Growth Patterns, Income Distribution and Poverty: Lessons from the Latin American Experience•

Carlos Aguiar de Medeiros®

Introduction

Latin American Countries (LAC) have shown historically a very high level of income concentration by all measures and, given their average income per capita, a high level of poverty. This stylized fact has periodically aroused many interpretations and analyses. Nowadays, given the resurgence of income distribution in modern theories of economic growth and the increasing disillusion of the liberal reforms implemented in the nineties to deliver better social results, many interpretations are in dispute.

The purpose of this paper is to explore some connections linking income growth, income distribution and poverty historically observed in LAC, with particular reference to the recent experiences in Argentina, Brazil, Chile, Mexico and Venezuela.

Methodologically it follows the classical political economists and the Latin American structuralist approach (Medeiros, 2002) emphasizing the mutual interdependence of economic structure, institutions and income distribution. In this approach, there is a complex interaction between functional and personal income distribution and by many mechanisms the level of occupation plays important roles on distribution and on poverty. It holds that the income of an individual (or household) reflects the relative economic position of the social class to which he (she) belongs and the national income distribution is shaped by the differences of relative economic position of social classes and their weight in the occupational structure (Lopez, 2005).

Besides this introduction, this paper contains three sections. First, it is presented a historical analysis of these connections in Latin America during different phases and economic regimes; second some new trends observed in the last years are outlined and finally, the paper exploits some myths on Latin America income distribution that are very ingrained in the common sense.

Section 1- Development, Income Distribution and Poverty in LAC

Primary Export and Financial Integration

• Paper prepared for the Workshop on "Policy Trends, Growth Patterns and Distributional Outcomes under Globalization" and conference "Economic Openness and Income Inequality: Policy Options for Developing countries in the new Millennium". IDEAS, Shanghai, 21-27th August, 2006. I would like to thank Franklin Serrano and Cristina Reis for comments and suggestions.

® Professor of Instituto de Economia, UFRJ, Brazil

After their formal autonomy as independent states LAC entered in the vast web of international order led by England as provider of raw material and food for industrialized countries. Changes in land tenures, tax systems, migration policies and in transports transformed integrally the economic landscape of the region. A large stream of capital came from London followed by huge flow of European labor. Orthodox policies were implemented in order to give convertibility of these peripheral currencies to gold (pound). A close integration with European merchant and banks was a fundamental anchor for this outward economic model.

The roots of the high income concentration and poverty that since that period has been a historical characteristic of this region are grounded on this model of growth. But despite that, very different national variants were present. In countries where high quality land was abundant such as *Argentina* and *Uruguay,* the European immigration was massive and set a subsistence wage and income more similar to the patterns in Europe[1]. A high demand of wheat and corn sets a high price for good lands, increasing the ratio of rents to wages and favoring a few big farmers. But a higher productivity level achieved in food production (that happened to be the main crop) and the favorable ratio land/labor allowed a relative high real wage. Low levels of poverty and higher consumer demand stimulated a diversification of infrastructure and urban investments. That's why a more industrialized economy distinguished Argentina from the rest of the continent in the first decade of the XX century. The modern urban labor class that emerged from this economic model achieved a kind of income conflict between wage earners and rural and industrial capitalist likewise those of more advanced economies.

In *Brazil* this pattern is similar to that of Sao Paulo during the coffee cycle in the last quarter of the XIX century and the first two decades of the XX century. But contrary to what happened in Argentina, the inheritance of slave labor and a higher level of poverty in the country's Northeast created a much more unequal economy.

The nucleus of the poverty was the large amount of population living in a low subsistence economy. The surplus labor depressed the wages paid in traditional Northeast crops (as sugar) and the surplus of this "plantation" economy was invested outside the region or consumed in imported luxury goods. This formed the essential dimension of the underdevelopment as explored by Celso Furtado (1971).

Higher income concentration and large poverty were a Brazilian characteristic but as a matter of fact this country is a synthesis of the continent. In *Venezuela, Colombia, Bolivia or Peru*, the dominant aspect of Brazilian Northeast underdevelopment - high income in export activity, low productivity in food production and labor surplus - was achieved in the production of mineral raw material. This was the base for large poverty and a high primary concentration of income not countervailed by a State captured by the interests of the owners of these valuable land assets. Although in *Chile* some of these aspects were present the higher productivity achieved in food production, the larger public investments and less pervasive surplus labor contributed for a minor level of

[1] For a classical connection see Lewis (1978) and Furtado (1971).

poverty.

In the *Caribbean* countries, the same pattern dominant in the Brazilian Northeast was in place with an aggravating circumstance: the foreign property of natural resources. In *Mexico*, as in Brazil, a rapid diversification of the economy occurred led by primary exports; but low productivity in food production and large surplus of native labor generated high income concentration and poverty. In the beginning of the century, the land tenure in Mexico favored the looting of the good public lands by rich families and precluded an expansion of middle income farmers. In opposite to what happened in Brazil or Argentina, where the land tenure was not changed, in Mexico a radical land reform took place in 1917 until the end of the thirties, when it was accelerated by the Government of President Cardenas. But in a country where the good land was not abundant and the public investment was very limited, this land reform did not enhance the food productivity of the *ejidos* (collective farms) and the population living in small plots of bad land increased. Poverty and income concentration had in Mexico the same root as everywhere in underdevelopment Latin America.

State Led Growth

The crisis of 1929 was a watershed for the Latin American economies and inaugurated what was conventionally described as import substitution industrialization. After a huge depreciation in exchange rates, the larger countries started a new policy led by the state centered on domestic demand. For the majority of countries, the Second World War and the two subsequent decades were characterized by scarcity of currency and a high protective policy for the industries competitive with imports. This new model brought about a high economic growth and, in the largest countries as Brazil, Mexico and Argentina, the process of industrialization included the principal sectors of the modern industrial system.

During this period, poverty was reduced and during the seventies the personal and household income concentration declined in many countries including Brazil, that was by far the most unequal country among the largest countries of the continent. But this improvement was very modest to alter substantially this inherited unequal pattern. Thus, what seems remarkable in LAC when confronted with other areas of the world was the persistence during these industrial years of a high income concentration and the high levels of absolute poverty[2].

First of all, different from what happened in East Asia, China or in Europe, no political U-turn happened along these years enacting a new distributional coalition in favor of middle farmers, urban labor and industrial sectors. With the exception of Cuba (and some defeated leftist experience in Bolivia during the fifties and in Chile in the beginning of the seventies) the coups of stat that spread along these years to many countries were conservative preserving the economic and political clout of the land

[2] This was an essential historical and analytical problem examined abundantly by the structuralist school – see for example Pinto (1976)- and recently it was taken up again with different approaches, as in Morley (2001) or in World Bank (2003).

owners. In the case of Brazil, this was achieved in alliance with industrial classes and some industrial labor sectors. The political dimensions of the Cold War after the Cuban revolution blocked any democratic and pro labor coalition against the traditional classes.

Some aspects inherited from the old pattern and, in many economies, the basic characteristic of the underdevelopment – the low productivity in food production and the surplus labor - was reproduced in a new and more complex economy. Again there were quite distinct realities that emerged along these years.

In *Argentina*, the characteristics of underdevelopment have never assumed the dimensions reached in other Latin America countries. After the Second World War, the high participation of formal wage urban employment, and the low ratio of agriculture employment created an environment closer to the middle income Western European economies. The economic struggle assumed a more classical class conflict between unions and the employers allied with land owners. Along these years, a conflict between low inflation and high economic growth took place. The most general base was the incompatibility between the level reached by the wages and the productivity of the export sector. The real depreciation of exchange rate that after 1930 inaugurated an industrial age in the majority of LAC was not achieved in Argentina. The nature of its main exports – food production - set an open conflict between real wage and real exchange rate, and between domestic demand and exports. As far as the rate of economic growth was constrained by the rate of exports, the pressures for a higher wage could not be accommodated without decreasing the surplus share. The modern industry that was established in the country could not, for the same reason, compete in the international market of manufactures, unless a technological upward shifted rapidly its capabilities.

This conflict was very vivid during 1967-74, after the ouster of Peron by a military coup, and was suppressed by a radical military coup in 1976. This promoted a drastic reduction of the labor share inaugurating a new distributive tendency for the years ahead. As shown by many sources (WB, 2003) the labor share fell down from 45% reached in 1975 to 25% in 1977!

However, this collapse in wages did not resulted only from labor repression but it was also the outcome of a mass industrial unemployment that followed the balance of payment adjustment based on a fixed nominal rate of exchange introduced in the second part of the decade. The same happened in Uruguay – where the basic conflicts were similar to these - and in Chile.

In *Chile*, a higher level of income concentration was inherited from the old model. The concentration of the economic activity on copper production, a high concentration of agricultural lands and a lower level of productivity in other activities including food production, brought about a pattern where the import substitution barely changed. The open distributive conflict assumed, as it happened in Argentina, a classical class struggle. After a brief period – between 1970/1973, when a socialist government headed by Salvador Allende promoted a land reform and social investments, a coup-of-state implemented after 1973 a dramatic U-turn in income distribution against urban labor and the peasants. As in Argentina the abundance of international loans were a basis for monetary stabilization centered in financial integration and trade opening.

In *Brazil*, the basic characteristic of underdevelopment has not changed and the well succeeded industrialization that took place in Sao Paulo attracted millions of migrants from the miserable Northeast countryside. These flows constrained wages paid in urban activities too low levels, opening a huge gap between productivity and the average wage. As a countervailing force, the minimum wage – that spread to urban activities along these years - set a higher floor for urban labor and the fast speedy of industrialization enlarged the formal wage employment. A high industrial protection and a devaluated exchange rate turned the terms of trade against agriculture with large compensations to the exporter's producers but without any compensation to food production, which remained as backward as it was in the old pattern. Because of that in the countryside the landscape changed less with the industrialization and the extreme inequality that characterized the Brazilian economy after the war was led by this urban/rural gulf.

A peasant and urban labor radicalization took place in the beginning of the sixties and opened new possibilities for a more balanced growth. The military coup of 1964 defeated this possibility. The attack to organized labor and the reduction of the real minimum wage caused a U-turn in the urban income distribution. Two opposite forces were in place. A demographic boom and the persistence of high levels of poverty in the countryside brought about a high migration of unskilled labor to industrialized regions; a high economic growth achieved by industrial policies created millions of formal wage jobs. During the seventies, the abundance of foreign currency was accompanied by a strong push on heavy industry. Because of this, the second force (growth of formal employment) predominated over the former (growth of labor force in urban sector), the minimum wage was increased in real terms and the unions became stronger[3]. Investments in infrastructure and modernization of food production started important changes in agriculture. In consequence the labor share, the personal and household income concentration and the levels of poverty declined.

In *Mexico*, as in Brazil, the industrial years have not changed the basic characteristic of the underdevelopment and the low productivity and income of the *ejidos* constrained the wages paid in urban activities. Different from other LAC, Mexico sustained since the fifties until the 1970s a fix rate of exchange and obtained a large flux of currency from tourism, oil and had a regular capital inflow from United States. Thus industrialization exerted a lower pressure on the inflation rate and the exchange rate was not used as a strong tool to protect industry. A very strict submission of the unions to the government and the constant pressure of non skilled labor from countryside kept the wages on control. The growing productivity of industry allowed a large surplus share and

[3] Due to the fact that the formal employees have a higher relative economic position than those of poor peasants and informal urban labor, a relative expansion of formal employment decreases income concentration and vice-versa. Additionally, an increase in formal employment enlarges the labor bargain power for higher wages. The unemployment rate affects directly the concentration index diminishing the number of those with no income. Because of this, the reduction of open unemployment decreases the concentration index and vice versa.

a great differentiation of income between professionals and skilled labor and non skilled labor. As in Brazil, the bottom of the distribution was formed by the wages and income earned in an impoverished subsistence agriculture. As far as the formal urban employment increased its contribution to total employment, income concentration declined and labor share enlarged. During the seventies (essentially during the Echeverria government, 1970/76), the income distribution did indeed improve pushed by the fact that wages increased faster than productivity and by some progressive social policies. This caused an increase in labor share from 30% observed in 1960 to 40% in 1975, the highest level reached by this ratio (Palma, 2003).

High abundance of foreign loans was used to finance large investments in oil production at the end of the decade and it was important to stabilize the rate of exchange on a high level: good for inflation and wages, bad for non oil export sectors. The crisis of balance of payment in 1982 ended this model and started a new distributive coalition that will rule the Mexican economy in the years ahead.

In a very rich natural resources country as *Venezuela*, after the Second World War a permanent abundance of currency lived together with social characteristics of underdevelopment. The capture of the State to deliver the oil rents through modern infrastructure for export activity and to provide the services and investments for the upper class was the most general aspect of the economic model that developed along these years. A valued exchange rate allowed high consumption for the professional and labor employed in oil sector and was an obstacle for the growth of non oil sectors that had no competitiveness to export. As a result, a large informal sector of low income was spread generating high income concentration and high level of poverty. During the seventies, the high prices of oil caused large fiscal spending without changing the bottlenecks of the economy. But several measures to protect and promote industrial activities were enacted and the expansion of public investment generated higher levels of formal employment with positive results on poverty. The abundance of liquidity added to the large oil revenues a wave of investment in the modern sector without changing the basic roots of underdevelopment.

In the other small countries, industrialization practically did not start and underdevelopment was a pervasive inheritance of the LA insertion on world markets. As far as the prices of land resources increased or, as it happened in the 1970s, the external finance was available, the expansion of the export sector brought about some public investment and social spending enlarging the formal employment. But the chronic surplus of labor and the low level of productivity of wage goods and food production industries blocked any large effect on poverty. Thus, the income growth was appropriated by the land owners, the owners of financial instruments and the professionals employed by them..

From Lost Decade to Washington Consensus Reforms

The crisis that characterized the decade of 1980 was a watershed in LAC similar to what happened in 1929. But differently from the earlier one, the crisis that followed the Mexican default in 1982 created the economic and political conditions for a renewed model of growth based on primary export and financial integration that emerged on 1990s.

In all countries (with a partial exception of Chile) the income concentration and the poverty levels increased due to high inflation (hyperinflation in countries like Argentina, Bolivia and Brazil), decline in formal employment, decline of the minimum real wages and of the wage share, and reduction of the social transferences. The large transferences to the creditors of the external debt were financed by a trade surplus stimulated by strong devaluations of the exchange rate and deflationary fiscal policies. The nationalization of public debts as it happened in Argentina, Chile, Brazil or Mexico was accompanied by a privatization of dollar denominated assets held by national rich residents. This enlarged greatly the concentration of income in the very top (not reported in the conventional measures of income based on household surveys) and prepared the economic and political coalition that led the liberal reforms of the nineties. In countries hit by episodes of hyperinflation as in Argentina and Brazil the most powerful groups of skilled and unionized labor and professionals could protect their income from depreciation feeding the conflict on income distribution. The decline of real minimum wage depressed the wage of non skilled labor in urban and rural areas that suffered along with the large informal sector the burden of this conflict. Large migration flows from countryside to metropolitan areas took place in LAC.

As previously observed the biggest U-turn in income distribution in Argentina and Chile happened in the seventies and was politically oriented with direct attack on labor's right and employment protection. During the eighties, civil government replaced military rightist dictatorships in many countries and enacted labor law more favorable to the workers but this could not offset the economic hardships that came from the "macro economy of transference".

In Chile, after the process of desindustrialization, the enlargement of the surplus share and the opportunities created by mass privatization enabled a new growth policy. This occurred after 1985 distinguishing this country from the stagnation that hit the continent

Table 1 - Trends in Distribution of Income Before 1990

	Year	Gini	Year	Labor Share
Argentina	1963	35.8	1974	45
	1975	36.6	1980	34.3
	1990	50.1	1986	28
Brazil	1970	57.6	1969	39
	1980	57.8		
	1990	62.7	1998	29
Chile	1968	45.6	1970	47.8
	1980	53.2		
	1990	55.4	1987	42.8

Mexico	1963	55.5	1982	46
	1975	57.9		
	1989	55.0	1989	35
Venezuela	1971	47.7	1984	25*
	1981	42.8		
	1990	47.1	1990	16*

Sources: Gini data before 1989: Deninger, K and Squire, L (1996), *Measuring Income Inequality: a New Data Base*, WB, Gini data of 1990: ECLAC (2002), *Social Pamorama o Latin America*, 2001-2. Labor share data: Morley (2001). * Only manufacture

The package of liberal reforms in the eighties was inaugurated by Mexico after the crisis of 1982 with a new government (De La Madrid, 1982/86). This package promoted - in an economy not hit by high levels of inflation - a drastic income concentration. Besides the continuous decline of the labor share that fell from 35% in 1980 to 25% in 1990 (Palma, 2003), the period 1984-1989 was characterized by a high shift in household and personal income towards the richest decile (Morley, 2002; Lopez, 2005).

Poverty and Distributional Changes in the Neoliberal Era

The political economy of trade and financial liberalization that spread in LAC in the nineties – a very radical liberal package when compared with other regions except the East Europe - was followed by a higher but very unstable growth with episodes of high exchange rate and import booms followed by collapse in exchange rate and gross capital flight. Chile escaped from this scenario thanks to its more restricted exchange policy. But in the other countries the fragile balance of payment was sustained by restrictive policies and massive privatizations deals used to attract new investments from international and national residents. Finance capital and cosmopolitan and dollarized groups were lured by the orthodox policies and strongly enlarged their position in the new economic commanding heights.

This pattern of growth was accompanied by significant reduction of poverty in many countries and insignificant reduction in weighted household income distribution. This trend was accentuated at the end of the nineties and the years of the next decade. For the dominant thought closer to multilateral agencies and to the government's technopols this outcome was, first of all, a consequence of a sounder macroeconomics coupled with liberalization policies that had broke the hitherto industrial protectionism. And, second, it was the result of a new model of social policy targeted on the poor that was spread in the region during this decade and which has expanded in the last years[4]. This evaluation is indeed very fragile and can not be sustained. Table 2 bellow shows a remarkable contrast within the region.

[4] Starting in the eighties in Mexico with the *Programa Nacional de Solidariedade* (National Solidarity Program) focused on the poverty, several focal programmes based on conditional cash transfer were introduced in the region. *Programa de Educación, Salud y Aliementación* (Mexico), *Familias e Acción* (Colombia), *Programa de Asignación Familiar* (Honduras), *Rede de Proteción Social* (Nicarágua), *Beca Futuro* (Bolívia), *Chile Solidário* (Chile), *Bolsa Família* (Brazil). (Medrano, Sanhueza and Contreras, 2006).

Table 2 - Trends in Income Distribution (Gini Index) and Poverty (percentage of population below poverty line) in Latin American Countries

		Early 90s	Early 00s	Change
Argentina	Gini	42.6	50.4	7.7
	Poverty	21.2	45.4	24.2
Brazil	Gini	59.5	57.2	-2.3
	Poverty	48.0	38.7	-9.3
Chile	Gini	54.7	56.1	1.4
	Poverty	38.6	18.7	-19.9
Mexico	Gini	53.9	52.7	-1.2
	Poverty	47.7	39.4	-8.3
Venezuela	Gini	41.7	45.5	3.8
	Poverty	39.8	48.6	8.8
LAC Average (non-weighted)	Gini	50.5	51.4	0.9
	Poverty	48.3	44.0	-4.3

Source: Gini coefficient based on WB (2003) and poverty based on ECLAC, 2004.

In *Argentina*, the collapse of the peso in 2002 brought about a shift in poverty and income distribution similar in extension and speed to the collapse of socialism in the former Soviet Union and East Europe. Between 1999 and 2002, two opposite forces were in place. First, a real appreciation of exchange rate contributed to the expansion of the purchasing power of wages and low income earners and to the decline in the industry's mark-ups. Second, a fast increase in unemployment (that resulted from this rate of exchange coupled with trade liberalization and massive privatization) nullified the first movement. Thus, before 2002 the labor share, the personal income distribution and the poverty remained constant around the level reached in the beginning of the decade[5]. When this untenable model of growth collapsed, the price hike that followed the exchange devaluation caused a big shift in poverty levels. The richest groups that could preserve their dollarized assets enlarged their position only reverted in recent years.

But it is important to consider that this reported stability in income distribution achieved in the nineties hides some important social changes barely reported. In fact there is little information and studies about changes in class structure in LAC. According to some analysis based on microdata extracted from household surveys, between 1992 and 2001, previous to the peso collapse, the relative individual income of capitalist and

[5] See Lopez (2005). Given the high valorization sustained by capital inflows, Frenkel (2004) argued that through a positive correlation between undervalued currency and employment growth a low exchange rate has a positive effect on income distribution. This result is not solid. The employment effect is possible but doesn't come automatically from the exchange rate devaluation and could be achieved through other policies. To say that is not to endorse the exchange rate valorization achieved by financial opening policies, as occurred in LAC during the nineties. As argued by Patnaik (2002) this valorization based on capital inflows is self-defeating because peripheral monies can not sustain their position of store of value in a financial integrated world. For this reason, a tendency of devaluation is always present and becomes real as soon as the "investor confidence" shifts inducing mobile capital to flight to strong monies. When the exchange rate finally collapses it affects disproportionably the wage earners.

professional/executives vis-à-vis formal and informal workers has increased significantly. The mass dismissal in the public utility sector that resulted from privatization and the restrictions established in their right to strike contributed for a fragile bargain power of these well paid workers. This occurred in contrast with the fast growth of new jobs for high skilled executive and professionals created in financial and business activities. The same happened in Brazil.

Table 3 - Class Structure in Argentina and Brazil: Percent Share of Working Population and Relative Income

	Share in Working Population				Relative Individual Income			
	Argentina		Brazil		Argentina		Brazil	
	1992	2001	1992	2001	1995	2001	1995	2001
Capitalists	1.6	1.1	1.2	1.3	144	173	145	149
Professors/executives	4.4	5.8	4.1	4.5	108	127	105	110
Petty entrep.	4.9	5.4	3.7	3.7	100	100	100	100
Formal Workers	46.5	45.9	33.8	31.7	41	46	26	29
Informal Workers	42.6	41.8	57.1	58.8	38	28	17	19

Source: WB (2003). Calculations based on microdata from Encuesta Permanente de Hogares (EPH) and Pesquisa Nacional por Amostra de Domicilios (PNAD).

The data shows that in Brazil the nineties were characterized by a significant reduction of poverty (after the episode of hyperinflation in the beginning of the decade), an insignificant reduction of the income concentration, a substantial decline of the labor share and an increase in the income of capitalist and professional/executive in relation to the formal and informal labor. Considering that the richest decile reported in household surveys captures essentially the high middle class and that the 9th decile captures wages paid to middle income groups including skilled industrial workers, it's evident that there was in Brazil and Argentina a relative decline of the middle income groups' size. The gulf between the richest decile and the 9th decile and between the richest and 4th quintile enlarged along these years. This has not affected the Gini index, which shows after 1994 (the stabilization year in Brazil) a process of downward leveling[6].

As occurred in Argentina, some countervailing forces were present. From 1994 to 98 a high real exchange rate was favorable to wages but the destruction of industrial employment nullified this effect resulting in a decline in the average wage. But other tensions with symmetrical effects upon income distribution distinguished this country. The high level achieved by the rate of open unemployment and the decline of the formal employment could have pushed down the incomes of the poorer groups with negative effect on poverty. Nevertheless, the real increase in minimum wage (and on the pensions that were extended to the rural sector) from 1994 to the present, was very positive to reduce the poverty. It was compensated for another tension. Since the eighties, but mainly in the nineties, the productivity in the agriculture sector (mainly in food production) has

[6] In Latin America countries the high income concentration reported in LAC household survey is strongly determined by the share appropriated by the richest decile (that by its turn shows a high concentration on the top 1%). The distribution among the first 9 deciles is not very different from other developing countries in other regions.

been increasing with a double effect in income distribution. From one side it has promoted a consistent decline in the food prices favoring the low wage earners; from the other side this very same process has reduced the income of small producers enlarging the migration for metropolitan and urban areas. But as the minimum wage was progressively diffused into the countryside, it set a bottom line for the wages paid in modern agriculture.

More than any other LAC, Brazil has a protagonist factor shaping income distribution: the real rate of interest set on public bonds. From 1994 it has achieved a very high level (circa 16% yearly in real terms) pushing up the opportunity cost of capital and depressing the real public spending. The regressive tax structure and the high concentration of the public bonds in few hands make the Brazilian interest rate an unequalizing determinant of the income distribution. The fact that this factor is not accurately reported in household surveys only shows the limit of this data for the analysis of the income distribution.

In *Mexico,* an accentuated decline of the labor share took place along the nineties. The most important structural change that resulted from the NAFTA agreement was the specialization of the Mexican economy in the provision of low valued manufactured goods produced in processing industries – *maquiladoras*- for American economy. Although a modest decline in personal income distribution and a significant reduction of poverty occurred after 1994. Two sub periods, according to Lopez (2005), can be identified. In the first (1989-94) income distribution is sharply concentrated, in the second, after the devaluation of the peso in 1994, there was higher rate of economic and a decline in poverty. The former period had high exchange rate accompanied by a low growth of formal employment. As the minimum wage was diminished in real terms and the average wage declined with the contraction of the formal employment, the reduction of the mark-ups did not compensate the wage decline. After 1994, a depreciated rate of exchange was followed by an expansion on formal employment and despite a fall in the share of the labor (stimulated by an increase in the imported components and higher mark-ups) the personal income distribution improved and poverty declined.

Contrary to what happened in Brazil, the minimum wage was not a countervailing force in Mexico. During the first years of the new century some policies as PROCAMPO destined to transfer income to the small peasant had a positive effect on poverty but can not explain the whole change. Probably the main factor underlying the reduction of poverty and an improvement in income distribution is the huge immigration flow from the Mexican countryside to the USA. The urban increase due to rural-urban migration was historically high in this country explaining a net transference of 32.1% in 1970/80 and 21.6% in the 1980s (World Bank). These numbers were comparable with other LAC. But in 1990-2000, while these numbers stayed very high for the majority of the countries, in Mexico the net transference became negative – 7.9%! According to CEPAL (2005), the contribution of the remittances of the large group of Mexican living in USA (US Census Bureau says that more than two million Mexicans entered legally in the country in the last decade) to income distribution was very significant.

In *Venezuela*, as the table above shows, the liberal years were accompanied by a big increase in personal income concentration, a dramatic drop in the wage share and great expansion on poverty. The sluggish growth, the continuous devaluation of the exchange rate in this oil producer country and its effects on inflation rate (that persisted high in this country in a decade where the inflation virtually disappeared in the other LAC) hit badly the low skilled worker and the poor peasant while the capitalist and the executive/professional groups enlarged their relative income position. The high middle class and the very rich dollarized their capital assets making Venezuela one of the most dollarized countries in the world.

This precarious and untenable situation persisted until 2003 when a hike in oil prices and a political turn around, culminated with the consolidation of the new popular government commanded by Hugo Chávez, changed the economic and political environment of this country.

The most important contrast of *Chilean* economy during the nineties was its higher and more stable economic growth with low inflation. This was based on a stable real exchange rate – good prices of cooper and capital controls were important for this achievement- and investments in agriculture and natural resource based industries. This higher economic growth was accompanied by a real growth of minimum wage, higher average wage and lower unemployment. As a result, poverty has declined strongly in a sharp contrast with the other experiences of Latin America. In 2000 only Uruguay had a lower poverty incidence. Despite that, this model of growth was very unequal. Although the labor share in manufactures had increased smoothly, in the last year of this decade the personal and household income distribution was even more concentrated than in the beginning (see table above). Its most probable reason was the polarized effect of this model of growth on labor market. In fact, the share of formal workers in working population decreased and the share of petty entrepreneurs strongly increased. Their income enlarged and the gap between the income of professional/executive and the average wage of formal and informal workers strongly increased. Chile entered the new decade with a very uneven income distribution, almost similar to the Brazilian and far more concentrated than in Argentina or Mexico. This was not, as we argued, the product of the recent years but the inheritance of the political shift not reverted so far.

Section 2 - New Trends in Growth, Distribution and Poverty in LAC

The fast growth of international economy led by USA and the strong shifts in the terms of trade favoring oil, copper and raw materials after 2003 interrupted the balance of payment crisis that hit LAC in the beginning of the century. The high rate of exports' growth allowed a higher rate of economic growth achieved unevenly by the region after 2003. In some countries it strengthened the fall in poverty.

By far Argentina and Venezuela had the fastest growth after the huge depression that in 2002/3 hit these countries and Brazil, constrained by a very conservative monetary and fiscal policy, had the slowest growth among the major countries. Table 4 contains the annual rates of GBP growth in Latin America.

Table 4 - GDP Annual variation - constant prices (2000)

	Latin America*	Latin America & Caribbean	Argentina	Bolivia	Brazil	Chile	Mexico	Peru	Venezuela
1991	4,0	3,9	10,6	5,3	1,0	8,0	4,2	2,8	9,7
1992	3,4	3,3	9,6	1,6	-0,5	12,3	3,6	-0,4	6,1
1993	3,5	3,5	5,7	4,3	4,9	7,0	2,0	4,8	0,3
1994	4,8	4,8	5,8	4,7	5,9	5,7	4,4	12,8	-2,3
1995	0,5	0,5	-2,8	4,7	4,2	10,6	-6,2	8,6	4,0
1996	3,8	3,8	5,5	4,4	2,7	7,4	5,2	2,5	-0,2
1997	5,5	5,5	8,1	5,0	3,3	6,6	6,8	6,8	6,4
1998	2,5	2,5	3,9	5,0	0,1	3,2	5,0	-0,7	0,3
1999	0,4	0,4	-3,4	0,4	0,8	-0,8	3,8	0,9	-6,0
2000	4,0	4,0	-0,8	2,5	4,4	4,5	6,6	2,9	3,7
2001	0,3	0,3	-4,4	1,7	1,3	3,4	0,0	0,2	3,4
2002	-0,8	-0,8	-10,9	2,4	1,9	2,2	0,8	4,9	-8,9
2003	1,9	2,0	8,8	2,8	0,5	3,7	1,4	4,0	-7,7
2004	5,9	5,8	9,0	3,6	4,9	6,1	4,2	4,8	17,9

Source: ECLAC - Economic Commission for Latin America and the Caribbean
*Includes 20 countries: Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Cuba, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Venezuela, Dominican Republic and Uruguay.
** Includes 33 countries: Antigua and Barbuda, Argentina, Bahamas, Barbados, Belize, Bolivia, Brazil, Chile, Colombia, Costa Rica, Cuba, Dominica, Ecuador, El Salvador, Granada, Guatemala, Guyana, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Venezuela, Dominican Republic, Saint Kitts and Nevis, San Vicente and Grenadines, Santa Lucia, Suriname, Trinidad and Tobago and Uruguay.

In *Argentina* the stabilization of a higher rate of exchange was achieved after a default and a rescheduling of international debt that limited the burden of the interests on current account. This stabilization was not detrimental to the wages. The fast expansion of the employment rate (mainly in manufacture) and a political turn on minimum wage generated a high growth of the real average wage. Consequently a drop in poverty occurred between 2002 and 2004. Although the present situation is immensely superior to the radical liberalism of the nineties and opens new opportunities for a stable growth, it did not change the basic conflict that historically has been present in Argentina: the conflict of a middle income and relatively high wage economy with a structure of exports strongly based on natural resources. The boom in exports achieved in 2004 was not achieved in 2005 due to a fall in terms of trade and the imports had a higher growth rate.

In *Venezuela*, the hike in oil prices after 2003 and the political consolidation of a nationalistic government resulted in an extraordinary growth in the last two years pushed by public and private investment in industry and infrastructure and in social spending. With a dramatic increase in the terms of trade, the current account allowed pro-growth policies. This upsurge investment was in great part explained by the large decline of the last years, but the drastic expansion of social spending was quite new in its goal to use the oil revenues for the poor sections of Venezuelan society. The persistent elevation of oil prices in 2005 contributed for a stabilization of exchange rate and a drop in inflation rate in a fast growing economy. The reduction of unemployment and the increase in minimum wage interrupted the expansion of poverty that occurred in the previous years.

Structurally the conditions for a less polarized pattern of growth will depend whether the present investment and social policies will increase the productivity of the agriculture and of non tradable goods. If not, a very likely fall in oil prices and in terms of trade will trigger the basic conflicts that historically characterized Venezuelan history.

In *Mexico*, the high growth of American economy pushed once more a high growth of exports of the *maquiladoras* but the basic characteristic of the Mexican economy did not change. Among the major LAC the terms of trade for Mexican economy have not significantly improved and the prices of its exports have not increased as in other countries. The specialization in exports of labor intensive manufactures in competition with other low wages and surplus labor economies in Asia has intensified. Low growth, low employment rate growth, declining minimum wage and stagnation of the real average wage have been pressing down the income distribution. The rural migration to USA and the remittances are the major countervailing mechanism.

In *Brazil*, as in Mexico, the major transformation in trade was exerted on the volume of exports and not in the terms of trade that nevertheless played a positive role. The basic model once described has not changed. After significant real devaluation, the real exchange rate appreciated after 2003 at the same time that the exports were booming. The consumer prices were stable and the policy of elevation of the minimum wage prevailed with a positive impact on labor income. But contrary to what happened in other countries, the monetary and fiscal policies remained very conservative and the real rate of interest, although declining, has been very high. A low investment in infra-structure and depreciated capital stock in important segments of public utilities resulted from these years. Most of the exports are based on natural resources industries and despite the recent valorization of real exchange rate they still have good international prices and high demand. But this valuated exchange rate has been a constraint for the industries with lower absolute competitiveness.

In consequence of these macro and structural determinants that led GDP growth above 2% between 2001 and 2003 (see table 4), the recuperation of the employment rate was very sluggish keeping down the real average rate. Despite that, the poverty has declined and the same happened with the Gini index. During the last years, the decline in poverty in Brazil was stronger in rural areas generating a rural-urban income convergence (CEPAL, 2004). This started to change the most basic dimension of Brazilian underdevelopment: the rural extreme poverty and the subsistence wage paid to the agriculture labor. The cash transfer program (Bolsa Família) introduced in the nineties and consolidated during the government of Luis Inacio Lula da Silva has contributed to decrease the poverty in the countryside, but the mayor cause was the increase of minimum wage.

The roots of Brazilian underdevelopment have changed as we observed in the last section. A modern production of food and an elevation of the wage paid to agriculture workers started to change a traditional source of surplus labor and low wages. But this process has happened along decades of low growth and low growth of formal employment enlarging the surplus labor in urban low-productivity jobs that reached explosive dimensions in metropolitan areas.

The protagonist role played by the rate of interest on income distribution can be roughly observed in table 5, which shows a decomposition of household income in 2004. Unfortunately the government transfers (mainly Bolsa Família) is informed together with the interest incomes (that is understated in the survey). The data tells that public cash transferences to the very poor people were a small part of the cake of total public transferences, while the largest part (interest, mainly paid to the bond holders) went to the very rich.

Table 5 - Distribution of Income Components to Households According to Deciles of Household Income Per Capita – Brazil, 2004

Deciles	Labor Income	Retirement	Transfers and Interest	Others
1	1.4%	0.8%	12.6%	1.6%
2	3.0	2.2	13.5	2.2
3	3.8	3.5	10.1	2.7
4	5.1	4.4	7.8	2.7
5	5.5	4.2	5.2	3.4
6	6.3	9.2	7.0	3.5
7	9.0	8.3	4.2	6.0
8	11.3	11.0	3.9	8.3
9	16.4	15.9	5.8	17.7
10	38.1	40.5	30.1	51.9

Source: Swartzman (2006) PNAD, 2004.

Chile, besides Venezuela, had the most accentuated shift in terms of trade. The price of cooper boomed after 2003 as well as its exports. A lower rate of exchange and lower inflation was achieved, without any change in the level of employment. This contributed for a higher real average and minimum wage and for further decline in poverty. Nevertheless, the lift of capital controls occurred in the last years and the major weight of the cooper on exports have increased the fragility of the economy to diversify exports and to maintain the rate of growth in the near future. The impact on income distribution depends (as in Venezuela) on the social direction of the enlarged rents of this natural resource.

Section 3 - Final Notes: Some Myths on Income Distribution and Poverty in Latin America

The history examined so far challenges some very common myths present in the current literature on income distribution and poverty in Latin America. A brief analysis of them resumes and ends this paper.

First Myth: Although economic growth has a positive effect to reduce poverty it has no effect on personal and household income distribution.

The history of LAC shows that when a period of high growth was achieved not only poverty but income distribution became less uneven. In the majority of the countries the income distribution became less uneven during the 1970s. One good example occurred in Brazil, where inequality stopped increasing and started to decrease, the other in Mexico where inequality substantially fell down along these years. The most likely reason is that the expansion of formal employment that followed the growth of GDP changed the structure of labor market, enlarging the share of better paid labor and reducing the number of informal and lowest paid labor. In addiction, the decline in open unemployment diminished the number of individuals and household without income. The weight of these effects depends on the extension and speed of the growth rate not matched by other countervailing force.

Second Myth: Latin American Countries are characterized for a very high income concentration that has not changed along their history.

This is a very inaccurate proposition. Although the levels of income distribution are very high when confronted with other regions they are quite distinct within countries. Historically, the main aspect was the share of the labor force associated to low-productivity jobs in agriculture and in informal urban employment. Despite the long run inequality showed in the region, income distribution changed abruptly in many of them. Considering the evolution of income distribution within countries one can observe that this was far from being smooth but has changed sharply in concentrated periods of time. Brazil in 1964-1974, Chile in 1970-1987, Argentina in 1974-1986 and Mexico in 1984-1989 experienced a high upward inequality geared by conservative and anti-labor governments. After those big changes the income distribution evolved around new and more concentrated distribution patterns.

Third Myth: The high level of income distribution achieved in LAC resulted from the high concentration of assets, mainly in land tenure.

The most counterevidence of this proposition is the Mexican experience started in 1917. The distribution of poor land without productivity enhanced investments (as happened similarly in Bolivia in the fifties and presently in Brazil) did not change the high levels of income concentration and poverty of the small producers. Considering some successful experiences in East Asia the real revolution begins with the huge public commitment to deliver public goods, to promote investment, to diffuse technical knowledge, and to create incentives to trigger the labor productivity of the reformed land. This developmental strategy has strong political dimensions since it systematically collides with private interests and breaks with the inertia forces.

Fourth Myth: The export of Manufacture is the best strategy for a sustainable and high employment growth of non skilled labor.

Again the Mexican experience provides counterevidence. Unless the productivity of food and wage good industries is increased and the reduction of surplus labor allows a higher wage rate, the terms of trade tend to deteriorate against peripheral exports in a "low-road" specialization. A high employment growth in low wage manufacture can not change this reality.

The same can be applied to Brazil. In the past high growth was achieved with high real exchange rates and terms of trade against agriculture with a very unequal outcome. Nowadays in order to achieve higher industrial productivity and exports, public investments in infrastructure and in wage goods are needed to release the real exchange rate from the burden to become the only policy to stimulate exports and import substitution.

In the case of Argentina, a country where the wages are much higher, only a new export industry can avoid the policies based on devaluations or in external indebtness that by different reasons block a sustainable and more balanced growth. In this country, as in all developing countries, Keynesian policies must be part of a structural plan of development.

Fifth Myth: The recent decline of poverty in LAC was the result of well target policies.

The most effectual policies for poverty diminishing in Latin America were: the sustainable high growth achieved in Chile; the persistent elevation of minimum wage and pensions for rural workers in Brazil; the migration of poor rural Mexicans to the USA and their remittances to their families. The first two were not target on poor but universal and the third was not a public policy but an individual decision to escape from mass poverty.

References

ECLAC (2004) Statistical Yearbook for Latin America and the Caribbean.
ECLAC (2006) Economic Survey of Latin America and the Caribbean - 2004-2005.
Ferreira, F Leite, P. Litchfield, J. (2006) "The Rise and Fall of Brazilian Inequality". World Bank Policy Research Working Paper 3867, March.
Frenkel, R.(2004) "Real Exchange Rate and Employment In Argentina, Brazil, Chile and Mexico" Paper Prepared for G 24, mimeo.
Furtado, C. (1971) "Desenvolvimento e Subdesenvolvimento" in Ricardo Bielschowsky, Cinqüenta Anos de Pensamento na CEPAL, Record, 2000.
Lewis. A. (1977) "The Evolution of the International Economic Order", Princeton University Press.
Lopez, J. (2005) "Income Distribution in Latin America. Theoretical Considerations and Mexican Experience"". Economie Appliquee, n 3.
Medeiros, C. A. (2002) "Trade and Financial Liberalization and its Effects on Growth, Employment and Income Distribution in Latin American Countries, Paper prepared for the IDEAS Conference on "International Money and the Macroeconomic Policies of Developing Countries", 16-19 of December 2002, Muttukadu, Tamil Nadu, India.
Medrano, P.; Sanhueza, C.; Contrera, D. (2006) "Inequality in Latin America: a synthesis of recent research on the levels, trends, effects, and determinants of inequality in its different dimensions". The InterRegional Inequality Facility.
Morley, S. (2001) "The Income Distribution Problem in Latin America and the Caribbean", ECLAC, Santiago do Chile.
Palma, G (2003) "Trade Liberalization in Mexico: Its Impact on Growth, employment and wages", ILO, Employment Sector, Geneva.
Patnaik. P (2002) "Globalization of Capital and the Terms of Trade Movements", paper presented on Agrarian Reforms and Rural Development in Less Developed Countries, January, 3-6 Kolkata.
Pinto, A. (1976) "Notas sobre os Estilos de Desenvolvimento na América Latina" in Ricardo Bielschowsky, Cinqüenta Anos de Pensamento na CEPAL, Record, 2000.
Prebisch, R (1949) "O Desenvolvimento econômico da América Latina e alguns de seus problemas principais"in Ricardo Bielschowsky, Cinqüenta Anos de Pensamento na CEPAL, Record, 2000.
Quadros, W. (2003) "A Evolução Recente das Classes Sociais no Brasil"in Marcelo W. Proni and Wilnês Henrique (org.), Trabalho, Mercado e Sociedade, Unesp, São Paulo.
Schwartzman, S. (2006) "Redução da Desigualdade e da Pobreza e os Programas de Transferência de Renda", IETS, Texto para Discussão, Fevereiro, Rio de Janeiro.
World Bank (2003) "Inequality in Latin American and the Caribbean: Breaking with History?"