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

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Abstract

This paper explores some of the factors linking income growth, income distribution and poverty, historically observed in LACs, with particular reference to the recent experiences in Argentina, Brazil, Chile, Mexico and Venezuela. Given that the LACs have historically shown a high level of income concentration by all measures along with a high level of poverty which has invited a multitude of interpretations, this paper tries to analytically explore some myths on Latin American income distribution that are ingrained in the conventional literature.

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Growth Patterns, Income Distribution and Poverty: Lessons from the Latin American Experience[1]

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Introduction

Latin American Countries (LACs) have historically shown a very high level of income concentration by all measures and, given their average income per capita, a high level of poverty. This stylised fact has periodically attracted many interpretations and analyses. Nowadays, given the resurgence of income distribution in modern theories of economic growth and the increasing disillusionment with 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 of the factors linking income growth, income distribution and poverty, historically observed in LACs, 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 presents a historical analysis of these linkages in Latin America during different phases and economic regimes; second, some new trends observed in the last few years are outlined and finally, the paper explores some myths on Latin American income distribution that are ingrained in the conventional literature.

Section 1 - Development, Income Distribution and Poverty in LACs

Primary Export and Financial Integration

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

The roots of the high income concentration and poverty which since that period has been a historical characteristic of this region are grounded on this model of growth. However, 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[2]. A high demand for wheat and corn set a high price for good lands, increasing the ratio of rents to wages and favouring a few big farmers. But higher productivity level achieved in food production (which happened to be the main crop) and the favourable land/labour ratio allowed a relative high real wage. Low levels of poverty and higher consumer demand stimulated a diversification of infrastructure and urban investments. Thus a more industrialized economy distinguished Argentina from the rest of the continent in the first decade of the twentieth century. The modern urban labour class that emerged from this economic model experienced the kind of income conflict between wage earners and rural and industrial capitalists like 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 nineteenth century and the first two decades of the twentieth century. But contrary to what happened in Argentina, the inheritance of slave labour 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 labour depressed the wages paid in traditional Northeast crops (like 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 massive poverty were a Brazilian characteristic but, as a matter of fact, this country is a synthesis of the continent. In Venezuela, Colombia, Bolivia and Peru, the dominant aspects of Brazilian Northeast underdevelopment–high income in export activity, low productivity in food production and labour surplus–were present. This was the basis for massive poverty and a high concentration of primary 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, higher productivity achieved in food production, larger public investments and less pervasive surplus labour meant a minor level of poverty.

In the Caribbean countries, the 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 labour generated high income concentration and poverty. At the beginning of the twentieth century, the land tenure in Mexico favoured the looting of good public lands by rich families and precluded an expansion of middle income farmers. Contrary to what happened in Brazil or Argentina, where the land tenure was not changed, a radical land reform process took place in Mexico in 1917 which continued until the end of the thirties, when it was accelerated by President Cardenas' Government. But in a country where good land was not abundant and 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 elsewhere in underdeveloped 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 and centred 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 highly protectionist policy for the industries with import competitiveness. This new model brought about high economic growth, and in the largest countries such 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 personal and household income concentration declined in many countries including Brazil, which was by far the most unequal country among the largest countries of the continent. But this improvement was too modest to alter substantially this inherited unequal pattern. Thus, what seems remarkable in LACs, when compared with the rest of the world, was the persistence during these industrial years of a high income concentration and the high levels of absolute poverty[3].

First of all, as opposed to what happened in East Asia, China or in Europe, no political U-turn happened in these years enacting a new distributional coalition in favour of middle income farmers, urban labourers 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-state that spread along these years to many countries were conservative preserving the economic and political clout of the land owners. In the case of Brazil, this was achieved in alliance with industrial classes and some industrial labour sectors. The political dimensions of the Cold War after the Cuban revolution blocked any democratic and pro-labour coalition against the traditional classes.

Some aspects inherited from the old pattern and, in many economies, the basic characteristics of underdevelopment – the low productivity in food production and surplus labour – 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 American countries. After the Second World War, the high participation of formal urban wage employment, and the low ratio of agricultural employment created an environment closer to the middle income Western European economies. The economic struggle assumed a more classical class conflict between the unions and the employers allied with land owners. During these years, there was a conflict between inflation and high economic growth. The most widespread basis was the incompatibility between the level of wages reached and the productivity of the export sector. The real depreciation of exchange rate, which after 1930 inaugurated an industrial age in the majority of LACs, 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 technological capabilities shifted upward rapidly.

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

However, this collapse in wages did not result only from labour 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 half 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 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 import substitution barely changed. The open distributive conflict assumed, as it happened in Argentina, a classical class struggle. After a brief period – between 1970 and 1973, when a socialist government headed by Salvador Allende promoted land reforms and social investments – a coup-of-state implemented after 1973 resulted in a dramatic U-turn in income distribution against urban labour and the peasants. As in Argentina, the abundance of international loans was the basis for monetary stabilization centred in financial integration and trade opening.

In Brazil, the basic characteristics of underdevelopment have not changed and the successful industrialization that took place in Sao Paulo attracted millions of migrants from the miserable Northeast countryside.

These flows constrained wages paid in urban activities to 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 labour and the rapid 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 exporters but without any compensation to food production, which remained as backward as it was in the old pattern. Thus in the countryside the landscape changed less with industrialization and the extreme inequality that characterized the Brazilian economy after the war was led by this urban-rural gulf.

A peasant and urban labour 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 on organized labour and the reduction of real minimum wages caused a U-turn in the urban income distribution. Two opposing forces were in place: a demographic boom and the persistence of high levels of poverty in the countryside brought about a huge migration of unskilled labour to industrialized regions; while the 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 labour force in urban sector); the minimum wage was increased in real terms and the unions became stronger[4]. Investments in infrastructure and modernization of food production led to important changes in agriculture. As a result the labour 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 characteristics of the underdevelopment and the low productivity and income of the *ejidos* constrained the wages paid in urban activities. Contrary to other LACs, Mexico sustained since the fifties until the 1970s, a fixed rate of exchange, and obtained a large flux of currency from tourism, oil combined with a regular capital inflow from the 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 labour from countryside kept the wages in control. The growing productivity of industry allowed a large surplus share and a great differentiation of income between professionals and skilled labour on the one hand and non skilled labour on the other. As in Brazil, the bottom of the distribution hierarchy was formed by the wages and income earned in an impoverished subsistence agriculture. As long as the formal urban employment increased its contribution to total employment, income concentration declined and labour share enlarged. During the seventies (essentially during the Echeverria government, 1970-76), 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 labour share from 30% observed in 1960 to 40% in 1975, the highest level reached by this ratio (Palma, 2003).

Foreign loans, abundantly available, 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 at a high level which was good for inflation and wages but bad for non-oil export sectors. The crisis of balance of payment in 1982 ended this model and started a new distributive coalition that is expected to govern the Mexican economy in the years ahead.

In a natural resource-rich country as Venezuela, a permanent abundance of currency co-existed with social characteristics of underdevelopment after the Second World War. The capture of state power to deliver oil rents through modern infrastructure for export activity and to provide the services and investments catering to 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 labour employed in the oil sector, but was an obstacle for the growth of non-oil sectors that were not export-competitive. As a result, a large informal sector of low income 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 smaller countries, industrialization practically did not start and underdevelopment was a pervasive inheritance of the LACs' insertion into the 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 formal employment. But the chronic surplus of labour and the low level of productivity of wage goods and food production industries blocked any large-scale effect on poverty. Thus, 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 LACs, similar to what happened in 1929. But different 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 in the 1990s.

In all countries (with the 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 that took place in Argentina, Chile, Brazil and Mexico was accompanied by the privatization of dollar denominated assets held by rich national residents. This greatly enlarged the concentration of income at the very top (not reported in the conventional measures of income based on household surveys) and laid the groundwork for 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 labour and professionals could protect their income from depreciation, fuelling the conflict in income distribution. The decline of real minimum wage depressed the wage of non-skilled labour in urban and rural areas, which, along with the large informal sector, bore the brunt of this conflict. Large migration flows from countryside to metropolitan areas took place in LACs.

As observed earlier, the biggest U-turn in income distribution in Argentina and Chile happened in the seventies and was politically oriented with direct attack on labour rights and employment protection. During the eighties, civil government replaced military rightist dictatorships in many countries and enacted labour laws more favourable 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 deindustrialization, the enlargement of the surplus share and the opportunities created by mass privatization enabled a new growth policy. This occurred after 1985, setting the country apart from the stagnation that hit the continent.

Table 1 - Trends in Distribution of Income Before 1990

	Year	Gini	Year	Labour 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 L. Squire (1996): *Measuring Income Inequality: A New Data Base*, WB
Gini data of 1990: ECLAC (2002): *Social Panorama of Latin America*, 2001-02
Labour share data: Morley (2001)
* Only manufacturing

The package of liberal reforms in the eighties was inaugurated by Mexico after the crisis of 1982 with the new government of 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 labour 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 LACs in the nineties – a very radical liberal package when compared with other regions except 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 privatization deals were 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 entrenched their position in the new economies.

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 sound macroeconomics coupled with liberalization policies that had broken the hitherto industrial protectionism. And, second, it was the result of a new model of social policy targeted at the poor that was followed in the region during this decade and which has expanded in the last few years[5]. This evaluation is indeed very fragile and can not be sustained. Table 2 below shows a remarkable contrast within the region.

Table 2 - Trends in Income Distribution (Gini Index) and Poverty (Percentage of Population below Poverty Line) in the Latin American Countries

		Early 90s	Early 2000s	Change
Argentina	Gini	42.6	50.4	7.8
	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
LACs Average (non-weighted)	Gini	50.5	51.4	0.9
	Poverty	48.3	44.0	-4.3

Source: Gini Coefficient based on De Ferranti et al (2004) 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 extent and speed, to the collapse of socialism in the former Soviet Union and East Europe. Between 1999 and 2002, two opposing forces were in place. First, a real appreciation of exchange rate contributed to the expansion of the purchasing power of wage and low income earners and to the decline in the industry's mark-ups. Second, a rapid increase in unemployment (that resulted from this rate of exchange coupled with trade liberalization and massive privatization) nullified the first movement. Thus, before 2002, labour share, personal income distribution and poverty remained constant around the level reached in the beginning of the nineties[6]. 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 enhanced their position, reverted only 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 the class structure in LACs. According to some analysis based on micro-data extracted from household surveys, between 1992 and 2001, previous to the peso collapse, the relative individual income of capitalists and professionals/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 placed on the right to strike contributed to the fragile bargaining power of these well paid workers. This occurred in contrast to 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: Percentage 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	1.6	1.1	144	173	144	173
Professors/Executives	4.4	5.8	4.4	5.8	108	127	108	127
Petty Entrepreneurs	4.9	5.4	4.9	5.4	100	100	100	100
Formal Workers	46.5	45.9	46.5	45.9	41	46	41	46
Informal Workers	42.6	41.8	42.6	41.8	38	28	38	28

Source: De Ferranti et al (2004): 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 labour share and an increase in the income of capitalists and professionals/executives in relation to that of formal and informal labour. Considering that the richest decile reported in household surveys captures essentially the high middle class[7] and that the 9th decile captures wages paid to middle income groups including skilled industrial workers, it is 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 during these years. This has not affected the Gini index, which shows a process of downward levelling after 1994 (the stabilization year in Brazil)[8].

In Argentina, some countervailing forces were present. From 1994 to 1998 a high real exchange rate was favourable 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 rate of open unemployment and the decline of formal employment could have pushed down the incomes of the poorer groups with negative effect on poverty. Nevertheless, the real increase in minimum wages (and on the pensions that were extended to the rural sector) from 1994 to the present, was instrumental in the reduction of poverty. It also compensated for another tension. Since the eighties, but mainly in the nineties, the productivity in the agriculture sector (mainly in food production) has been increasing with a dual effect on income distribution. On the one hand, it has promoted a consistent decline in the food prices favouring the low wage earners; on the other hand this very same process has reduced the income of small producers enlarging the migration to 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 had an important factor shaping its income distribution: the real rate of interest set on public bonds. From 1994 it has achieved a very high level (around 16% yearly in real terms) pushing up the opportunity cost of capital and depressing real public spending. The regressive tax structure and the high concentration of the public bonds in few hands make the Brazilian interest rate an inequalizing 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 income distribution.

Real increases on minimum wages can be considered the most important countervailing factor to this tendency. Although the increases in real term were more important after 2001, the minimum wages stopped falling in real terms and started to increase after 1994, avoiding a decline in low wages income that would follow from the increase on unemployment.

In Mexico, an accentuated decline of the labour share took place during the nineties. The most important structural change that resulted from the North American Free Trade Agreement (NAFTA) was the specialization of the Mexican economy in the provision of low-valued manufactured goods produced in processing industries – *maquiladoras* – for the American economy. 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 a higher rate of economic activity and a decline in poverty. The former period had high exchange rate accompanied by a low growth of formal employment. As the minimum wage declined in real terms and the average wage declined with the contraction of 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 of formal employment and despite a fall in the share of labour (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, policies such as PROCAMPO destined to transfer income to the small peasant, had a positive effect on poverty but this factor alone 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 increase in urban population 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, 2003). These numbers were comparable with that in other LACs. 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 Mexicans living in the USA[8] to a better income distribution was very significant.

In Venezuela, as table 2 above shows, the liberal years were accompanied by a large increase in personal income concentration, a dramatic drop in the wage share and a great expansion of poverty. The sluggish growth, the continuous devaluation of the exchange rate in this oil producing country and its effects on inflation rate (that was persistently high in this country in a decade where the inflation virtually disappeared in the other LACs) badly hit the low-skilled workers and poor peasants while the capitalists 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 the country.

The most important contrast in the case of the 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 copper and capital controls were important factors 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 declined significantly in sharp contrast to the experiences of other LACs. In 2000 only Uruguay had a lower poverty incidence. Despite that, this model of growth was very unequal. Although the labour share in manufactures had increased smoothly, the personal and household income distribution was even more concentrated in the last year of the decade than in the beginning (see table 2 above). The most probable reason was the polarized effect of this model of growth on the labour market. In fact, the share of formal workers in the working population decreased and the share of petty entrepreneurs increased significantly. Their income enlarged and the gap between the income of professionals/executives and the average wage of formal and informal workers increased greatly. Chile entered the new decade with a very uneven income distribution, almost similar to that of Brazil and far more concentrated than in Argentina or Mexico. This was not, as 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 LACs

The rapid growth of international economy led by the 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 LACs in the beginning of the century. The high growth rate of exports allowed a higher rate of economic growth achieved unevenly by the region after 2003. In some countries it led to a fall in poverty levels.

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, Saint Vicente and Grenadines, Santa Lucia, Suriname, Trinidad and Tobago and Uruguay.

Argentina and Venezuela had the fastest growth by far after the huge depression that hit these countries in 2002-03; and Brazil, constrained by a very conservative monetary and fiscal policy, had the slowest growth among the major countries. Table 4 above shows the annual rates of GDP growth in Latin America.

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 interests on current account. This stabilization was not detrimental to the wages. The fast expansion of the employment rate (mainly in manufactures) and a shift in political focus to minimum wages 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 stable growth, it has not changed the basic conflict that has been historically 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 the fall in terms of trade and the higher growth rate of imports.

In Venezuela, the hike in oil prices after 2003 and the political consolidation of a nationalistic government resulted in an extraordinarily high growth in the last two years, pushed by public and private investment in industry, infrastructure and in social spending. With a dramatic increase in the terms of trade, the current account allowed pro-growth policies. This upsurge in investment was in great part explained by the large decline of the last few years, but the drastic expansion of social spending was quite new in its goal to use the oil revenues for the poor sections of the Venezuelan society. The persistent elevation of oil prices in 2005 contributed to the 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 on whether the present investment and social policies will increase the productivity of the agricultural and non-tradable goods. If not, a fall in oil prices and in the 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 LACs the terms of trade for the Mexican economy have not significantly improved and the prices of its exports have not increased as in other countries. The specialization in exports of labour intensive manufactures in competition with other low wages and surplus labour economies in Asia has intensified. Low growth, low employment rate growth, declining minimum wages and stagnation of the real average wages have been suppressing the evenness in the distribution of income. The migration of poor rural Mexicans to USA and their remittances are the major countervailing mechanisms.

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 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 labour 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 infrastructure 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.

As a consequence of these macro and structural determinants that led to GDP growth of 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, poverty has declined and the same has happened with the Gini index. During the last few 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 the Brazilian underdevelopment: the rural extreme poverty and the subsistence wage paid to agricultural labour. Although, the cash transfer program (*Bolsa Família*) introduced in the nineties and consolidated during the government of Luis Inacio Lula da Silva contributed to the decrease in poverty in the countryside, increase in minimum wages remained the major factor for this positive development.

The roots of Brazilian underdevelopment have changed as we have observed in the last section. The modern mode of food production and the elevation of wages paid to agricultural workers started to change the traditional source of surplus labour and low wages. But this process has happened alongside decades of low growth and low growth of formal employment enlarging the surplus labour in urban low-productivity jobs that reached explosive levels in metropolitan areas.

The prominent role played by the rate of interest in the determination of income distribution can roughly be observed in table 5, which shows the composition of household income in 2004. Unfortunately the government transfers (mainly *Bolsa Família*) is clubbed together with the interest incomes (that is understated in the survey). The data shows 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	Labour 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, like Venezuela, had the most accentuated shift in terms of trade. The price of copper, as well as its exports, boomed after 2003. A lower rate of exchange and lower inflation were achieved without any change in the level of employment. This led to higher real average and minimum wages and a further decline in poverty. Nevertheless, the lifting of capital controls that occurred in the last few years and the dominance of copper in overall exports have increased the fragility of the economy necessitating the diversification of exports for maintaining 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

In Conclusion: 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. This paper concludes with a brief analysis of these myths.

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

The history of LACs 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 income distribution became less uneven during the 1970s. One good example is Brazil, where rise in inequality was first stopped and then made to decline. The other is Mexico where inequality substantially fell during the same period. This can be explained by the fact that the expansion of formal employment, that followed the growth of GDP, changed the structure of the labour market, enlarging the share of better paid labour and reducing the number of informal and lowest paid labour. In addition, the decline in open unemployment reduced 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 forces.

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

This is an inaccurate proposition. Although the level of inequality of income distribution is very high when compared to other regions, it is quite distinct within the region itself. Historically, the main aspect was the share of the labour force associated with low-productivity jobs in agriculture and in informal urban employment. Despite the long running inequality in the region, income distribution changed abruptly in many of them. When one considers the evolution of income distribution within these countries one can observe that this was far from being smooth and 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-labour governments. After these big changes the income distribution evolved around new and more concentrated distribution patterns.

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

The best counterevidence of this proposition is the Mexican experience that began in 1917. The distribution of poor land without productivity enhanced investments (as was the case in Bolivia in the fifties and in Brazil today) did not alter 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 labour productivity through land reforms. This developmental strategy has strong political dimensions since it systematically clashes with private interests and breaks with the forces of inertia.

Fourth Myth: The export of manufactures is the best strategy for a sustainable and high employment growth of un-skilled labour.

Again the Mexican experience provides a useful counterevidence. Unless the productivity of food and wage good industries is increased and the reduction of surplus labour 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 manufactures can not change this reality.

The same can be applied to Brazil. In the past, high growth was achieved with high real exchange rates coupled with adverse terms of trade for agriculture, which resulted in a very unequal outcome. Today, in order to achieve higher industrial productivity and exports, public investments in infrastructure and wage goods are needed to avoid the real exchange rate from being used as the sole policy instrument for stimulating exports and for import substitution.

In the case of Argentina, a country where wages are much higher, only a new export industry can avoid the policies based on devaluations or on external indebtedness, that tend to 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 LACs was the result of well targeted policies.

The most effective policies for poverty reduction in Latin America were: the sustainable high growth achieved in Chile; the persistent elevation of minimum wages 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 targeted at the poor but were universal and the third was not a public policy but an individual decision to escape mass poverty.

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Notes

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

[3] This was an essential historical and analytical problem examined abundantly by the structuralist school. See for example Pinto (1976). Recently it was taken up again in different approaches, as in Morley (2001) or in De Ferranti et al (2004).

[4] Due to the fact that the formal employees have a higher relative economic position than those of poor peasants and informal urban labour, a relative expansion of formal employment decreases income concentration and vice-versa. Additionally, an increase in formal employment enlarges labour's bargaining 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.

[5] Starting in the eighties in Mexico with the *Programa Nacional de Solidariedade* (National Solidarity Program) focused on 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).

[6] 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 financially integrated world. For this reason, a tendency towards devaluation is always present and becomes real as soon as the "investor confidence" shifts inducing mobile capital flight to strong monies. When the exchange rate finally collapses it affects disproportionably the wage earners.

[7] The income of the very rich (income from capital and not labor going to the capitalist, landownners, bankers, etc) is not included or is misrepresented in this kind of data. So, sociologically the richest decile is better described as high middle class like college professionals but statistically they are in the top of distribution.

[8] In Latin American countries the high income concentration reported in LAC household survey is strongly determined by the share appropriated by the richest decile (that in 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.

[9] US Census Bureau says that more than two million Mexicans entered legally in the country in the last decade.