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WHERE DOES INEQUALITY COME FROM? IDEAS AND IMPLICATIONS FOR LATIN AMERICA

by

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PREFACE

Over the 1980s many developing countries recorded disappointing performances in terms of growth, development and, especially, poverty reduction. The 1990s has been the decade of globalisation — defined as both external opening and an increased role of markets domestically. Globalisation in developing countries has occurred largely as a consequence of moves towards external liberalisation, part of broader shift to more market-oriented, export-led development strategies, often in the framework of stabilisation and structural adjustment programmes with the IMF and World Bank. This simultaneous emphasis on globalisation with the unsatisfactory performance of developing countries in lowering inequality and poverty levels, has led to an intense debate over whether globalisation, and the development strategies associated with it, are part of the problem, or part of the solution. The debate has been largely about perceptions, rather than about well-defined propositions, in part because of lack of data, inadequate analysis, and insufficient attention paid to cultural differences.

In the light of this debate, on 30 November and1 December 2000 the Development Centre organised a policy dialogue to assess the impact of globalisation on poverty and income inequality in developing countries. What policies should developing countries pursue to achieve “inclusive globalisation”, supported by pro-poor growth? What policies should OECD member countries adopt to help them through, for example, bilateral development assistance and influencing international institutions? In the Development Centre’s tradition of frank policy dialogue between experts, policy makers and stakeholders, this particular event gave a voice to those countries and people in the world economy who do not normally participate in the meetings of international institutions.

This series of papers* consists of regional surveys of the impact of globalisation that the Centre commissioned as input and background for the dialogue. For each of three regions — Latin America, Southeast Asia and Sub-Saharan Africa, two contributions were commissioned. The first focused on the economic impact of globalisation, especially the effect on poverty and inequality. The second looked at the political economy of countries in the context of policy formulation in response to globalisation.

The results presented here and in the rest of the series show that globalisation is not the major cause of income inequality and poverty in developing countries, but has none the less contributed to the poor performance of a number of developing countries. What has differentiated winners from losers has been that globalisation has worked by amplifying the effects of pre-existing inequalities in the distribution of assets, especially human capital, and of access to infrastructure and other productive resources. In countries where inequalities were high, globalisation tended to make inequality worse; similarly globalisation has tended to increase inequalities across countries.

This analysis implies two key, development policy lessons. First, for globalisation to be pro-poor, it needs to be combined with policies which create a more equal distribution of, or access to, productive assets and resources, particularly for vulnerable groups facing the increased competition which comes with globalisation. Second, the speed and sequencing of external and domestic liberalisation must be tailored to the particular circumstances of individual countries, based on their institutional capacity to transform the economy.

Jorge Braga de Macedo
President
OECD Development Centre
5 December 2001

* *Globalisation, Poverty and Inequality in Sub-Saharan Africa: A Political Economy Appraisal*, by Yvonne M. Tsikata.

Distribution and Growth in Latin America in an Era of Structural Reform: The Impact of Globalisation, by Samuel A. Morley.

Globalisation, Liberalisation, Poverty and Income Inequality in Southeast Asia, by K.S. Jomo.

Globalisation, Growth and Income Inequality: The African Experience, by Steve Kayizzi-Mugerwa.

The Social Impact of Globalisation in Southeast Asia, by Mari Pangestu.

Where Does Inequality Come From? Ideas and Implications for Latin America, by James A. Robinson.

RÉSUMÉ

Les différences entre pays d'Amérique latine en ce qui concerne les inégalités ne sont pas tant le fait de la globalisation que de la diversité des structures politiques et économiques ainsi que des politiques publiques. L'hostilité des élites à l'égard de la démocratie ont fragilisé celle-ci et ont retardé la généralisation de l'éducation et la redistribution des revenus *via* l'impôt, processus que l'Europe a connus au siècle dernier grâce à la démocratisation et au socialisme. L'évolution des inégalités en Amérique latine reflète l'alternance de coups d'État et de phases démocratiques. La récente tendance au creusement des inégalités en Argentine, au Chili et au Pérou est due essentiellement aux changements structurels de l'équilibre politique déclenchés par les mesures prises par le gouvernement militaire et par la crise de la dette. La démobilisation des travailleurs et de la gauche a ouvert la voie à de nouvelles coalitions politiques qui ont sérieusement réduit les chances pour la démocratie de jouer le rôle clé qui a été le sien dans le changement en Europe. En théorie, la globalisation pourrait accroître les inégalités par son impact sur les prix et les salaires, ou encore en limitant la capacité des pouvoirs publics à mettre en œuvre des politiques. En réalité, on dispose de peu de preuves d'un tel pouvoir d'influence.

SUMMARY

Differences in inequality between Latin American countries are not so much caused by globalisation as by a variety of political and economic structures and government policies. Hostile elites have made democracy fragile and are delaying the mass education and tax-driven income redistribution that democratisation and socialism produced in Europe over the past century. Trends in inequality in Latin America are governed by coups and democratic phases. Recent rising inequality in Argentina, Chile and Peru is mostly due to structural changes in the balance of political power triggered by policies of the military and the debt crisis. The demobilisation of labour and the left has led to new political coalitions that have seriously reduced the chances of democracy playing the key role it did in changing Europe. In theory, globalisation can increase inequality through its impact on prices or wages or by curbing the government's ability to implement policies. In fact there is little evidence it has an important role.

I. INTRODUCTION

Distribution of income in a society depends on the distribution of income-generating assets or factors of production — who owns the land and capital and how human capital is distributed in the labour force. It also depends on the returns to these assets. If the distribution of assets could be treated as exogenous then the distribution of income would be determined by specifying preferences and technology, calculating the equilibrium supply and demand for goods and factors, and eventually factor prices or asset returns. In this narrow economic model, differences in inequality between countries result from differences in preferences and technology.

Despite the popularity of this approach amongst economists, it does not explain much. Even though some (Grossman and Hart, 1986) stress that asset ownership is driven by the degree of efficiency, others have shown this is not so when there are market imperfections[1]. So there is no particular distribution of assets we would expect the economy to gravitate to. Different countries might have very different asset distributions despite identical preferences and technology. Initial conditions and historical circumstances would therefore help determine future distribution of income. Redistribution of assets, such as land or educational reforms, may have permanent effects on subsequent inequality[2].

Two examples suggest the importance of this caveat to the neoclassical theory of distribution. Inequality of income and land ownership is very low in South Korea and Taiwan. This egalitarian system of asset ownership did not evolve naturally but mainly comes from extensive agrarian reform in the late 1940s and early 1950s aimed at warding off the threat of communism. In South Korea, the 1949 land reform redistributed about half the agricultural land (Haggard, 1990, p. 55) while the 1949-53 reforms in Taiwan redistributed 24.6 per cent (Ho, 1978, p. 163).

Compare them with two Latin American countries, Costa Rica and Guatemala[3]. In the 19th century, as transportation costs fell, European economies developed a large market for tropical products. Central American countries were ideally equipped to meet the expanding world demand for coffee. In Costa Rica, the government passed laws allowing peasants to farm and own frontier lands, creating the well-known class of Costa Rican yeoman farmers. In Guatemala, a mass land grab by political elites in the 1870s led to the creation of large coffee estates and reintroduction of colonial forced labour laws that lasted until the post-1945 democratic interlude. So land and income inequality is higher today in Guatemala than Costa Rica.

Land is not the only key asset for determining the distribution of income. Human capital is probably even more important these days. Both South Korea and Taiwan started their modern growth paths very well endowed with human capital. In 1960, their respective adult literacy rates were 71 and 54 per cent and their primary/secondary school enrolment rates 83/12 and 94/27 per cent. The origins of these remarkable initial conditions reflect the post-war political equilibrium and also have complex historical roots[4].

The record of human capital accumulation is very different in Latin America. Differences between Costa Rica and Guatemala are themselves stark. By 1900, 36 per cent of adults were literate in Costa Rica and only 12 per cent in Guatemala. By 1950, these figures were 80 and 30 per cent respectively (Thorp, 1998, Table IX.2). Guatemala still lags far behind in human capital attainment.

This suggests asset ownership does not evolve naturally to any level, but reflects historical, institutional and political conditions. Inequality is low in South Korea and Taiwan because elites redistributed land to boost their political legitimacy in the face of external threats. Political competition in Costa Rica gave citizens access to land while in Guatemala it was expropriated by political elites. The distribution of various assets are probably linked. The fairly egalitarian pattern of land-ownership and human capital in Costa Rica are certainly intimately connected (Nugent and Robinson, 1998, and Engerman, Mariscal and Sokoloff, 1998).

However these assets are distributed, institutions and government policies determine the rates of return they earn, not just preferences and technology. In the OECD countries, which have similar educational systems and measures of land inequality, there are big differences in inequality (See Table 1)[5]. The empirical evidence clearly shows that these are due not to differences in preferences, factor endowments and technology, but to differences in labour market institutions[6]. Also, periods when there are large increases in inequality always coincide with periods of extensive labour market deregulation (Britain and New Zealand in the 1980s).

This suggests that institutions and politics in a world with endogenous property rights are important in understanding the distribution of assets and income.

What has globalisation got to do with all this? Globalisation affects inequality when the distribution of assets is fixed and it can change the rates of return on different assets under an unchanged set of institutions and policies. It may also alter the distribution of assets by, say, massively increasing incentives to expropriate the assets of others. It can in turn alter the equilibrium of domestic institutions and policies and hence its inequality.

The most obvious example of the first effect is when a country specialises on the basis of comparative advantage. As Latin America joined the world economy in the late 19th century, it specialised in producing commodity exports to the industrial world[7]. In line with the Stolper-Samuelson Theorem, this increased the rate of return to the abundant factor, which was land. Williamson (1998) backs this up with data on real wages and the ratio of wages to GDP (see also O'Rourke, Taylor and Williamson, 1996).

But seeing the impact of globalisation on Latin America simply in terms of the Stolper-Samuelson Theorem with a fixed distribution of assets is only half the story. The second major impact of globalisation was that the increase in the rate of return on land increased the incentives to own it[8]. Since property rights are endogenous, this led to big changes in land distribution that depended crucially on differences in political power structures. In some countries, such as Guatemala and Mexico, this dwarfed the impact of the Stolper-Samuelson[9]. In others, such as Costa Rica and Colombia, it enhanced it.

But political and institutional equilibrium is itself influenced by globalisation, which can affect the bargaining and political power of domestic actors, who in turn can use globalisation to increase their power. Globalisation is not an exogenous force influencing a society as if it were rainfall[10]. The decision to integrate with (or separate from) world markets is endogenous and may be part of a new political equilibrium with important consequences for inequality. While international factors such as the impact of GATT are largely exogenous to developing countries, it was no coincidence that the military regimes in Chile (after 1973) and Argentina (after 1976) were the first Latin American countries to embrace globalisation. Trade liberalisation, which weakened the power of their domestic opponents, such as trade unions powerful in the import substitution sector, was politically important. Capital market integration can also affect domestic policies. Albert Hirschman (1981, p. 257) notes: *"Exit of capital often takes place in countries intending to introduce some taxation that would curb excessive privileges of the rich or some social reforms designed to distribute the fruits of economic growth more equitably. Under these conditions, capital flight and its threat are meant to parry, fight off, and perhaps veto such reforms; whatever the outcome they are sure to make the reforms more costly and difficult."*

In these two examples, globalisation implied weakening labour's bargaining power, but the effects of globalisation on domestic political power will vary according to time and place.

Globalisation may change relative prices, induce changes in the distribution of assets, and alter, or be used to alter, the political equilibrium in ways that affect inequality. The last effect is the most pernicious because it means that if globalisation increases inequality for either of the first two reasons, it may simultaneously alter the political equilibrium and stop the state compensating for these effects[11]. The idea that globalisation bundles these forces together in a unique way that both increases inequality and removes the state's ability to compensate for it lies at the heart of the critique of globalisation.

Is this critique valid? The first two mechanisms may cause globalisation to increase inequality, but it can also go hand in hand with dramatically falling inequality. There is little evidence the third mechanism is important. What really determines the impact of globalisation on inequality is a country's political equilibrium, which seems largely governed by forces other than globalisation[12]. The impact of globalisation on inequality in Latin America is not inevitable. Its impact depends on how it is handled by domestic institutions[13] and it does not by itself prevent domestic governments responding (Rodrik, 1997). Whether or how a government responds depends on the domestic institutions and balance of political forces, which seems only peripherally related to globalisation.

II. GENERAL CONSIDERATIONS

Cross-country differences in inequality are huge. Tables 1a and 1b show some of Klaus Deininger and Lynn Squire's data on income distribution in selected non-Latin American countries. Tables 2a and 2b record data from Latin America, updated from Londoño and Székely (2000). These first four tables contain only "high quality" data that pass the most stringent test of comparability. Since it unfortunately excludes countries we need to consider, Table 3 records lower quality data from the Deininger and Squire's dataset for Argentina and Uruguay.

Table 1a. **Gini Coefficients for Income Distribution**
(Deininger and Squire)

Date	United States	Canada	United Kingdom	France	Belgium	New Zealand
1950	36.0					
1955	34.8					
1956				49.0		
1960	34.9					
1961		30.8	25.3			
1962				49.0		
1965	34.6		24.3	47.0		
1970	34.1		25.1	44.0		
1971		32.2				
1975	34.4	31.6	23.3	43.0		30.0
1979				34.8	28.2	
1980	35.2		24.9			34.8
1981		31.8				
1982						33.9
1984				34.9		
1985	37.3	32.8	27.1		26.2	35.8
1990						
1991	37.9	27.6	32.4			
1992					26.9	40.2

Table 1b. **Gini Coefficients for Income Distribution**
(Deininger and Squire)

Date	Japan	South Korea	Taiwan
1953		34.0	
1961		32.0	
1962	37.2		
1964			32.2
1965	34.8	34.3	
1970	35.5	33.3	29.4
1975	34.4		31.2
1976		39.1	
1980	33.4	38.6	28.0
1985	35.9	34.5	29.2
1988		33.6	
1990	35.0		30.1
1993			30.1

Table 2a. **Gini Coefficients for Income Distribution: Latin America**

Date	Brazil	Chile	Colombia	Costa Rica
1960	53.0			
1961				50.0
1968		45.6		
1970	57.6		57.0	
1971		46.0	55.0	44.4
1974			48.0	
1976	60.3			
1977				50.0
1978			48.8	
1979				45.0
1980	57.8	53.2		
1981				47.5
1982				
1983	59.1			47.0
1984				
1985				
1986				42.0
1987	58.0			
1989		57.9		46.1
1991			50.3	
1994		56.5		
1995	61.4			46.5

Table 2b. **Gini Coefficients for Income Distribution: Latin America**

Date	Guatemala	Mexico	Peru	Venezuela
1950		52.6		
1957		55.1		
1963		55.5		
1968		57.7		
1970			48.5	48.0
1971				
1973			49.3	
1975		57.9		
1976				42.6
1977		50.9		
1979	49.7			
1981			42.7	44.3
1984		47.4		
1986			43.0	47.4
1987	58.3			
1989	59.1	53.7		46.1
1992		53.6		
1994		54.2	44.9	
1995				47.1

Table 3. **Gini Coefficients for Income Distribution: Latin America-Other Data**[1]

Date	Argentina #1	Argentina #2	Uruguay
1953	44.4		
1959	47.6		
1961	45.9		36.6
1963			37.1
1967			41.8
1970	39.4		
1974		34.5	
1975	36.6		
1976			45.0
1978			
1980	41.0	39.0	42.37
1981			
1982		42.0	
1983			
1984		42.0	48.37
1985			
1988		44.9	
1992		44.2	
1996		48.4	
1999		48.8	

Note: *1)* Data for Argentina #1 from Altimir (1986), Argentina #2 from Bebczuk and Gasparini (2000), and for Uruguay from Rottenberg (1993).

Table 4. **Gini Coefficients for Land Distribution:**[1] **Latin America**

Country	Gini Index	Year of data
Peru	93.3	1961
Venezuela	90.9	1956
Argentina	86.7	1960
Colombia	86.4	1960
Ecuador	86.4	1954
Guatemala	86.0	1950
Brazil	84.5	1960
El Salvador	82.7	1961
Costa Rica	78.2	1963
Mexico	69.4	1960
East Asia		
Malaysia	47.3	1960
Japan	46.5	1960
Taiwan	46.3	1960
South Korea	38.7	1961
Europe/North America		
Italy	73.2	1960
United Kingdom	72.3	1960
Austria	70.7	1960
Norway	67.6	1959
West Germany	66.8	1960
Belgium	60.4	1959
Netherlands	57.9	1959
Sweden	50.6	1961
Denmark	45.8	1959
USA	71.0	1959

*Note: 1)*The data is from Taylor and Hudson.

Latin American countries have very high levels of inequality compared with OECD or Asian countries. The also data reveals very different patterns of inequality over time. Inequality in some OECD countries (Britain, New Zealand and the US) has been rising, but in most it is falling or constant (France and Belgium). Latin America is similar. In Costa Rica and Colombia inequality has been unchanged for 30 years, while there have been big increases in Argentina, Chile and Guatemala and to a lesser extent in Mexico.

Why these big differences and their changes over time? They are clearly due to differences in the underlying distribution of assets or differences in rates of return on assets and their determinants (technology, preferences and institutions) that map the distribution of assets into a distribution of income. Recent attempts to explain rising wage inequality in the United States have focused on technical change, but this is not so convincing when applied to other countries. Within the OECD, differences in underlying asset inequality are not large in terms of land distribution and of educational attainment as a measure of the distribution of human capital. So differences in income distribution must be due to the other factors. Yet it seems implausible that technological differences can explain the much higher rate of return to skill in the United States or why changes in technology, presumably quite common to all OECD countries, produce rising inequality in the United States and Britain but not other Western European countries, such as France and Belgium. This also applies to the effects of globalisation on inequality. As Freeman

(1980) argued and Wallerstein (1999) has recently shown, the most plausible explanation of differences in inequality is institutional differences in the labour market. The countries that have experienced rising inequality have all aggressively deregulated the labour market, notably Britain, New Zealand and Australia. DiNardo, Fortin and Lemieux (1996) say much of the rise in wage inequality in the United States is due to de-unionisation and the fall in the real value of the minimum wage (Card, 1996). Looking across OECD countries, Wallerstein (1999) shows pay-setting institutions, and especially the degree of centralised wage bargaining, explain the big differences in wage distributions[14].

Unlike within the OECD, differences in asset distribution are important in explaining the variation in inequality in the rest of the world. Bourguignon and Morrisson (1989, 1990, 1998), Li, Squire and Zou (1998) and Rodrik (1999*a*) all stress the same list of variables: the distribution of human capital (as shown by educational attainment), land inequality and the amount of democracy or political freedom[15].

Land is much more unequally distributed in Latin America than in Western Europe, North America or East Asia. Li, Squire and Zou (1998) find that *"the Gini coefficient for the distribution of land in Thailand is 45.4 compared to 92.4 in Venezuela. Increasing Thailand's coefficient to that of Venezuela would increase the Gini coefficient (for income) from its fitted value of 41.8 to 49.6, an increase of 7.8."* Table 5 shows measures of educational attainment[16]. Latin American countries have been catching up in literacy and primary enrolment but are still far behind in other ways, such as secondary enrolment, that show differences in the distribution of human capital. This suggests human capital is more unequally distributed in Latin America than in Europe or North America. Parameter estimates for democracy differ according to the data set used, but Rodrik finds that moving from Mexico's level of democracy to that of the US may raise wages as much as 90 per cent.

Table 5. **Comparative Educational Attainment**[1]

Country	Adult literacy (%)	Primary enrolment	Secondary enrolment	Tertiary enrolment	Educ. expend. (% GDP)
Peru	88.7	93.8	83.9	40	2.9
Venezuela	92.0	82.5	48.9	29	
Argentina	96.5	99.9	76.9	41	3.5
Colombia	90.9	89.4	76.4	16	4.4
Ecuador	90.7	99.9	50.9		3.5
Guatemala	66.6	73.8	34.9	8	1.7
Brazil	84.0	97.1	65.9	12	5.2
El Salvador	77.0	89.1	36.4	15	2.2
Costa Rica	95.1	91.8	55.8	30	5.3
Mexico	90.1	99.9	66.1	14	4.9
Chile	95.2	90.4	85.2	27	3.1
Malaysia	85.7	99.9	64.0		5.2
Japan	100.0	99.9	99.9	30	3
Taiwan					
South Korea	97.2	99.9	99.9	48	3.7
Italy	98.3	99.9	95.0	37	4.7
U K	100.0	99.9	91.8	37	5.4
Austria	100.0	89.4	76.4	43	5.7
Norway	100.0	99.9	97.6	54	7.5
Germany	100.0	99.9	95.3	36	4.8
Belgium	100.0	99.9	99.9		3.2
Netherlands	100.0	99.9	99.9	45	5.2
Sweden	100.0	99.9	99.9	38	8.3
Denmark	100.0	99.9	94.8	41	8.2
USA	100.0	99.9	96.3	81	5.4

Note: *1)* All data from 1999 *Human Development Report* except for the tertiary enrolment rate from the *1996 World Development Report.*

Some authors (Engerman and Sokoloff, 1997) have suggested that variations in factor endowments may matter, through Stolper-Samuelson type effects on asset returns. Inspired by this, Leamer *et al.* (1999) argue that specialising in agricultural exports increases inequality by reducing the incentive to accumulate human capital. Bourguignon and Morrisson (1989) also find that being a mineral or agricultural exporter tends to increase inequality, but the effect of agriculture is almost completely removed when land ownership is not highly concentrated. They note (p.1125) that the impact of "a comparative advantage in agriculture cannot be considered separately from the land ownership structure of the country[17]." These cross-country empirical results may help explain comparative inequality.

Historical research yields the same kind of message as the recent cross-country studies and explains much about why inequality exists in the OECD, how far institutional differences in the labour market affect inequality and where they come from. In most Western European countries, democratisation induced extensive welfare programs and public commitment to education and tilted distribution of labour market bargaining power towards labour. Acemoglu and Robinson (2000*a*,*c*) show that long-term changes in inequality in several Western European countries closely follow the path of political development. In Britain, France, Germany and Sweden, falling inequality coincided with mass democratisation and creation of the redistributive state (Morrisson, 1999; Lindert, 1989, 1994, 1999; Lindert and Williamson, 1985). They also stress the connection between democratisation, education and the introduction of labour market reforms that strengthen the bargaining power of labour. Easterlin (1981) was first to emphasise that mass education follows mass democratisation, noting that *"a major commitment to mass education is frequently symptomatic of a major shift in political power and associated ideology in a direction conducive to greater upward mobility for a wider segment of the population."* This has since been backed up by Lindert (2000) for Europe and Engerman, Mariscal and Sokoloff (1998) for the Americas. Investing in mass education does not seem in the interests of narrow political elites, either because they cannot appropriate the social benefits (Engerman, Mariscal and Sokoloff, 1998) or because it undermines their power by politically mobilising the masses (Bourguignon and Verdier, 2000*a*,*b*).

What causes the differences in labour market institutions or the educational system that produce big differences in inequality? Most OECD countries have been solid democracies for some time, although Greece, Spain and Portugal have been only since the 1970s. The egalitarian impulse induced by democratisation has differed across countries and is not fully understood by social scientists but its strength seems to depend on whether a socialist party emerged and won power. Where it did (Sweden and Britain), inequality was dramatically reduced. Where it did not (the United States), the institutional equilibrium was different and greater inequality from the pre-democratic era persisted[18]. Differences in the party system appear to be an important part of persistent inequality in Latin America and it seems there is a close relationship between the kind of party system, the political institutions and the history of political development.

Democratisation encouraged equality in the distribution of assets (land and human capital) in Europe, but important institutional differences persist concerning labour market institutions and the degree of redistribution through the tax system, whose existence seems to be linked to the success of socialist or social democratic parties.

How does globalisation explain the cross-country variance in changes in inequality over the last 25 years? There has been heated debate in the US about globalisation's part in rising wage inequality and the consensus seems to be that it is quite small[19]. But within the OECD, there is no trend of increasing inequality, despite globalisation being a shock for all countries. Williamson says globalisation largely explains historical patterns of inequality (Williamson, 1998; O'Rourke and Williamson, 1998) but he relies on a small class of hypotheses which does not include the institutional or political economy factors that are key to explaining, for example, why inequality fell in Britain after 1870.

Globalisation involves either rising or falling inequality. It may unleash forces that push in one direction or the other, but how far they affect the actual distribution of income depends on other factors. Both the contemporary cross-national and historical evidence points to the key role of institutions and politics in the distribution of assets and income in society. There is no evidence globalisation is significantly connected to them.

III. IMPLICATIONS FOR LATIN AMERICA

Cross-country differences in income inequality in Latin America seem related to inequality in land distribution and educational attainment. Historical evidence suggests that asset distribution and the mapping from that to the income distribution is greatly affected by the presence or absence of democracy and the nature of institutions such as political parties within democracy.

Argentina's pattern of inequality matches its political history, with inequality falling during democratic periods and rising under dictatorships. Inequality fell rapidly during the 1920s, rose at the end of the authoritarian 1930s and fell dramatically under Perón's more populist administration. After he was overthrown in 1955 it rose rapidly, stayed mostly unchanged during the 1960s and fell again during the second Peronist administration from 1973 to 1976. After the 1976 coup, it rose dramatically[20]. Dornbusch and Di Tella (1989, p. 6) report: *"Regarding the share of wages in GNP, the strikingly high period, that of 1946-49, was the consequence of the distributive policies of the first years of the Peronist administration, which increased labour's share by more than 10 per cent. This was reversed sharply in 1959 when it went below even the pre-1946 level. It then settled at 45 per cent of GNP and remained there for many years, only to go down to its lowest level, 30-35 per cent, during the 1976-83 period as a consequence of the policies of the military government."*

This still leaves unexplained the increasing inequality during the 1990s, which seems to be the first instance of rising inequality in Argentina during democracy.

In Chile, inequality had fallen gradually under a series of democratic regimes after 1932. Mamalakis (1976, p. 212 Table 10.1) shows the wage share increased from 42.4 per cent in 1940 to 44.5 per cent in 1950 and to 51.6 per cent in 1960[21]. This rise continued in the 1960s with the wage share reaching 54.9 per cent in 1970 and then increasing rapidly to 65.8 per cent in 1971. One of the biggest increases in inequality was in Chile after the coup of 1973. (Table 2a shows the Gini coefficient rose from 46 in 1971 to around 58 at the time of the democratic transition in 1989[22].) So if modern Chile has experienced a Kuznets curve, the driving force seems to be political developments.

The situation is similar in Brazil and Colombia. In Brazil, inequality widened significantly after the military coup against Goulart in 1964, levelled off in the late 1970s and remained steady through most of the 1980s. Again there seems to be a hint of increasing inequality in the 1990s. In a seminal historical study of Colombia, Londoño (1995) found that inequality rose from 1938 until the mid-1960s and then fell monotonically afterwards until the late 1970s. He attributed the fall to the major expansion of education in the early 1960s after the return to civilian rule in 1958.

Democratisation once again plays a key role, as did the desire to stem the serious violence that had afflicted the country during the 1950s.

Not all military regimes redistribute away from labour and towards capital. Falling inequality in Peru during the 1970s is probably due to the agrarian reforms introduced by General Velasco after 1968. However such regimes are the exception[23].

The connection between political regimes and trends in inequality in Latin America is impressive and entirely consistent with the cross-country regressions. However, in the past 20 years, the main modern period of globalisation, militarism has declined in Latin America but inequality has risen in many countries, such as Mexico in the 1980s and Argentina or Peru since the late 1980s. If the rise in inequality in Chile in the 1970s was due to the actions of the military, why has it not fallen more since the return of democracy? Székely and Hilgert (1999) find that in El Salvador, Honduras, Nicaragua, Peru and Venezuela inequality increased sharply in the 1990s.[24] In the other Latin American countries they looked at, inequality trends depended on how the Gini coefficient was adjusted and only in Costa Rica did inequality not worsen under any definition. So why this more recent rise in inequality?[25]

In Europe, democracy had an important egalitarian effect, but the impact on the level of inequality depended on there being a socialist party with a redistributive agenda. Economic development and urbanisation in Latin America began creating a politically-mobilised working class in the 1920s and 1930s, mostly integrated into political parties that were cross-class coalitions. Such parties were very different from European parties such as the Swedish Social Democrats or the British Labour Party[26]. They certainly had redistributive policies but these did not change the long-term institutional equilibrium as in Western Europe and so had little effect on the inequality level.

Also, when real redistributive agendas emerged and even won power, as in Guatemala and Venezuela in 1945 or Chile in 1970, they provoked an anti-democratic backlash. This was because democratisation was opposed by the traditional political elites in nearly all Latin American countries, typically in alliance with the military. So not only did strong socialist parties not emerge in Latin America, but when they did they were undermined by a military that tried to demobilise the left[27]. This happened in Europe too (Spain, Portugal and the rise of National Socialism in Germany and Italy in the 1920s) but not very often, probably because democracy was more of a threat to Latin American elites, whose most important asset was land, which is very immobile and easy to redistribute[28].

Rising inequality in the post-military period probably stems from structural political changes induced by military regimes when they manage to demobilise trade unions and the left to eliminate the political base for redistributive politics. This was clearest in Chile, where inequality failed to decline following Pinochet, and in Argentina, where it rose. In Chile, Kurtz (1999, p.400) says that “the organisation of state-society relations was modified in an effort to induce changes that would permanently defeat the left”. These changes were in the structure of the economy (to undermine the economic base of the unions) and also attempts to completely demobilise leftist political forces. Such ideas were also embodied in the new constitution that aimed to re-order the national political equilibrium to stop redistribution emerging again as a successful political agenda[29].

These structural changes in political institutions and in the organisation of the left, as well as worries about a lingering military threat, explain why the increase in inequality created by the military has not been reversed in Chile by a democratic regime as in the past.

In Argentina, the 1976-83 military regime repressed labour as ruthlessly as the Pinochet regime. Since re-democratisation and adjustment to the debt crisis, inequality has increased under the reconstituted Peronist party, which has now dropped its redistributive agenda. The party's ability to maintain its vote share regardless reflects the structural changes in Argentine society induced by the military and the debt crises. As Roberts (1995, p.113) notes, "in periods of economic crisis, social fragmentation, and political deinstitutionalisation, the personalist mobilisation of lower class support is not necessarily contingent upon statist or redistributive policies". The change in the Peronist party's political strategy and its adoption of neoliberal policies reflects the new constellation of political forces[30]. Inequality can now rise during a democratic period because one of the major coalitions in favour of redistribution has been vanquished[31].

This interpretation of rising and persistent inequality throws a different light on the role of *neoliberalismo* and the set of policies connected to the 'Washington consensus.' The mass privatisation and deregulation many Latin American countries have carried out since the 1980s must have had important effects on income distribution. Even if it was due to *neoliberalismo* it would be hard to say what part globalisation played since trade and capital market liberalisation comes as a package with other reforms. So far the econometric evidence is mixed[32]. Behrman, Birdsall and Székely (2000) discuss the many ways structural changes in the economy can influence distribution (see also Bourguignon and Morrisson, 1989) and find that wage inequality grew in the 1990s in Latin America, with the return to schooling rising by 7 per cent as increases in the return to higher education more than offset falls in the return to primary and secondary schooling. They say policy reforms had a significant impact, with financial market and capital account liberalisation and labour market deregulation leading to higher wage inequality. However, they find that privatisation tends to lower wage inequality.

But Stallings and Peres (2000) fail to find major effects of policy reform on inequality in Latin America and their results conflict with Behrman *et al.* (2000). They say import liberalisation, tax reforms and privatisation all increase inequality, while capital account opening and domestic financial liberalisation tend to reduce it.

Neoliberal economic policies may have led to increased inequality. But the military regimes of the 1970s and 1980s managed to fundamentally change the institutions and distribution of political power in Latin America so their successors would not pursue a redistributive political agenda and reduce inequality as in the past. So neoliberal policies are a result of these new political equilibria, whether or not they actually increase inequality. Roberts (1995, p.114) argues that "the Peruvian case demonstrates that it may be possible to craft populist formulas that complement neoliberalism[33]".

Rising inequality is not clearly linked to globalisation and *neoliberalismo*, but in OECD countries it is closely connected to labour market deregulation and in Latin America to labour repression. Tables 6 and 7 show two possibly key factors in the bargaining power of labour — the percentage of the workforce that is unionised and the real value of the minimum wage[34]. Chile, one of the few countries to have (slightly) reduced inequality in the 1990s, is the only one where unionisation has increased. In Colombia and Costa Rica, where inequality did not increase over this period, the value of the real minimum wage was maintained. But in Argentina and Mexico, where inequality notably grew, unionisation fell sharply, along with the real minimum wage. These correlations are far from conclusive[35], but OECD evidence suggests changes in labour market institutions hold the clue to changes in inequality[36].

If labour market deregulation has been the key to rising inequality, what explains labour market deregulation? It comes from the reliance on markets embodied in the Washington consensus, though the extent of it varies greatly between countries and seems closely related to the changing structure of political power.

Table 6. **Labour Market Institutions in Latin America**[1]

		Trade Union membership (thousands)		**Trade Union density** (% of non-agric. labour force)		**"Unprotected" employment** (% of total employed)
Argentina	1986	3262	1986	48.7	1990	21.7
	1995	3200	1995	25.4	1996	34
Brazil	1991	15205	1991	32.1	1985	63.6
					1996	68.5
Chile	1985	361	1985	11.6	1990	17
	1993	684	1993	15.9	1996	22.3
Colombia	1985	877	1985	11.2		
	1995	840	1995	7.0		
El Salvador	1985	79	1985	7.9	1994	59.1
	1995	103	1995	7.2	1997	61.3
Mexico	1989	9500	1989	54.1	1990	43.4
	1991	7000	1991	31.0	1997	49.6
Peru	1991	442	1991	7.5	1990	25.5
					1996	34.1
Uruguay	1990	222	1990	19.9		
	1993	151	1993	11.6		
Venezuela	1988	1700	1988	25.9		
	1995	1153	1995	14.9		

Note: 1) Table 7 comes from Rodrik (1999*b*).

Table 7. **Real Urban Minimum Wage in Latin America, 1985-92** (1989=100)

	1985	**1986**	**1987**	**1988**	**1989**	**1990**	**1991**	**1992**
Argentina	113.1	110.0	120.8	93.5	42.1	40.2	56.0	48.0
Brazil	88.9	89.0	72.6	68.7	72.1	53.4	59.9	57.3
Chile	76.4	73.6	69.1	73.9	79.8	87.5	95.6	99.8
Colombia	109.4	114.2	113.0	109.0	110.8	107.9	104.3	101.6
Costa Rica	112.2	118.7	117.9	114.6	119.4	120.5	111.8	111.5
El Salvador	66.2	57.5	46.0	43.6	37.0	34.8	34.1	35.2
Guatemala	94.0	68.6	61.1	75.9	68.1	48.2	38.9	35.0
Mexico	71.1	64.9	61.5	54.2	50.8	45.5	43.6	42.1
Peru	54.4	56.4	59.7	52.0	25.1	23.4	15.9	15.9
Uruguay	93.2	88.5	90.3	84.5	78.0	69.1	62.0	60.0
Venezuela	96.8	90.4	108.7	89.5	72.9	59.3	55.1	60.7

IV. CONCLUSIONS AND POLICY IMPLICATIONS

Inequality is determined by institutions and policies that determine the distribution of assets and their relative returns[37]. Globalisation has no clear impact on inequality. To some extent, it is endogenous and its net effects are mediated by the same institutional and political forces. Brenner (1976, p.11) argues that *"it is the structure of class relations, of class power, which will determine the manner and degree to which particular demographic and commercial changes will affect long-term trends in the distribution of income and economic growth".*

In Latin America, the distribution of assets is highly skewed because of unequal distribution of land and education rooted in history. The main factor in inequality trends in 20th century Latin America seems to be the nature of the political regime. The different evolution in inequality in Chile and Costa Rica over the past 30 years can mostly be attributed to the very different political set-up in each country.

Globalisation did play some part in this. In the 19th century, it raised the stakes and encouraged land expropriation that led to large increases in inequality. More recently, in the 1970s, military regimes used it to consolidate their political power and demobilise their opponents. Since the 1980s, it has been part of the Washington consensus package of policies implemented in the region.

But the basic cause of different levels of inequality is lack of democracy and the nature of the party systems. In the 19th century, the only countries that deviated from the trend of land expropriation, such as Costa Rica and Colombia, were those where there was serious political competition, if not full-blown democracy. Yet even this was limited. The Conservative and Liberal parties in Colombia are classic cross-class coalitions that stopped a socialist party entering the political system and avoided emergence of a political coalition in favour of redistribution. During the 1970s, while inequality rose sharply in authoritarian Argentina and Chile amid policies to open the economy quickly to international economic forces, it fell in Peru as the result of egalitarian agrarian reform. In the 1980s and 1990s, inequality rose again in many places as neoliberal economic policies were implemented, but was largely unchanged in Costa Rica and Colombia where labour market deregulation was avoided.

The East Asian experience suggests solid democracy is not necessary for radically reducing inequality. Authoritarian regimes can make land reforms too. But the Western European experience suggests it might be sufficient. In the 19th century, Latin American societies developed free from international geopolitical competition[38] and with well- developed institutions for internal social control. Latin American states and their relationship to society evolved very differently from those of East Asia or Europe and this largely accounts for their very different levels of inequality now.

So how should Latin American governments respond to the challenges and opportunities of increasing globalisation? If globalisation does not by itself create inequality, what should Latin American governments be doing about inequality? How could international institutions help? Many kinds of policies can cushion the impact of globalisation on inequality, but these policies, however well-intentioned, are unlikely to be self-enforcing in Latin American political systems. Democracy seems far from consolidated there, as recent events in Peru, Paraguay, Ecuador and Venezuela show. Without belittling the recent democratic handover in Mexico, we should remember that Mexico did not have a single democratic election in its previous 180 years of independence.

We could say (Rodrik, 1999*c*) we should be promoting democracy as a "meta-institution" with big positive and normative payoffs. But how could be done? The history of conditionality on structural adjustment lending to LDCs shows how hard it is to persuade a recalcitrant country to adopt clear economic policies. Building an accountable democracy that would empower the bottom of the income distribution seems far more complex and the theory of creating and consolidating democracy much more primitive[39]. Building democracy also has to be in the interests of First World powers and the international institutions that hold the balance of power in the global economy. Post World War II history shows this cannot be assumed. Cold war politics sustained many oppressive and anti-democratic regimes and actively undermined Latin American democracies, notably in Guatemala in 1954 and Chile in 1974. Things have changed since 1989 but no effective and credible policy alternatives have been designed.

Moving beyond this pessimistic assessment demands much deeper understanding of the relationship between political institutions, party systems and democratic consolidation[40] and of why the political economy process of Western Europe has been so different from Latin America over the last 150 years.

NOTES

1. These imperfections may be in the capital market (Banerjee and Newman, 1993; Legros and Newman, 1996) or arise for other reasons. Baland and Robinson (1998) show that absence of an effective secret ballot is an incentive to concentrate landownership so as to control the voting behaviour of agricultural workers. The political rents this control generates may not be transferable because of increasing returns in politics.
2. See Piketty (1999) for a review of the different types of mechanisms that can lead to persistence of asset inequality.
3. The evidence is in Nugent and Robinson (1998), though see the classic works by McCreery (1986, 1994) for Guatemala.
4. One important cause seems to be the impact of Japanese colonial policy (Kohli, 1994), another that, prior to agrarian reform, land was mainly farmed by tenants who had much greater incentive to acquire education (Conning and Robinson, 2000).
5. The Gini coefficient ranges from zero (complete equality with each person receiving the same income) to one (complete inequality where one person receives all the income generated in the economy).
6. Freeman (1980) was probably the first to emphasise this.
7. Bulmer-Thomas (1994, Table A.2.1, p. 439) shows the share of Latin American exports in GDP increased from around 10 per cent in 1850 to 25 per cent by 1912.
8. Even Williamson (1998, p. 23) notes: *"To the extent that land holdings were highly concentrated at the top, these trends clearly implied rising inequality in Argentina"*. Thus he notes that the effects of globalisation depend on assumptions about who owns what.
9. Coatsworth (1981) shows how the railway system in Mexico and the expansion of opportunities for export agriculture during the Porfiriato led to systematic expropriation of Indian lands.
10. One could of course claim that rainfall affects the political equilibrium (Wittfogel, 1957).
11. Many other ideas in the literature link globalisation to the structure of political power. Cardoso and Faletto (1979) and Lewis (1978) argue that specialisation in agriculture strengthens the power of landowners and is ultimately inimical to development.
12. Many other large shocks and changes in society — such as a big technological or institutional innovation, the creation of the factory system or urbanisation — can have the same kind of simultaneous impacts as globalisation. In early 19th century Britain, inequality increased dramatically and there were big changes in the balance of political power as the Industrial Revolution unfolded (Williamson, 1985; Acemoglu and Robinson, 2000*a*).
13. Garrett (1998) and Rodrik (1998) himself have shown that countries more open to the world economy tend to have larger governments.

14. His results imply that (1999, p. 666*) "the long-term impact of a permanent change in the system of wage setting from a system of plant or individual level bargaining (as in Britain, Canada or the US), to a system of industry-level bargaining (as in Switzerland, Austria or Germany) is to reduce the wage differential (between the top and bottom deciles) by 30%. (…) A move from highly-centralised bargaining, as in Sweden before 1983, to a system of industry level bargaining would raise the predicted wage differential by 50%".*

15. These authors play down the institutional determinants of equilibrium prices because these are much harder to measure in a large sample of countries and because it is thought the big differences between, say, Western Europe and Latin America are due more to differences in their asset distributions.

16. This data is imperfect because it does not allow for differences in quality of education that are obviously very large.

17. If specialisation in agriculture matters for inequality in Latin America, it is probably because it makes land, a non-reproducible factor, the most valuable asset. The non-reproducibility of land makes it much more attractive to expropriate and monopolise and therefore leads to much greater underlying asset inequality.

18. See Lipset and Rokkan (1967) for a seminal analysis of the origins of party systems in Europe.

19. Wood (1998) strongly argues that globalisation has played a big role in increasing wage inequality within the OECD (see Wood, 1997, for his views on LDCs). See Burtless (1995) for a balanced overview of the debate.

20. Randall (1978, p. 29) says the share of wages in national income was "*28% in 1919, and reached 42% in 1928. By 1930, the share was only 38% of a falling national income. From 1931 to 1939, the wage share was roughly stable at 42%; it fell until 1942*". Diaz Alejandro (1970, p. 43) notes "*a rising wage share in the domestic product from 1915-19 to 1930-34 and a higher share in 1935-39 than before World War I*". However (p. 108) "*the wage share in national income declined between 1935-36 and 1940-42*". He also finds (Table 2.23, p. 129) that the wage share in national income moved from 39.2% in 1950-52 to 33.8% in 1959-61. So after falling under Perón, inequality widened. The data in Table 3 from Altimir (1986) and Bebczuk and Gasparini (2000) supports this, showing the rapid worsening of inequality during the military regime from 1976.

21. Stallings (1978) supports this, although she suggests there may have been a slight increase in inequality during the late 1950s rather than a monotonic fall over the whole period. This seems possible since the period was one of tough anti-inflationary policies under the Alessandri presidency.

22. See Romaguera *et al.* (1995) for a discussion of "Labor market deregulation" Chilean style.

23. Though there are interesting examples in this respect of left-wing military regimes in Africa (Benin, Guinea and Ghana).

24. They did not have comparable data for Argentina and the rise in inequality in Mexico was mostly in the 1980s, not the 1990s.

25. This rise in inequality, and in particular the rise in the skill premium, is surprising given the Stolper-Samuelson Theorem. One approach is therefore to amend ones views about what actually is the factor that is in relative abundance in Latin America. This is the approach of Robbins (1996) who summarised the evidence showing rising, not falling, wage differentials in Latin America. Davis (1996) and Spilimbergo, Londoño, and Székely (1999) propose changes in the basic trade model that can account for this.

26. See for example Collier and Collier (1991).

27. Even after mass shocks to socio-political systems like revolutions, structural inequality in Latin America has easily managed to recreate itself. This happened in Mexico where the regime that emerged in the 1920s was quite similar to the regime of the Porfiriato before the revolution and in Bolivia after the 1950s (Kelley and Klein, 1981).

28. Note the connection between this idea and those of Moore (1966) and Luebbert (1991).

29. See Londregan (2000) and Siavelis (2000) for insightful analyses of Pinochet's constitution and its long-run implications for the political equilibrium in Chile.

30. See McGuire (1997) and Levitsky (1999) for insightful analyses of the changing political strategy of the Peronist party.

31. See Weyland (1996) for a discussion of the Brazilian case. He points to political and electoral institutions as a major reason for the lack of a redistributive coalition in Brazil.

32. During the late 1940s, when the British Labour government carried out large-scale nationalisation and greatly expanded the state's role in society, there was a significant fall in inequality. The reversal of this in the 1980s led to a significant increase in inequality. How is Latin America different? Perhaps because government interventions there were never so consistently egalitarian.

33. For the electoral success of such strategies, see Roberts and Arce (1998) and Weyland (1998).

34. Data is also included on the proportion of workers not "protected" by formal written contracts or inclusion in social benefit programs (see Rodrik, 1999*b*).

35. The much larger informal sector in Latin America than in the OECD gives these numbers less meaning than they would have in Britain or New Zealand.

36. For example, Peru introduced legislation in 1991 permitting workers to be hired on a range of probationary contracts at the end of which time they enjoy few (if any) fringe benefits. The number of workers on one-month contracts rose from 35,000 in 1990 to 176,000 in 1993.

37. An obvious but telling example of the importance of politics and institutions for inequality is the very low income inequality of the former Soviet bloc countries. Since the 1989 transition, inequality has been rapidly increasing there.

38. Which many scholars, for example Tilly (1990) and Herbst (2000), have said is important for the evolution of representative institutions.

39. Though there are some tentative steps towards such a theory. See Acemoglu and Robinson (2000*a*,*b*,*d*).

40. See Jones (1995) and Carey and Shugart (1992) for useful beginnings in this direction.

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