trade liberalization have generally caused a rise in income inequality, most pronounced in a widening of the income gap between skilled and unskilled workers. Capital account liberalization leading to greater capital inflows and through that aggregate demand expansion, employment growth and/or price stabilization has offset tendencies towards greater inequality and permitted poverty reductions in a number of instances. Yet financial opening also has been associated with greater volatility, impeding sustained improvements in equity or poverty reduction.*" (pg 3)

The mechanism of transmission from trade liberalization to personal inequality considered by the authors in many Latin American national experiences is based on structural changes in demand composition for skilled and unskilled labor in a deregulated labor market. As far as the capital account liberalization is associated with the increase on capital inflow the authors considered that it had mixed effect for income distribution. A positive influence trough exchange rate and income growth on real wage and poverty levels, partially counterbalanced by a high volatility precluding a sustained improvement in income distribution.

For Ros (1999), the substantial increase in wage inequity occurred in the last decade in Mexico can also be attributed to shifts in composition of demand favoring the skilled labor. The reduction in the mark-ups in the tradable sector due to trade overture has lead to a high cut in non skilled labor increasing the premium paid to skill.

In a very different methodological approach Behrman, Birdsall and Szekely (2001) emphasized the effects of financial liberalization on income distribution. Considering a trade liberalization index (average and dispersion of tariffs), a financial liberalization index (controls on FDI, current balance controls, capital account controls) and inequality index (Gini on household surveys) and poverty incidence they conclude that trade liberalization did not "explain" the changes observed on inequity and poverty in Latin America countries along the eighties and nineties. The financial liberalization seem to them to have played a mayor role for the increase observed in inequity.[27]

From our point of view, the connections of financial and trade liberalization on income distribution in the nineties were not qualitatively very different from those we historically observed in the region. Lets consider primarily the "import led consumption boom" based on overvalued real exchange rate. The analysis will be concentrated in Argentina, Brazil, Mexico, where a manufacturer sector has been so far the machine of economic growth with a important export diversification (far more developed in Brazil than Argentina or Mexico previously the NAFTA) and in Chile and Colombia. In countries like Venezuela, Bolivia, Honduras, Nicaragua or Peru, although the financial and trade opening have implied in common aspects observed in large countries, the dominant factor that sets their economic cycle and income distribution is still governed by the external prices of their main commodity. Small countries like Panama, Jamaica or Republic Dominican have their principal income from services and private transfers.

Due to high inflation that typically characterized Latin American countries in eighties and in beginning of nineties, the exchange rate based stabilization programs brought a sharp decline in inflation with a positive impact on growth and poverty incidence. This was very important in Brazilian and Argentinean experiences of hyperinflation . In this phase a imports surplus resulted from the exchange appreciation coupled with trade liberalization. The expansion of domestic credit and the increase in real wages boost the internal demand and economic growth. A high consumption of upper classes follows the wealth effects brought about fast growth in asset and equities prices. In the cases in which the cut in inflation comes together with a lower real interest rate, the prices of

[27] The mechanisms of transmission from financial liberalization to inequity envisaged by authors in this econometric paper are based in a (neo-classical) supposition that a greater capital influx associated with financial liberalization increases the "capital endowments" yielding a decline in the price of capital. Assuming a complementary relation between capital and skilled labor, the authors conclude that the financial liberalization shifts the labor demand increasing the returns to skill.

wages goods and allows increases the minimum real wages, the positive effect on income distribution depends on the length of this phase and the effects on labor market. While the shifts in relative prices against trade goods and the displacement of domestic manufacturer occurs as happened everywhere but specially in Argentina and Brazil, the contraction in manufacturer employment and the expansion of service and non salaried workers push downwards the job structure and average wage. (See Table 10) .The fast increase in import coefficient leaked to outside the stimuli of income growth on employment[28].

The decline in industrial mark-ups in the tradable sector and the increase in dollar labor cost compelled a strong cut in employment – mainly non skilled- and modernization in the manufacture that could resist the strong external competition[29]. The capacity of competition contemplates different situations across LAC. In Mexico the winners were the manufactures integrated to U.S., outside Mexico the manufacturers with important absolute advantages based on natural resources. In a country like Brazil, the imports penetration in electronics and capital goods caused a significant import de-substitution. Combined with a huge penetration of imports in traditional sectors as textiles, footwear and garment the trade and financial liberalization brought about an important de-industrialization in labor force.

The increase of industrial unemployment in countries like Brazil or Argentina made the positive effect of exchange rate on wages be partially counterbalanced by diminishing bargaining power of industrial wage earners. The results in wage share and in labor income distribution depend of the intensity of this process and the evolution of the interest rate and the minimum wages. In Brazil for instance, the decline in industrial and rural employment and a consequent expansion of urban informal employment was accompanied by an increase in minimum wages. As soon as a high interest rate was in motion in order to sustain an overvalued rate of exchange the pressures on employment and in labor costs levels in traded sector held the average wages. A significant contraction on wage share has occurred. A kind of hollow out of middle wage earners has befallen simultaneously with a small but positive growth in low wages. Measured by conventional concentration index (as Gini index) the income distribution has not changed in Brazil along the nineties, a clear result of changes of opposite directions.

In Mexico, despite a major industrial employment, the fiscal contraction and a high interest rate destroyed employment outside the "maquila" sector generating a large surplus labor. Because Mexico did not have a high inflation as Brazil or Argentina the cuts in inflation resulted from the exchange rate anchor was not followed by a such high reduction in poverty incidence and contrary of what happen in Brazil the minimum wage has declined. Contrary what happen in Brazil, in Mexico, the productivity in agriculture has lagged far behind the industrial productivity. Probable, the major income concentration observed in Mexico in the nineties is due to the effects of trade liberalization on Agriculture sector (Stalling and Peres, 2000).

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[28] "..the observed outcome of those processes has generally been a contractionary trend in manufacturing employment. That is, the increase in the aggregate demand for manufacturing goods – even in its expansionary phase – was not sufficient to compensate for the negative components: the direct displacement of domestic production by imports and the process of labor reduction per unit of production in the surviving firms."(Frenkel 1998:26)

[29] "Especially when it went together with real appreciation, current account liberalization pushed traded goods producers toward workplace reorganization (including greater reliance on outsourcing) and down sizing, such as Mexican and Argentine manufacturing" (Taylor and Ros, 2000: 8)

As well as in Mexico, in Argentina the wage distribution worsened all the time. The main process was the decline in traded employment and a rising iniquity in non traded sector mainly in services (Frenkel, 98, Taylor and Vos, 2000).

The rise of productivity was very unequal among sectors and within sectors. In Brazil a high agricultural productivity growth diminished the agriculture/manufacture gap but the structural change occurred increasing the gap between manufacture/industrial services and personals services. In Mexico the agriculture sector was a sponge for surplus labor. A productivity gulf inter and intra sectors enlarged the heterogeneity of the whole economy acting negatively on distribution of labor income and in capitalist rents[30].

The "import led consumption boom" did not have a long life in Latin America. With the current account deficit and the external financial fragility rising, the authorities has driven first to contractionary policies centered on fiscal cuts and high increases in interest rate. After the "Tequila Crisis" in 1994 and Brazilian exchange rate crisis of 1998, the devaluation on rate of exchange in float exchange rate regimes inaugurate another macroeconomic cycle with different impacts on income distribution [31].

In the previous exchange rate regime, a high interest rate was necessary to attract capital inflow to sustain a rigid exchange rate, in a float exchange rate regime a high interest rate was necessary to prevent sharp devaluation and control the pressures on inflation

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[30] Ocampo and Taylor (1998) connect trade liberalization and income distribution though its impact on *skill demand and on the structural change associated to that policy*. If, as a consequence of a liberal trade reform a divergence in productivity among sectors increases in a low grow economy, the income distribution effect will be very different from a more balanced productivity growth.

[31] "A surge in capital inflows associated with exchange-based stabilization programs and accompanied by trade liberalization can artificially boost real wages by allowing exchange rates and trade balances to deviate significantly from their sustainable levels. Because of the erosion of competitiveness due to currency appreciation, employment tends to decline in manufacturing, although it may increase in services. While tariff cuts and appreciation lower imports costs for industry, and efforts to rationalize production lead to labor shedding profits in industry may nevertheless be squeezed as increased competition reduces firms' total sales. When the bubble bursts and capital flows are reversed, the exchange rate comes under pressure, and a deflationary adjustments follows, involving cuts in domestic absorption and depreciation of the currency. Labor tends to lose the gains achieved during the boom phase, not only through shrinking employment; while there is a rise in employment in export sectors, it is often more than offset by a decline in the non traded goods sectors..." (Unctad:1997:140)
Similarly Taylor and Ganuza (1998) grounded on evidences for 15 countries in Latin America in the last two decades distinguished two stylized scenarios. In the first, the inflation speeds up and balance of payment worsens, devaluation and fiscal contraction generates a go-stop cycle with a average low growth. The effects on poverty as occurred in Latin America during the eighties depend on the extent of output cuts and reduction in real wages related to devaluation and inflation rate. "The second scenario is more relevant to the 1990s, when large capital inflows together with liberalization of current and capital accounts of the balance of payments permitted visible output and employment expansions. Inflation rates went down (dramatically, in some cases) in response to exchange rate-based stabilization programs. In the 1970s, favorable external factors...went together with similar phenomena. Poverty typically declines in such episodes because of faster output growth as well as slower inflation and or increases in real minimum wages which price stabilization permits. However, residual domestic price increases often lead to real appreciation (especially if the nominal exchange rate is pegged as an anti-inflation "anchor") with possibly favorable effects on real wages but adverse impacts on output in traded goods sector. Ultimately, the authorities may be driven toward contractionary policies (fiscal cuts, high interest rates exacerbated by attempts at sterilization of capital inflows) to attack widening trade deficits. A return to go-stop cycles is a real and present danger, especially if external conditions deteriorate as during the "Tequila crisis of 1994-5". (1998:3)

rates. Thus, a high interest rate seem to be a persistent and long lasting effect of trade and financial liberalization[32]. Naturally, this situation is not alike across the countries and depends on how the exports react to devaluation. In this respect there are two different histories. In Mexico and other small countries above Panama, after 1994, a fast rate of exports released the external constraints favoring a higher income growth despite a meagre result in terms of employment. The competitivity in labor intensive sectors as electronics, garment, textiles in a cross border integrate trade network has rapidly increased. For this performance the low wages paid in industrial sector was an important component. In addition, the high growth in Mexican exports was extraordinarily pulled by American growth – that responds for about of 90% of Mexican exports- occurred along the second half of the nineties.

In Brazil, the rate of exports in dollars did not respond so fast and so high. The structure of exports – more concentrated in sectors based on natural resources - in a epoch characterized by a huge decline in terms of trade and tariff protection in industrialized countries explain this result. The sharp increase in interest rate and a drop in fiscal real disbursement in order to attract capital influx, constrain the imports rate and controls the internal debt was the basic economic policy of this regime. In Brazil, as well as many other Latin American countries, the excess of interest rate over GDP growth was a basic factor for a depressive macroeconomics. The trade adjustment that succeed from this policy was basically centered on imports reduction.

With a devaluation in real exchange rate, the positive effect on poverty incidence and in real wages brought about by the shifts in relative prices during the “import-consumption boom” was partially canceled. As it happened in Brazil or Argentina after the devaluation, the inflation pressures are growing despite the economic recession[33].

The price pressures on real wage comes additionally from other source. As a result of privatization and internationalization, the tariffs of public utilities have increased everywhere affecting most the urban low income earners. The positive impacts on employment that resulted from exports and import substitution did not compensate in any country the negative distributive impact from the shifts in relative prices and the negative impact that a depressive macroeconomics exerted on the general level employment.

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[32] “...Where do the high interest rates often observed in the wake of market liberalization come from?” Ask Ocampo and Taylor (1998) and they answers, “One possible explanation is that economic actors at home may pull back from the local market in a dynamic process.” (pg14) As we have seen, first of all, the domestic rate of interest depends on the American rate of interest over American bonds. Given that rate, the expectation of devaluation and the country risk explain this almost permanent pressure on rate of interest in the continent. Efforts to sterilize capital inflows in anti-inflation programs based on exchange rate used as nominal anchor –as was the case in many Latin American countries in the first half of the nineties- or to control a float exchange rate as it was the case in many countries from the midi nineties do not change substantially this broad pressure that result from financial fragility.

[33] Considering the social consequences of Argentinean acute crisis O’Connel following the collapse of the exchange rate regime observed that, “One dramatic element of this matter is that food products being the major exportables, their prices have tended to rise in association with the exchange rate, hitting relatively more the lowest paid sectors of society. Not surprisingly, therefore, that as shown above poverty levels have shot up and the proportion of people below the food-poverty line has increased to a socially unacceptable level.” (O’Connell, 2002). As we have seen in the first section of this paper this situation – apart for its dramatic dimension- has been a permanent tension in Argentinean economy since the Second War Two revealing the modesty of structural change occurred in the last decades.

Open Questions for Research and Final Remarks

In the last section we presented some evidences and explored some connections that running from financial and trade liberalization affect directly or indirectly the income distribution in Latin America countries. Although its is very difficult and to some extent meaningless to isolate the effects of financial and trade liberalization (in a sense that the real exchange rate that is essential for the balance of trade is strongly influenced by financial liberalization) on income distribution let us summarize some transmission mechanism and explore new aspects.

Financial liberalization in Latin America countries has created a high volatility in income growth engendering a short cycle of economic activity following the capital influx movements. Coupled with trade liberalization, it has increased the Latin American external financial fragility and, consequently, has created a strong instability on the rate of exchange. A high interest rate and a pro cyclical fiscal expansion amplified the discontinuities in income growth. As it was considered this cycle has generated a pattern of distribution formed by a sequence of exchange rate evaluation-income growth- expansion of internal credit - expansion of real wage with changes favoring the most qualified workers followed by exchange rate devaluation –credit crunch- increase in interest rate -decline in income growth and in real wages.

From this sequence some structural and long lasting effects seem to appear: a "bad specialization" and dependency on commodities and on exports based on natural resources increased (as it happened in the countries below Panama) or on low wages as in the Mexican case, an increase in structural unemployment and in industrial heterogeneity as it happened in the majority of countries, and a high fragile external finance position.

As we considered historically the balance of payment constraint through its influences on the rate of exchange, rate of interest, on employment level and on structural heterogeneity was the principal macroeconomic force that shaped income distribution. After the balance of payment liberalization a renewed external dependency is shaping a high concentrated income distribution. However some new aspects seen to be assuming great importance.

So far the impacts of high interest rate on income distribution was considered through its effects on wage share. This ultimate effect depends on how much the financial costs are passed through prices. As we have seen in a regime of fixed or semi fixed exchange rate the new financial pressures can not be translated to prices in tradable sectors resulting in a compression of margins and unemployment. In a float system these pressures are more easily passed through on prices with a stronger effect on labor share.

But as was put by UNCTAD[34] the immediate short term effect of a rise in interest rate is a redistribution of property income from profits to interest earners. This movement has to be seen in a economic circumstance where large public debts and extraordinary

[34] "The rise in interest rates has also been a key factor in the increase in interest payments as a proportion of value added in the corporate sector.....Thus, the rise in interest rates and the share of interest in national income were initially reflected in a redistribution of property income from profits to rentiers....However, mark-ups in trade and industry typically respond to sustained increases in interest rates in the same way as they respond to changes in other costs. Since, under financial liberalization, interest rates adjust rapidly to changes in the price level, mark-up pricing implies that the greater interest burden tends to be shifted onto labour." (147)

capital gains that spread in stock market in most countries created a new class of rentiers[35]. Since the limits of industrial and finance capital were blurred by financial deregulation the expansion of this new rentier class encompass the main interest of big business and wealthy people. As we observed in the last section, this dimension of financial liberalization on income distribution is strongly underreported in standard household surveys in LAC based essentially on labor incomes[36].

Income distribution is strongly influenced by the relative political and economic power of different groups and social classes. The fragility of public sector and the enrichment of a class of bond holder rentiers (indexed to the rate of interest or to exchange rate) has been a remarkable feature of the last decade above all in a country like Brazil. As a matter of fact this is not a new situation as we have seen in the South Cone in the beginning of eighties. But it is a new reality in Brazil where so far the developmental state was very strong. The highly subsided process of privatization that took place in the continent and the internalization of large business groups in a deregulated financial market has enlarged the edge of private sector against the public sector. A depressive macroeconomics aimed to protect the private wealthy is the counterpart of his economic transformation.

In relation to the distribution of labor income some new process are in action. The high interest rate affected firms and sectors differentially. In large export oriented companies with strong links to foreign capital the access to a lower interest rate allow them to obtain a rent not available to the remaining companies increasing the income differences among companies. In addition, the process of privatization and internationalization of banks, business services and public utilities has created a strong differentiation in income and techniques amplifying the role played by rents captured by big firms. When we consider the low increase in average and minimum wages the differential rents captured by big business can not be exaggerated. But a new dimension, barely explored in the literature, comes from the effects of business income concentration on wages differentiation. As far as the labor market became more flexible and deregulate, a rent sharing in privatized and other winners sectors favoring some lucky professionals seems to be in place increasing the wage dispersion[37].

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[35] "For a number o reasons, financial liberalization in many middle-income countries gave rise to a massive expansion of public and private debt.....a number of governments in highly indebted countries, particularly in Latin America, faced net financial transfers abroad as net new borrowing fell short of interests payments. Consequently, they had to borrow at very high rates at home in order to service their external debt.

The increased public and private debt has witnessed the emergence of a new class of rentiers whose incomes depend as much on capital gains on financial assets as on interest payments.....The attractive terms which have been offered on public debt in order to shift government financing from the central bank to the private sector has meant that low risk, often tax free, government bonds constitute an increasing proportion of total investments of such rentiers. This tendency has gone so far that in some middle-income countries the corporate sector has become a surplus sector, lending directly and indirectly to the public sector." (146).

[36] In this direction see Stallings and Peres (2000) an exeption to the mainstream analysis circumscribed to labor's incomes. Examining the profile of individual in the top 10% of the LAC distribution Székely and Hilgert (1999) concluded that it "is closer to the prototype of highly educated professionals obtaining labor incomes, rather than capital owners living on profits."(page 34). It is really amazing how large income and wealth transference from wages to profits/ interests and from state to private enterprise can go so unnoticed in standard surveys and accepted in most studies on income distribution.
[37] For an analysis of this process in United States see Galbraith (1998)

This new process has emerged in economies where the public employment and the influence of unions were important for the middle employment jobs. Somehow the contraction of these jobs reflects this structural change This movement has not to do with a general tendency of wage differentiation based on skill established in literature and observed empirically in many countries. The average wages on skill (proxies by years of schooling) hides a differentiation that depends on the wages paid to special professionals in different sectors and firms. The income differentiation in the high income wage earners has been great and strongly underreported. As we have seen in the case of Brazil, the average wage of graduate professional in comparison with workers with 7-9 years did not improve in the nineties – the stagnation in the wages paid in public sector can respond partially for this performance- but the dispersion of wages between firms and sectors has increased. As in the case of rentier's income, this kind of wage differentiation is barely accessed in national data based on household informed wages.

The connections between functional and personal income distribution are not usually explored in the studies on income distribution. Its reasonable to suppose two links. If we consider that the non labor income is far more concentrated than labor income, and that there is a public spending transference based on wage contract, the decline in wage share leads directly and indirectly to a higher personal income concentration. This second link is based in the fact that in Latin America countries the taxes on profits, capital gains and finance rents is not effective as it happens with income wages. Despite this importance, this result is, however, very difficult to be tested because the non wage income is usually underreported.

The heterogeneity of techniques and productivity and consequently the dispersion of rents was an important dimension for primary income distribution in real terms in Latin American countries. While different income social groups have different patterns of consumption changes in relative prices alter, as above examined, income distribution in real terms . The low level of productivity in food production – a dominant share of wage goods- was and still is an essential cause for the high incidence of poverty and low real wages. But when we consider the basic needs in housing, infra-structure and collective goods we have new dimensions. The mere income distribution that arisen from an increase in wages or in pensions or other nominal income transference does not translates in a fully access to these services. Their demand can not be supplied by market forces because they depend on public investments in infraestructure.

The Latin American countries ceased to invest in infra-structure – save for Chile – since the last decade; the boom in privatization and FDI in energy, telecommunications, roads, has not so far, except for a massive diffusion of a new product such as the cell phone, provided a mass diffusion of public facilities for the majority of people. On the contrary, a huge exclusion from modern and old services characterize the normal life of common people in Latin America. Here we have the old and modern dimensions of structural heterogeneity of internal markets whose reduction is today as it was in the past a necessary base for a less polarized economic growth.

Statistical Annex

TABLE 1: Real Interest Rate and Export Growth in World Economy

	1971/80	1981/85	1986/90	1991/95	1996/98
Eurodollar Interest rate	8.5	11.7	7.8	4.7	5.6
Change in the dollar exchange rate*	-3.9	11.0	-9.1	-1.2	4.7
Change in world export prices	15.0	-2.8	6.1	1.2	-2.9
Real Interest Rate on international debt	-6.5	14.5	1.7	3.5	8.5
Real rate of world export growth	4.7	2.3	7.0	7.8	7.0

Source: Schulmeister, S. (2000) * US$ exchange rate with 4 international currencies

TABLE 2: Total Flows to Latin America and Caribbean 1975-1988

Years	Mean (1990 US$ billions)	Standard Deviation (1990 US$ billions	Coefficient Variation (per cent)
1975-81	45,6	8,1	17.8
1982-90	-15,4	9.6	-62.3
1991-98	44,9	16,7	37,1

Source: Griffith-Jones, 2000

TABLE 3: Latin America and Caribbean: Principal Economic Indicators

	1993	1994	1995	1996	1997	1998	1999	2000	2001
GDP*	3.3	5.2	1.1	3.7	5.2	2.3	0.5	3.9	0.4
GDP/Pop*	1.6	3.4	-0.5	2.1	3.5	0.7	-1.1	3.3	-1.1
Consumer Prices*	872.4	328.7	26.0	18.6	10.7	10.0	9.7	9.0	6.1
Open Urban** Unemployment	6.6	6.6	7.5	8.0	7.6	8.1	8.9	8.4	8.4
Public Balance/GDP	-1.7	-2.0	-1.7	-1.6	-1.3	-2.2	-3.0	-2.8	-3.3
External Debt/Exports	263.5	245.3	226.1	211.8	198.5	223.6	218.3	177.7	178
Trade Balance***	-21	-27	-12	-10	-33	-54	-22	-13	-20
Current Account	-45	-52	-37	-38	-65	-88	-55	-46	-51
Capital Account	70	42	29	68	85	69	49	61	33
Global Balance	17	-15	-20	30	20	-18	-6	15	-8

ECLAC, 2002. * Annual growth rate , ** per cent , *** in millions of dollars

TABLE 4: Latin America: Real Exchange Rate* (1995=100)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Latin America and Caribbean	105.6	104.9	102.9	100.0	97.0	93.4	94	98.4	99.5	97.5
Argentina	103.5	95.4	94.6	100.0	101.9	98.6	95.7	89.1	89.6	87.1
Brazil	117.0	112.3	112.4	100.0	94.0	93.4	98.4	148.1	137.7	160.8
Chile	109.1	110.9	107.1	100.0	97.0	91.0	94.5	99.4	100.7	109.9
Colombia	133.4	125.3	101.9	100.0	92.6	87.4	96.5	109.5	120.2	123.2
Mexico	69.2	65.9	67.7	100.0	89.1	79.6	82.3	75.5	69.8	66.2
Paraguay	103.4	107.7	101.3	100.0	96.4	96.2	108.9	106.2	110.5	115
Uruguay	128.2	114.4	104.7	100.0	99.3	98.7	100.8	94.6	96.5	97.7
Venezuela	125.2	121.5	126.4	100.0	119.4	92.5	82.0	73.3	71.6	68.2

ECLAC based on IMF data. * corresponds to the average real rate of exchange of each country in relation to the currencies of its main trade partners weighted by their volume of imports according to the average observed in 1995-1998.

TABLE 5: Oil and Non-Oil Commodity Prices, 1981-1998

(annual percentage change in nominal U.S. dollars, World Bank commodity price indexes)

Commodity Group	1981-90	1991-95	1997	1998
Non-Oil Commodities	-2.3	4.1	2.2	-15.7
Agriculture	-3.2	5.6	2.5	-16.2
Metals and Minerals	0.5	0.3	1.2	-16.2
Fertilizers	-2.5	0.7	-0.1	2.0
Petroleum	-4.7	-5.6	-6.2	-31.8
G-5 MUV*	3.3	3.6	-5.1	-3.9

Source: World Bank, 1999 * Manufactures Unit Value Index

TABLE 6: Latin America: Differences Between National and International Interest Rates*

	1989	1990	1991	1992	1993	1994	1995
Argentina	26.4	127.7	-12.6	9.2	5.8	3.1	7.8
Brazil	98.8	-2.0	24.1	38.7	32.1	49.5	27.6
Chile	-3.3	15.7	4.1	11.2	2.1	17.1	5.8
Colombia	-9.3	-8.4	3.7	-8.3	17.3	20.9	5.3
Mexico	9.0	8.9	6.1	10.1	12.4	-13.6	-34.7
Uruguay	-4.6	-7.9	4.8	5.6	6.7	3.9	3.2
Venezuela	-29.6	3.2	2.8	0.8	27.2	-2.0	-32.8

Source: ECLAC, 1995. * national rates equivalent in dollars less Libor rate

TABLE 7: Latin America: Real Interest Rates

	1993	1994	1995	1996	1997	1998	1999	2000	2001
Argentina	3,1	5,7	14,0	10,3	8,7	9,6	12,4	12,2	24,2
Brazil	157,6	-0,4	18,7	27,5	38,2	50,8	49,1	30,0	29,7
Chile	8,1	6,4	7,9	8,1	8,0	18,4	8,3	9,6	7,5
Colombia	10,9	14,2	17,4	17,8	13,3	20,3	17,1	10,0	13,7
Mexico	11,2	12,5	19,3	1,3	3,1	11,1	7,9	8,0	7,6
Paraguay	10,7	12,3	18,2	20,1	19,4	17,1	21,9	16,4	19,1
Uruguay	27,9	34,5	39,7	48,8	42,9	42,4	45,8	42,3	43,9
Venezuela	17,1	-1,7	-13,1	-29,1	-19,4	6,8	6,0	6,9	10,5

ECLAC 2002, based on IMF data. Nominal rates on short-term loans adjusted by consumer prices

TABLE 8: Latin America: Income Distribution in Urban Households, by Quintile

Country	Year	Quintile 1 (poorest) Decile 1	Decile 2	Quintile 2	Quintile 3	Quintile 4	Quintile 5 (richest) Decile 9	Decile 10
Argentina	1980	2.8	4.0	10.6	15.7	21.7	14.4	30.9
	1990	2.3	3.9	8.7	14.2	20.9	15.2	34.8
	1994	2.1	2.9	8.8	14.1	21.0	16.9	34.2
	1997	2.1	3.3	9.5	13.4	19.9	16.1	35.8
Brazil	1979	1.3	2.6	7.9	12.2	20.0	16.9	39.1
	1990	1.1	2.2	7.0	11.1	19.4	17.4	41.8
	1993	1.2	2.6	7.8	10.9	18.2	16.1	43.2
	1996	1.1	2.3	7.2	10.4	18.2	16.6	44.3
Chile	1987	1.6	2.8	8.3	12.8	19.4	16.5	39.6
	1990	1.7	3.0	8.7	12.1	18.7	15.8	39.2
	1994	1.7	3.0	8.7	12.4	18.7	15.2	40.4
	1998	1.7	3.0	8.7	12.4	19.4	15.8	39.1
Colombia	1980	0.9	2.5	7.6	11.3	18.9	17.5	41.3
	1991	2.0	3.6	10.4	14.9	21.6	15.6	31.9
	1994	1.1	2.6	7.9	12.4	18.9	15.3	41.9
	1997	1.9	4.2	11.3	16.8	23.7	15.4	26.8
Mexico	1984	3.2	4.7	12.3	16.8	21.9	15.4	25.8
	1989	2.5	3.7	10.1	13.4	19.0	14.4	36.9
	1994	2.9	3.9	10.0	13.9	19.7	15.3	34.3
	1998	2.8	4.0	10.5	13.6	19.3	15.1	34.8
Paraguay	1986	2.2	3.6	10.6	14.5	20.2	17.1	31.8
	1990	2.7	4.1	11.8	15.7	21.4	15.4	28.9
	1994	2.4	3.7	10.1	13.6	20.4	14.6	35.2
	1996	2.6	3.9	11.0	15.1	19.8	14.6	33.1
Uruguay	1981	2.7	4.1	10.9	14.7	21.2	15.2	31.2
	1990	3.5	4.7	11.9	15.4	19.9	13.3	31.2
	1994	3.7	5.3	12.8	16.8	21.5	14.6	25.4
	1997	3.7	5.3	12.9	16.5	21.1	14.6	25.8
Venezuela	1981	2.5	4.4	13.2	17.1	24.9	16.0	21.8
	1990	2.0	3.7	11.1	15.9	22.8	16.2	28.4
	1994	2.5	3.7	10.5	15.6	21.3	15.0	31.4
	1997	1.8	3.2	9.7	14.4	21.4	16.8	32.8

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TABLE 9: Latin America: Average (a) and Minimum (m) Real Wages (1995=100)

	1980	1990	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Argentina (a)	128	99	101	100	101	100	99	99	99	100	101	100
(m)	132	28	57	74	103	100	99	99	98	99	100	101
Brazil (a)	94	104	87	95	96	100	107	110	110	105	104	99
(m)	121	87	90	99	94	100	104	106	111	112	116	126
Chile (a)	77	80	88	91	96	100	104	106	109	112	113	115
(m)	87	76	87	92	95	100	104	107	114	124	133	138
Colombia(a)	80	94	93	97	98	100	101	104	102	105	110	109
(m)	97	104	99	102	100	100	99	101	99	103	104	105
Mexico(a)	113	88	100	109	114	100	90	89	91	92	98	104
(m)	323	128	116	114	114	100	91	90	91	88	88	89
Paraguay(a)	89	87	90	91	93	100	103	102	100	98	99	101
(m)	87	114	99	96	98	100	102	107	105	101	105	109
Uruguay(a)	99	91	97	102	102	100	100	100	102	104	102	102
(m)	233	161	141	122	108	100	96	94	98	98	96	95
Venezuela(a)	302	138	136	124	104	100	76	96	101	96	90	96
(m)	184	88	108	95	106	100	94	80	80	82	86	86

ECLAC, 2002. Argentina: manufacturer average wage; Brazil: formal labor; Chile: until 1993 only non agricultural labor; Colombia: manufacturer average wage; Mexico: manufacturer average wage; Paraguay: only capital; Venezuela: urban workers

TABLE 10: Labor Costs and International Competitivity

	Hourly Wages (US$) (a)	Labor Hourly Cost(US) (b)	Labor cost for piece (U.S.=100)	1990-1995 Annually Growth in (a) Local(1) US$	Produc-tivity	Competitivity (2) 1990/1995	Competitivity(2) 1997/1998
Argentina	4.6	6.5	55	-2.0 13.1	7.0	-6.1	3.7
Brasil	3.7	5.9	60	2.9 8.5	7.5	-0.9	4.3
Chile	2.5	3.5	23	4.3 9.4	3.2	-5.7	5.9
Mexico	1.9	2.8	47	1.2 1.5	5.2	3.6	...
Peru	1.3	2.1	43	5.1 11.6	6.6	-4.5	0.3
U.S.	12.6	17.7	100	2.6	3.8	-1.2	
South Korea	6.8	8.2	60	3.6	11.9	8.0	50.0

Source: Tokman and Klein, 2000. Data related to manufacture industry in 1997. (1) Variation in local currency in constant prices deflated by consumer index. (2) Difference between productivity and labor cost

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