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DISCUSSION PAPER

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SUMÁRIO

RESUMO

A “década perdida” já era. Graças às reformas estruturais e ao êxito das políticas de estabilização empreendidas nos últimos anos, a economia latino-americana cresceu, durante a primeira metade da década de 90, mais do que durante a de 80 como um todo, ao mesmo tempo em que reduzia substancialmente sua taxa média de inflação e registrava progressos no combate à pobreza.

Estas tendências comuns tendem a ocultar, todavia, importantes diferenças nas condições iniciais, no ritmo e na natureza das reformas que foram implementadas nos diferentes países do continente — e, portanto, em suas conseqüências macroeconômicas e sociais.

Neste artigo procura-se, primeiramente, analisar a experiência recente de quatro países: Argentina, Brasil, Chile e México, com ênfase na diversidade do **timing** e da profundidade das reformas e das políticas de estabilização implementadas. Em seguida, estudam-se os impactos destas medidas sobre o desempenho macroeconômico, o mercado de trabalho e a distribuição de renda. Finalmente, parte-se para a formulação de diretrizes de políticas que possam vir a reduzir a pobreza mais rapidamente do que a registrada no período recente.

ABSTRACT

Latin America´s lost decade seems to be definitely over. During the first half of the 1990´s, GDP growth was higher than during the 1980´s as a whole, at the same time than inflation was substantially reduced and poverty indicators progressively improved.

These common trend tend to hide, however, important cross-country differences in the timing and in the nature of the structural reforms and of the stabilization policies that were at the origins of this process, and therefore of their macroeconomic and social impacts.

The purpose of this paper is to study the recent experience of four among the main countries of the continent: Argentina, Brazil, Chile and Mexico. I start describing their macroeconomic policies and performances since the beginning of the 1990´s. Then, I analize the impacts of the macroeconomic behaviour on the labor market and on income distribution. Finally, I try to investigate which kind of policies would be apropriated in order to reduce poverty faster then during the last years.

1 - INTRODUCTION

The Latin America's **lost decade** seems to be definitely over. On the one hand, according to the Economic Commission for Latin America and the Caribbean (ECLAC), the continent's GDP accumulated growth rate during the first half of the 1990's (14,9%) was higher than during the 1980's as a whole (13%). On the other, its average rate of inflation, which attained 1.200% in 1990 was reduced to 25% in 1995. Finally, poverty was meanwhile progressively reduced — even if not enough to compensate its increase during the previous decade.

Structural reforms — such as trade and financial liberalization and privatization — and stabilization policies focused on sharp fiscal deficits' cuts and on "fixed" nominal exchange rates were at the origins of this metamorphosis almost everywhere in the continent.

These common features, however, tend to hide important differences in the starting conditions, in the rhythm and in the nature of the reforms which were implemented in the different countries — and, therefore, in their macroeconomic and social impacts.

The purposes of this paper are:

- to describe the schedule and the main characteristics of these reforms in four of the main countries of the continent: Argentina, Brazil, Chile and Mexico;

- to investigate how their macroeconomic performances were influenced by these reforms;

- to evaluate their impacts on the labor market and on income distribution; and, finally,

- to try to think about policy issues which should be considered in order to alleviate poverty faster than it has been done recently.

The eruption of the foreign debt crisis, in the beginning of the 1980's, symbolized the end of the import-substitution process which allowed Latin America to record GDP growth rates considerably higher than the rest of the world for more than three decades after WW-II. The reforms that have been implemented since then cannot be understood outside of this context. For a reason or for another, some countries were more successful in arriving to this diagnostic faster than the others. We shall see, for instance, that while Chile and Mexico, in different ways, were the precursors, Argentina and particularly Brazil were the late-comers of this process. The starting conditions in which the reforms were implemented are analyized in Section 2, while their nature and rhythm in each one of these countries are described in Section 3.

The aim of the fourth section is to illustrate the main macroeconomic effects of the liberalizing reforms in these countries. The questions to be answered are:

- why Chile is the only country of the continent to have reached a sustainable path of GDP growth with low inflation rates? and

- which are the conditions that the other countries have to satisfy in order to attain this kind of performance?

In the fifth section, I examine how the overall process impacted on the labor market.

In the sixth, I try to show that the effects of liberalization and stabilization policies on income inequality and poverty are still ambiguous and vary considerably from one country to another.

In the conclusion, therefore, the attempt is to guess what's next to reduce poverty. Two different ways are investigated:

- the pursue of the reforms where there are still incomplete; and

- complementary measures, as compensatory or employment policies and/or increases of social public spending share's in overall government expenditures.

2 - STARTING CONDITIONS

The import substitution strategies followed by most Latin American countries after WWII were successful both in obtaining high GDP growth rates and in reducing poverty. Given the uneven nature of this process, however, poverty alleviation was — as a rule — slower than GDP growth.

Industrialization was accompained by fast urbanization. Indeed, only some of the swelling urban labor force found work in the "modern" urban sectors; the others were accomodated in the informal sectors (either as informal employees or as self-employed). Under the import-substitution regime, collective bargaining assumed, much times, the pattern of sectorial agreements in the most protected sectors of the economy. As the modern sectors were protected towards foreign trade competition, they were able to guarantee formal contracts to their workers, which meant (and still means) the right to a minimum wage, paid vacations, a fixed number of hours worked per week, social insurance and — in most cases — to get a higher income than that attainable in the informal sectors. In the context of a closed economy where the State had a proeminent role in the determination of prices, the entrepreneurs were able to translate to prices this increase in their costs. The linkages between the pattern of real incomes with that of productivity were quite weak, as real wages in these sectors could increase with no damage in terms of employment, but to the workers and entrepreneurs in the others sectors, which payed more for their products.

Therefore, the employment level (and its composition) depended crucially of the behaviour of aggregate demand and was practically unsensitive to labor costs' oscillations; being so, it was possible to accrue more and more the benefits for the workers of those sectors. The increase of modern sectors shares in GDP and in overall employment were therefore associated, in most cases, with increasing income inequality.[1]

Thanks to the capability of the informal sectors to act as good buffers and to the lack of solid unemployment insurance schemes, open unemployment was definitely not (except perhaps in Chile) the main problem of Latin American labor markets in the early 1980's.

This model of development faced its first difficulties (stagnation and acceleration of the rate of inflation) in the 1960's. From then, and until the beginning of the 1980's, some of the countries of the region (as Chile and Argentina) tried, more than once, to liberalize their foreign trade and their capital accounts, frequently in the context of stabilization attempts focused on exchange rate overvaluations. As these policies hurt the modern sectors's interests (both of the entrepreneurs and of the workers), they were typically implemented by authoritarian regimes — politically sustained by the traditional sectors. All them implied significant short-run outcomes in terms of the reduction of the rate of inflation, growing real wages and fast deterioration of the trade balance compensated by increasing capital inflows. At a certain point, once the current account of the balance of payments deficit overtook a given ceiling, these flows were reversed and the governments had to devaluate, provoking a new acceleration of the rate of inflation. The only net result of these strategies by the late 1970's/early 1980's was a significant increase of these countries' foreign debt. Despite of the fact that the indebtedness was leaded by the private sector, the burden of the debt fell, in a way or in another, predominantly on the public sector.

In others, as Brazil, thanks to the growing diversification of exports, import substitution went further, through the 1970's, and foreign indebtedness had as its main counterpart increasing investment rates in infra-structure by the public sector more than of speculative capital movements. It has also allowed the preservation of high GDP growth rates and the maintaining of income inequality at the same (although very high) levels — and therefore a significant diminution of the proportion of poors.[2]

In any case, Latin America as a whole proved to be more successful promoting economic than social development; i.e., its share of people living under the poverty line is higher that it should be for international standards — given its (PPP

[1] In such a context, as it is pointed out by Cortázar (1993), the behaviour of trade unions (which did exist only in the modern sectors) tended only to increase the differentials between the modern and the informal (and/or traditional) sectors.
[2] See Barros and Mendonça (1993) for more details.

corrected) **per capita** GDP. There are, of course, important differences among the countries of the region; for instance, according to UNDP (1995) the proportion of poor in Brazil in 1992 was three times higher than in Argentina, whereas the **per capita** GDP of these two countries resulted to be approximately equivalent. Anyhow, given that the starting-point was one in which poverty was too high for the international standards, there are good reasons to pay a particular attention to the effects of the structural reforms on the social indicators.

By the early 1980's — when the foreign debt burden raised considerably because of the increase of international interest rates (and, for some countries, of the second oil shock) — it was clear that the public sector in Latin America would not be able to pursue its leading role in the development strategy adopted after WWII. The lack of capability to understand promptly that the import-substitution process was over — which is possibly related to the most organized sectors's (those which emerged thanks to import-substitution) political weight in the florishing democratic regimes throughout the continent — is at the root of the continent's **lost decade**: a combination of GDP stagnation (or even fall), hyperinflation, increasing inequality and, thus, raising poverty.

As it was already mentioned, the recognition of the need of strucutural reforms arised in differentiated ways and timings in the main countries of the continent. The first to adopt them were Chile and Mexico, the former under Pinochet's dictatorship, the latter in a time that PRI still was the unique organized political party. Then came the time of Argentina, ironically by the means of the political ascencion of the Peronist party — which was historically the one that had promoted import-substitution. Finally, and more slowly than anywhere else, came Brazil, where the redemocratization process was more complex and has not generated a clear hegemony of interests around the reforms.

3 - NATURE AND RHYTHM OF THE REFORMS

Everywhere, most of the liberalizing reforms were adopted as a reaction to the macroeconomic performance during the **lost decade**, simultaneously with stabilization policies; their social impacts, therefore, depended not only of their depth and of the structural and institutional features of the economies where they took place, but also of the nature of the stabilization policies that were implemented together with them.

To remove the obstacles to the freer functioning of these different markets meant to hurt interests that during more than three decades were the prevailing ones. The difficulty of this task — then — was proportional to the complexity of the political course of each country and, therefore, to the advance of the democratization process that was in progress in virtually all the continent.

3.1 - Trade Liberalization

Import substitution meant the protection of the manufacturing sector through tariff and non-tariff barriers. As already mentioned, a first attempt to decrease trade barriers was made by Southern Cone countries in the second half of the 1970's, in the context of (unsuccessful) stabilization policies focused on exchange rate overvaluation. In the early 1980's, however, in response to foreign debt crisis, the degree of protection was increased again everywhere.[3]

A new attempt to liberalize foreign trade happened almost simultaneously everywhere in the continent, during the second half of the 1980's (see Table 1).[4] As we shall see later in this paper, in some cases (as Mexico and Chile) the diminution of import tariffs were accompanied by other structural adjustment and measures, while in others (as Argentina and Brazil) they were not — at least in the beginning.

Table 1
Average import tariffs (%)

	Beginning	1993
Argentina (1989)	38	15
Brazil (1988)	51	14
Chile (1985)	35	11
Mexico (1985)	24	12

Source: ECLAC (1995).

3.2 - Financial Liberalization

Financial liberalization is more complicated than trade liberalization.

On the one hand, it can be seen as an important tool to:

- increase investment through the reduction of the cost of capital;
- smooth the consumption profile;
- complement the trade balance; and to
- introduce modern technology through foreign direct investment.

On the other, it is costly, in the sense that:

[3] See Barros, Foguel, Mendonça and Miranda (1996) for a good description of this process in Brazil.
[4] The "beginning" of the process of trade liberalization is indicated in the first column of this table. Notice that the data in this table do not take into account non-tariff barriers, which — in some cases — were even more important than the tariffs themselves.

• it increases the exchange rate volatility, turning the foreign sector more exposed to recurrent crisis; and that

• once the short-run capital flows are pro-cyclical, they tend to create de-stabilizing wealth-effects of expenditure and intensify domestic economic cycles.

Moreover, as already mentioned, several countries of the region had experienced the failure of stabilization packages centered on perfect capital mobility (and fixed nominal exchange rates) in the late 1970's/early 1980's.

It is not difficult to understand, hence, the reluctance of many of the Latin American countries to adopt financial liberalization. In this field, the reforms came later and not in such a generalized way than those concerning trade flows.

Mexico was the first to liberalize almost entirely its capital account — what has to be understood in the context of the increasing role of NAFTA for that country.[5] Chile was more prudent: it started the reform almost at the same time than Mexico, but even now — more than one decade later — it continues to maintain strong restrictions to short-term capital inflows.[6] Argentina represents the extreme case where the reforms as a whole was (and still is) dependent of perfect capital mobility, since the US$-peso parity is the "holy" anchor of Cavallo's stabilization plan.[7] Brazil, finally, was the last one to follow this trend; it is important to notice, however, than financial liberalization was an important tool for creating the conditions which allowed Real plan — launched a couple of years later — to be succesful: thanks to high interest rates differentials, in fact, it implied the accumulation of a high stock of international reserves which, in its turn, allowed the maintenance of an increasingly overvalued real exchange rate.

3.3 - Privatization

State-owned enterprises played an important role in the Latin-American import-substitution process, specially in infra-structure and basic goods sectors. According to the spirit of the reforms, privatization was desirable because it would:

• stimulate capital inflows;

• help to reduce public debt and government budget deficits; and

• improve the performance of infra-structure and basic goods sectors through new investments.

[5] See Gurria Treviño (1995).
[6] See Agostin **et alii** (1995).
[7] See Fanelli and Machinea (1995).

As one can see in Tables 2 and 3, Chile and Mexico were at the **avant-garde** of this kind of reform.

Table 2
Number of privatized firms - 1990/95

	1990	1991	1992	1993	1994	1995
Argentina	6	13	30	34	34	4
Brazil	0	5	15	6	12	5
Chile	4	2	0	0	5	1
Mexico	90	70	28	21	12	0
Total/LA	109	108	115	129	120	63

Source: ECLAC (1995).

Table 3
Fiscal receipts obtained through privatization (% of GDP)

	1985-1990	1991-1993
Argentina	1,5	6,0
Brazil	-	1,5
Chile	6,5	-
Mexico	2,4	8,5

Source: ECLAC (1995).

While Chile accomplished practically all its privatization process during the 1980's, however, most of the Mexican one was done during the 1990's — and went even further than the Chilean in terms of its fiscal impacts. The same applies to Argentina, which started later. The last one, once again, was Brazil, where privatization was shyly launched in the early 1990's and until the middle of the decade did not had much fiscal significance. In other terms, Brazil is the only of the main Latin American countries where most of the privatization has still to be done, not only because of the low number of privatized firms and of the small fiscal impact of the process as a whole but also because, as we have seen above, it is a country where state-owned enterprises have a more remarkable weight in the overall economy.

3.4 - Fiscal and Tax Reforms

Fiscal and tax reforms were necessary to avoid public deficits which were at the root of the short-run imbalances that distinguished the macroeconomic performance of Latin American countries during the **lost decade**. The goal to be pursued was to replace the inflationary tax, which in many cases became the main source of government receipts, by some other non-inflationary tax and/or a (permanent) cut of public expenditure.

Chile was the only country that was able to implement these reforms successfully. As we shall see later in this paper, government deficit reappeared after privatization either in Mexico and in Argentina, forcing painful fiscal rearrangements in recessive contexts, while in Brazil the cuts in government expenditure that permitted the record of balanced budgets in the early 1990's proved to be unsustainable in the medium-run. Now, after almost two years of relatively low rates of inflation and increasing deficits, it is more and more difficult for the government to convince the Congress that fiscal discipline is a necessary condition to the maintenance of macroeconomic stability.

3.5 - Exchange Rate Policies

The increase of capital inflows resultant from financial liberalization and privatization allowed most of the countries of the region to pursue anti-inflationary policies through a progressive overvaluation of their domestic currencies (Figure 1).

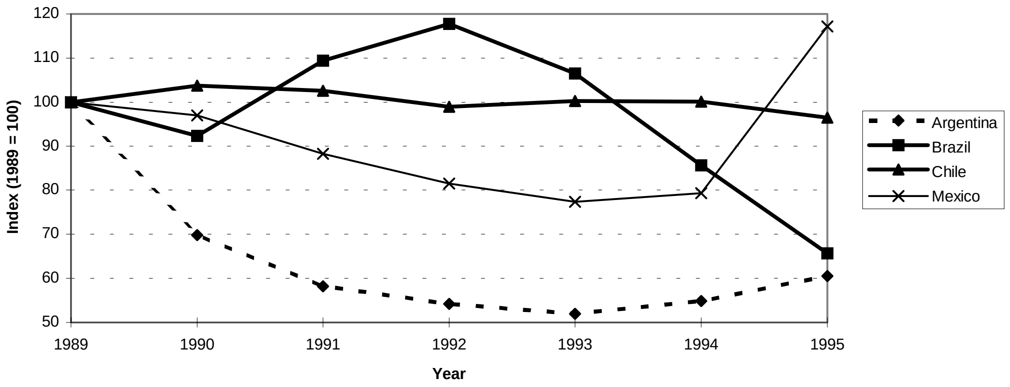
Argentina, with its fixed nominal US$-peso parity, is certainly the most paradigmatic case of such a procedure. From 1989 to 1993, the Argentinean peso was appreciated almost 50% in real terms.

Mexico also followed the same path until the end of 1994, when it have to devaluate in order to break the capital outflows which suddenly appeared in response to the lack of credibility provoked by its increasing current account deficit.

Brazil was once again a late-comer in this process: it adopted overvaluation to stop inflation only after having accumulated enough international reserves through the short-term capital inflows that followed financial liberalization and foreign debt renegotiation (both occurred in 1992).

Chile, finally, represents an exception. The prudence in liberalizing its capital account had, in fact, a counter-part in the **crawling-peg** rule which was adopted in order to keep up the real exchange rate.

Figure 1
Real exchange rates (1989-1995)



Source: ECLAC (1995).

3.6 - Labor Market Regulation

Keynesian policies became ineffective during the 1980's. The level of employment and of real wages issues, which were so important during the previous decades, were replaced by the discussion about how the labor market's institutional framework which was in place played a crucial role in determining the rate of inflation in increasingly open small economies, where real wages should more and more accompany the path of labor productivity.

There was not one unique response to this crisis throughout the continent.

The easiest ones — and the more common — were the extreme ones; i.e, the **neo-liberal** and the **conservative**. While the latest's emphasis was put on the need of increasing State protection for the loosers from the reforms, the former endorsed the opposit ideas, once its diagnosis was that collective bargaining avoided market clearing and stimulated corporatist behaviour. In both cases the outcomes were not very brilliant: on the one hand, the countries that followed the neo-liberal reforms (as Bolivia, Chile during the last years of Pinochet's regime and Argentina) fell in a trap, in the sense that their governments have practically lost the capability of coordinating the path of real wages — unless through very costly aggregate demand managing policies; on the other, those (as Brazil) which were not able to remove the old privileges of the protected sectors had — as the economy became progressively more open — to pay increasing costs in terms of employment in that sectors.

A third and more moderate solution was tried, in the beginning of the 1990's, by the Chilean democratic regime. Its basic ideas was that decentralized bargaining was essential to ensure the coincidence between the paths of real wages and productivity, but that the government should not renounce to implement income policies, particularly through the determination of an increasing minimum wage and acting itself as an employer.[8]

4 - MACROECONOMIC PERFORMANCE

We shall see, in this section, that — as a result of the different timings and depths of the reforms — the macroeconomic performance throughout the continent was quite heterogeneous during the 1990's.

4.1 - Government Budget

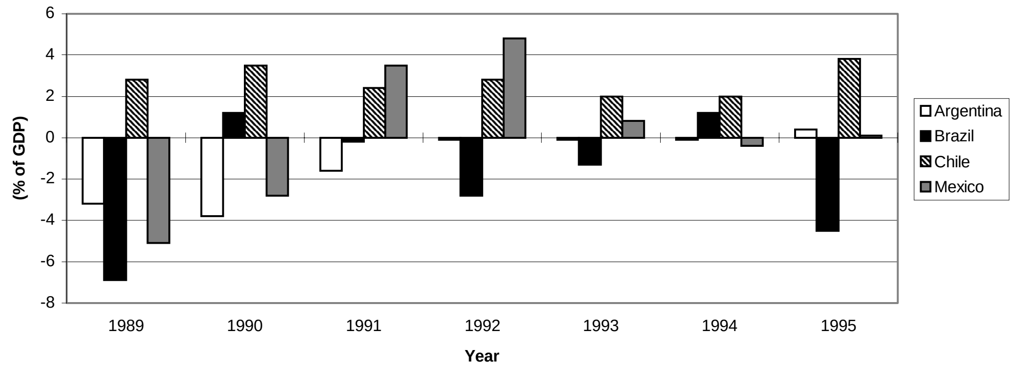
As most of the reforms analyzed in the former section were intended to modify the role of the government in the economy, we start to analyze their macroeconomic impacts by studying what happened with governments surpluses (or deficits).

Figure 2 shows that Chile ended the 1980's with a public sector budget surplus and was able to sustain this situation during the overall period — even after its privatization process was over.

It was followed, in 1990, by Brazil — that, however, was unable to preserve this position: it had new deficits from 1991 to 1993, a small surplus in 1994 and a new strong deficit in 1995 — when Real plan was already in act.

Combining the data of this figure with those of Table 3, finally, one can measure the crucial role of privatization in obtaining balanced fiscal budgets in Argentina and Mexico. This feature enhances the difficulties that were found by these governments to implement fiscal reforms in their countries.

Figure 2
Government budget surplus (or deficit) (1979-1995)



Source: ECLAC (1995).

[8] See Cortázar (1993) for more details.

4.2 - Inflation

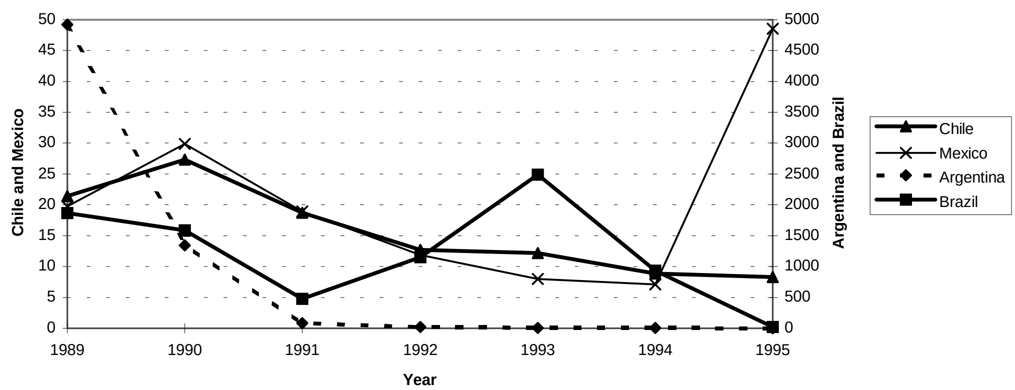
The first countries to implement the reforms (Mexico and Chile) were also the only ones which entered in the 1990's with relatively low rates of inflation. Notice (Figure 3) that, despite of the important differences in the macroeconomic policies implemented in these two countries during this period,[9] their rates of inflation followed very similar patterns until 1994. The divergence was caused by the strong devaluation that the Mexican government had to adopt in order to contain the capital flights that characterized the beginning of Zedillo's government, that multiplied the annual rate of inflation by 4.

In the meanwhile, Argentina and Brazil entered in the 1990's in the middle of hyperinflations.

Argentina was the first to manage to get out of that situation, through trade and financial liberalization **cum** nominal exchange rate fixation practically altogether. The results were astonishing: the annual rate of inflation fell year after year, from almost 5.000% in 1989 to less then 2% in 1995.

Brazil, on its turn, was once again the last-comer: it succeeded to stabilize only in 1994. The reason for the delay is basically that it was the last to implement the reforms which were necessary to adopt such a policy. Even if most of them (as the deepening of privatization, tax reform etc.) were left do be done after stabilization, the financial liberalization implemented in 1992 allowed the accumulation of a significant stock of international reserves — and, therefore, the adoption of an anti-inflationary policy centered on a nominal exchange rate anchor which was very successful in reducing the rate of inflation in the short-run. Its long-run success, however, is mortgaged by the increasing government deficit.

Figure 3
Annual Rates (%) of inflation (1989-1995)



Source: ECLAC (1995).

[9] Chile had continuous government surpluses and a fixed real exchange rate, while Mexico's currency was continuously overvaluated and the balance of its fiscal budget depended crucially of privatization.

4.3 - Growth

Since for a given income inequality, poverty is a negative function of the level of GDP, growth is a key issue to understand the consequences of the reforms on poverty.

It is important to notice, first of all, that the reforms themselves did not had clear effects on GDP performance, at least in the short-run. In contrast, successful stabilization policies proved to have significant expansive effects everywhere in the continent. One of the main reasons for that is the aggregate demand expansion caused by the cut of the inflationary tax. The lack of capability to implement the structural reforms, however, avoided some of the countries analyzed here to transform this instantaneous stimulus in a long-term recovery. Short-run growth caused by an increase of consumption, in fact, tends to deteriorate the trade balance; increasing capital inflows and/or contractionary fiscal or monetary policies are then necessary to clear the balance of payments in order to maintain the exchange rate anchor. The cuts of aggregate demand moderate the recovery's rhythm and induce speculative short-term capital inflows.

The only escape from this vicious circle is to have an aggressive industrial policy in order to obtain high productivity gains (stimulating foreign direct investment through privatization, for instance) and to implement successfully a tax reform during the privatization process.

Chile was the only country, among those analyzed in this paper, which was able to do that. We have seen before in this paper that:

- despite of the fact that its overall privatization process was accomplished in the 1980's, this country was able to manage government surpluses during the entire period;

- its stabilization policy implied a fixed real (and not nominal) exchange rate; and that

- thanks to the fact that its financial liberalization was far more careful than the one implemented in the other countries of the continent, it recorded a predominance of foreign direct investment on short-run speculative capital inflows.

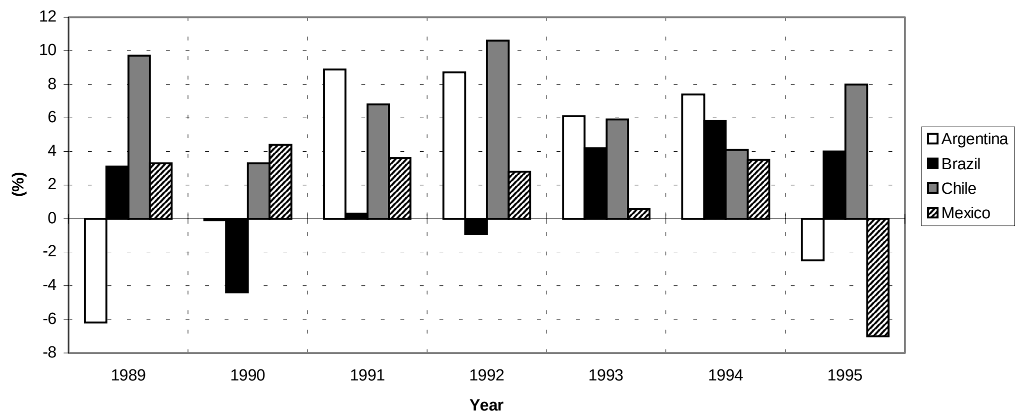
As a result (see Figure 4), it was the only one to record systematically high GDP growth rates throughout the 1990's: in 1995, its GDP was more than 45% higher than in 1989.

Mexico also recorded positive rates (but lower than Chile) until 1994. In 1995, however, the situation was completely reversed, with GDP falling 7%. At the root of this recession are the devaluation and the contractionary macroeconomic policies adopted to contain the balance of payments' collapse of the end of 1994.

As we have seen, the crisis was provoked by a sudden lack of confidence of foreign investors in the government's ability to implement the tax reform which was needed to reduce fiscal and current account deficits, in a context of full financial mobility.

Argentina went from negative GDP growth rates during the hyperinflation of the late 1980's to high positive growth rates after stabilization — and until 1994. Among others, one explanation to the 1995 recession is the need to cut government spending to save the government budget after the end of privatization and to reduce absorption in order to contain the trade balance deficit, since **tequila** effect reduced sharply the net capital inflows in that country.

Figure 4
GDP growth rates (1989-1995)



Source: ECLAC (1995).

Brazil recovered growth just before stabilization, in 1993, after a three-years recession. GDP growth rate, however, increased after stabilization — thanks to a boom of consumption which fastly eroded its trade balance surplus. After Mexico's crisis, thus, the Brazilian government had to relax the nominal exchange rate rigidity to stimulate exports and to adopt a contractionary monetary policy to reduce imports through cuts of aggregate demand. Consequently, its GDP growth rate was considerably reduced in 1995, and by the end of the year became already negative.

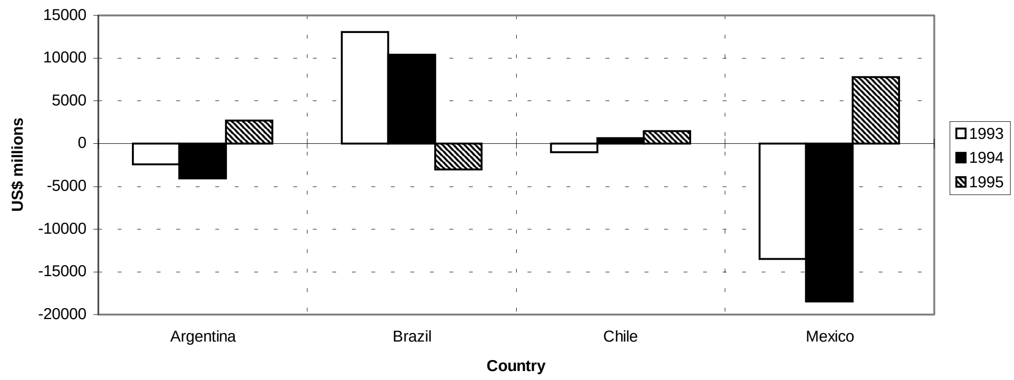
4.4 - Balance of Payments

All the countries that focused their stabilization policies on real exchange rate overvaluation tended to accumulate trade deficits, at least during the first years of the plans (Figure 5) — exacerbating their current account deficits (Figure 6) and thus increasing their demand for capital inflows (Figure 7). Foreign direct investment was multiplied by three from 1990 to 1995, increasing its participation in overall capital flows — particularly after the Mexican crisis.

Argentina recorded increasing trade deficits from 1991 to 1994; its current account deficit reached US$ 10 Billions (or about 5% of its GDP) in 1994. This trend was somehow reversed in 1995 — when the **tequila** effect virtually locked capital inflows; thanks to the recession and to the increasing exports to Brazil — resulting both from Mercosul agreements and from Real plan —[10] Argentina was able to achieve a trade surplus and to reduce by 70% its current account deficit in only one year.

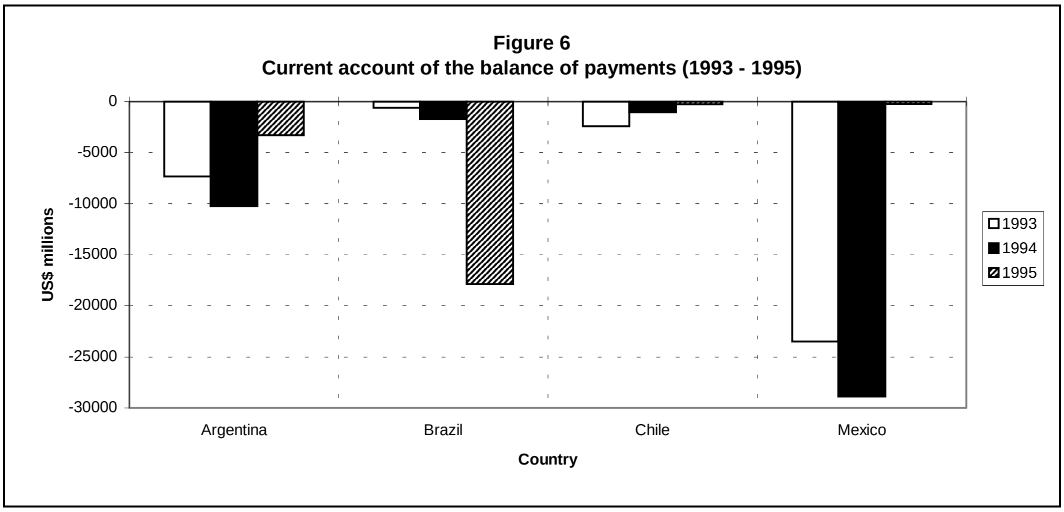
After 13 consecutive years of trade surpluses, in fact and of relatively small current account deficits, Brazil recorded a trade deficit — and thus a current account deficit equivalent to about 3% of its GDP — in 1995, due essentially to an explosion of its imports.[11] By the end of the year, however, the trade balance equilibrium was already restored, thanks to the reduction of GDP growth and to a temporary import tariffs increase. Notice, on the other hand, that — as already mentioned above — the net capital flows became positive before stabilization (thanks to financial liberalization).

Figure 5
Trade balance (1993-1995)

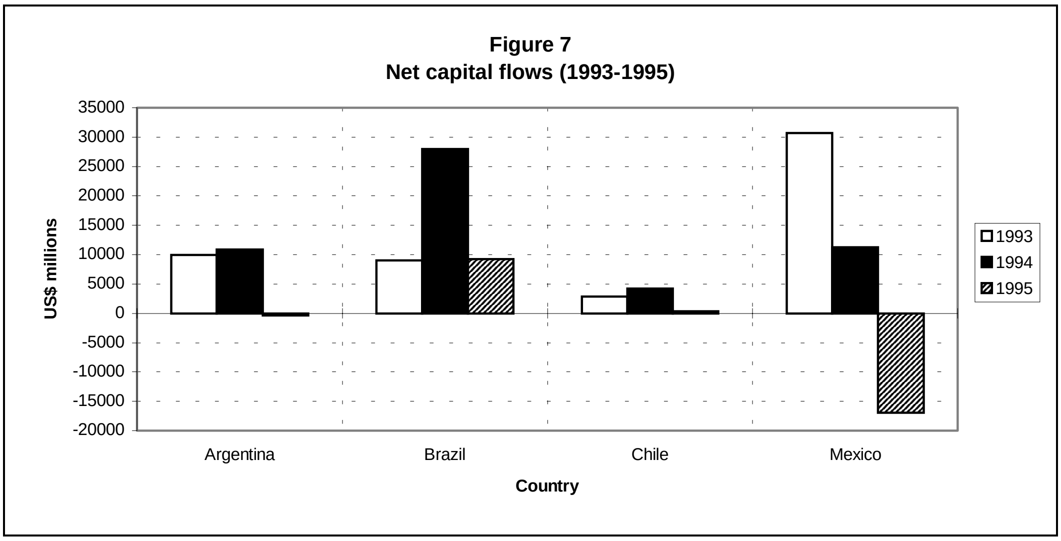


Source: ECLAC (1995).

[10] The real value of international trade among these two countries was multiplied by three from 1990 to 1995.
[11] The Brazilian imports increased more than 50% in 1995, from US$ 33 to US$ 50 billions.



Source: ECLAC (1995).



Source: ECLAC (1995).

The most dramatic case, as it is well-known, is Mexico, where the trade deficit reached 4% of GDP in 1994. The adjustment of the trade balance was, nonetheless, very fast: already in 1995, thanks, to the devaluation and to the recession, the country recorded a trade surplus equivalent to 2% of GDP.

Chile, finally, combined moderate trade balances with small and decreasing current account deficits all over the period — consistently with its policy option to preserve the equilibrium of its balance of payments without having to run over to speculative capital inflows.

5 - “MESO”-EFFECTS: THE PERFORMANCE OF THE LABOR MARKET

Since poor often rely entirely on their labor services to generate primary incomes, the labor market is, of course, central to any consideration of how macroeconomic policy affect poverty. By assuming fully competitive labor markets, most of the theoretical literature on poverty effects of macroeconomic adjustment tends to neglect the complex ways in which labor market might transmit income changes to the poor.[12] Moreover, even when labor market imperfections are taken into account, little attention has been given to what happens when adjustment is implemented simultaneously with stabilization.[13]

5.1 - Unemployment and/or Informalization

Given the starting conditions in which they were implemented, the first labor market impact of structural reforms as a whole — as well as of the exchange-rate overvaluation — is a sharp decrease in the modern sector’s share in the labor force.

There are several reasons for that:

1. **trade liberalization**: as it is pointed out by Cox Edwards and Edwards (1995), labor which is — following the simplest Hecksher-Ohlin textbook model — the factor of production that is supposed to gain from freer trade, is actually negatively affected in the short-run if the wage distortions before the reforms are proportional to the degree of trade protection; i. e., if the starting conditions of the reforms are similar to those which prevailed in most Latin American countries after import-substitution. Under these assumptions, in fact, the immediate effect of a trade liberalization is a decline in the level of employment in the importable sectors and a decrease of wages in the rest of the economy, as some former workers of the importable sectors seek employment there.[14] Some of the sectors which were previously protected simply disappear;[15] other have to proceed to deep re-structuring (and thus massive firings) in order to be able to survive against foreign competition;

2. **the removal of capital controls**: as it is recognized by these same authors, this measure tends to increase employment in nontradables (or traditional) sectors through a positive expenditure effect;

[12] See Addisson and Demery (1995) for more details.
[13] See Urani and Winograd (1994).
[14] The authors also recognize that, as long-term gains are hard to perceive when compared to the initially distorted situation of the economy, one can better understand the opposition towards this kind of reform.
[15] As, for instance, the informatic one in Brazil.

3. **privatization**, once in practice it always implies in a sharp reduction of the number of employees of the firms which are touched by this process;[16]

4. **the administrative reform inside the public sector** itself also means massive firings;

5. **the exchange rate overvaluation** itself, given that it tends to decrease the demand for exportables and increase that of importable goods and services;

6. **the lack of capability to remove nominal rigidities in the labor market**; and

7. **the need to implement tight aggregate demand policies** in order to sustain stabilization, specially when there is a delay in implementing tax reforms.

Whether this formal sector's relative size diminution is translated in increasing unemployment or not, it depends of the capability of the informal sectors to act as good buffers during adjustment.

Figure 8 enhances that the Latin American country in which the open unemployment rate reacted the most to this diminution of formal employment was clearly Argentina, and particularly after 1992: from then to 1995, in fact, the unemployment rate in that country was multiplied by 2,6. Following the timing of the reforms and of their macroeconomic impacts, one should infer that this shift was provoked first by privatization and by exchange rate overvaluation and then, in 1995, by recession itself.[17]

The pattern of unemployment in Mexico was quite different: it started to grow only with the 1995's recession, despite of the intensive privatization and exchange rate overvaluation recorded in the previous years. There are several alternative explanations for that:

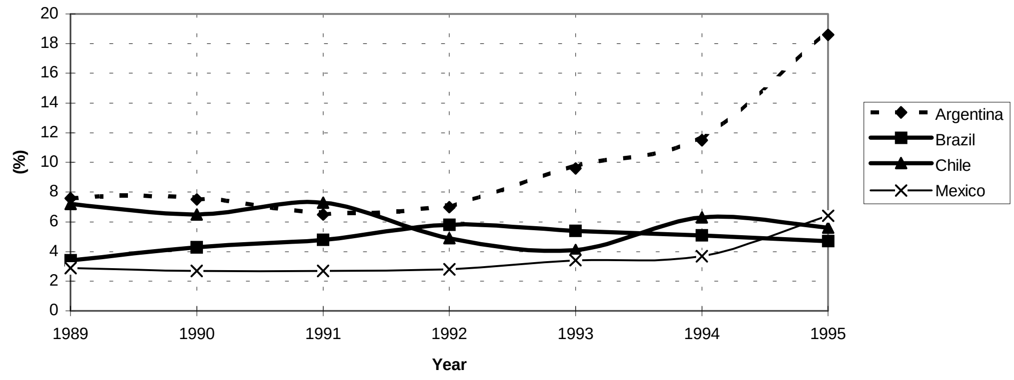
a) the Mexican informal labor market acted as a **buffer** better than the Argentinean did;

b) exchange rate overvaluation in Mexico was not so deep as in Argentina; and

c) privatization did not imply in such a severe diminution of formal employment in Mexico than in Argentina.

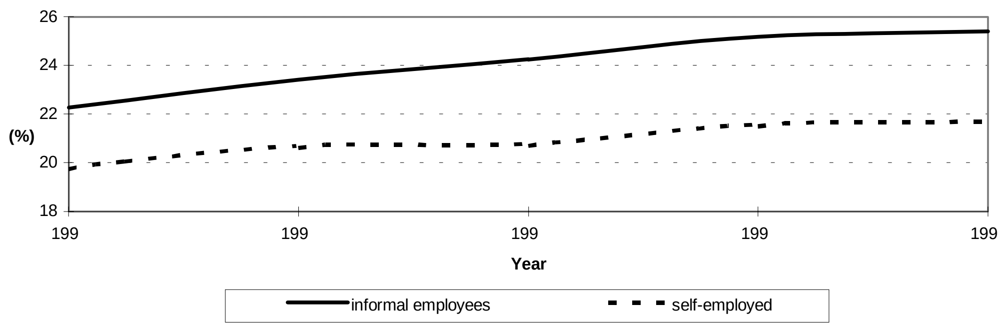
[16] For instance, in the case of the Brazilian Federal Railway Company, the number of employees had to be reduced from 43.000 to 20.000 before privatization.
[17] It is important to notice that, in such a context, unemployment becomes macroeconomically useful in the sense that — pressuring nominal wages downwards — it allowed some persistence to the peso-US$ parity.

Figure 8
Unemployment rates (1989-1995)



Source: ECLAC (1995).

Figure 9
Informal segments participation in overall employment - Metropolitan Brazil (1991-1995)



Source: PME/IBGE in IPEA (1996).

In Brazil the unemployment rate stood roughly stable all over the 1990’s, despite of the strong oscillations of GDP growth rates, of trade liberalization and — from 1994 — of exchange rate overvaluation. This country was, by 1995, the one which recorded the lowest unemployment rate among those analyzed here. As one can see in Figure 9, the main counterpart of the fall of formal employment’s share in total labor force was an increasing informalization of labor relationships: both the self employed and the formal employees segments, in fact, augmented considerably their shares in overall employment.[18]

There are two alternative explanations to the maintenance of this relatively low unemployment rate in Brazil, which happened, it is important to notice, despite of

[18] It is important to stress that these are different phenomena: while the increasing share of informal employees has to be seen as a fruit of the fall of labor demand in the formal sectors, that of self-employed is basically caused by a diminution of the labor supply. Self-employed, in fact, are — in most cases — workers who have accumulated some experience on the labor market and decide by themselves to quit it in change of the perspective of becoming small entrepreneurs. One of the reasons for that — specially in a period characterized by so many sectorial shifts — is that they understand that their skills became less attractive for the firms.

the fact that — in this same period — a relatively solid unemployment insurance system was build:[19]

- as we have seen above, the reforms were implemented slower than in other countries of the region;[20] and

- the strong decrease of the rate of growth of labor supply provoked by the significant drop of the youngest's participation rates in the labor market.[21]

In Chile, finally, the unemployment rate during the 1990's continued its declining path started in the second half of the preceding decade, but not in a monotonic way.[22] If in 1991 its unemployment rate was similar to the Argentinean — on the highest levels recorded at that time around the Continent — in 1995 it had reached Brazilian levels, the lowest.

5.2 - Earnings

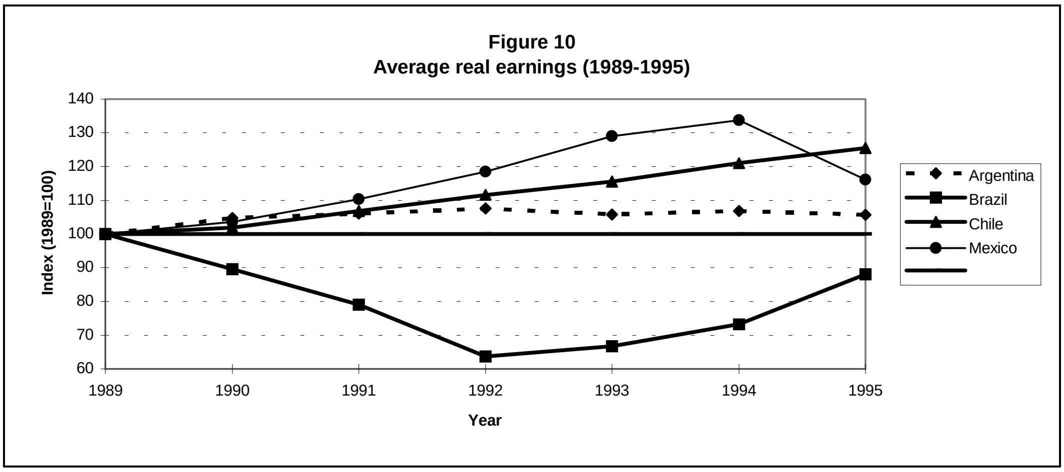
The overall reform package tends to provoke, in the short-run, an increase of real wages, because:

- **trade liberalization** increases competition and hence reduces profit margins; and

- the **decline of seignorage** provoked by stabilization.

The evolution of average real labor earnings differed sharply from one country to another (Figure 10); these differences cannot be explained uniquely by the rhythm and the intensity of the reforms.

[19] See Azeredo and Chahad (1994) for further details on this issue. Only in 1995, around 4.700.000 persons (something like 7% of the entire labor force) had received benefits from this system.
[20] And with some "stop-and-go"s; in 1995, for instance, import tariffs were temporarily increased in order to protect some sectors or regions from massive unemployment.
[21] The overall participation rate in Metropolitan Brazil fell from almost 64% in 1990 to 59% in 1995. This shift is entirely due to what happened to the youngest: for instance, the rate of indivividuals between 15 and 17 years old was reduced from 42 to 31% during this period. For more details, see IPEA (1996b).
[22] It is important to remember that the unemployment rate in Chile during the first half of the 1980's reached 25%, which is one of the highest rates ever recorded in Latin America.



Source: ECLAC (1995) and IPEA (199.b).

In Argentina, for instance, average real wages were roughly constant for the whole period analyzed here, i.e., before and after stabilization and structural adjustment. In other terms, the Argentinean workers were not able, during the first half of the 1990's, to incorporate the productivity gains to their real wages. There are at least two reasons for that loss of bargaining power:

- the **neo-liberal** reform of the labor market, that has considerably weakened the bargaining power of the trade unions; and

- the tremendous increase of the rate of unemployment.

In a sharp contrast with that, Chile maintained throughout the period a constant rate of growth of the average real wage; in 1995, it was more than 25% higher than in 1989.

The increase of the average real wage in Mexico was even higher than in Chile from 1989 to 1994; in 1995, nevertheless, it felt more than 13%, in response to the acceleration of the rate of inflation provoked by the peso devaluation and to the recession.

In Brazil, finally, the average real wage was cut by more than one third during Collor's government (1990/92),[23] partly because of the deep recession, partly due to the persistence of high and increasing rates of inflation. It started to recover at the end of the recession, in 1993, and continued this new path after stabilization, in 1994/95. At the end of 1995, however, it was still more than 10% lower than in 1989.

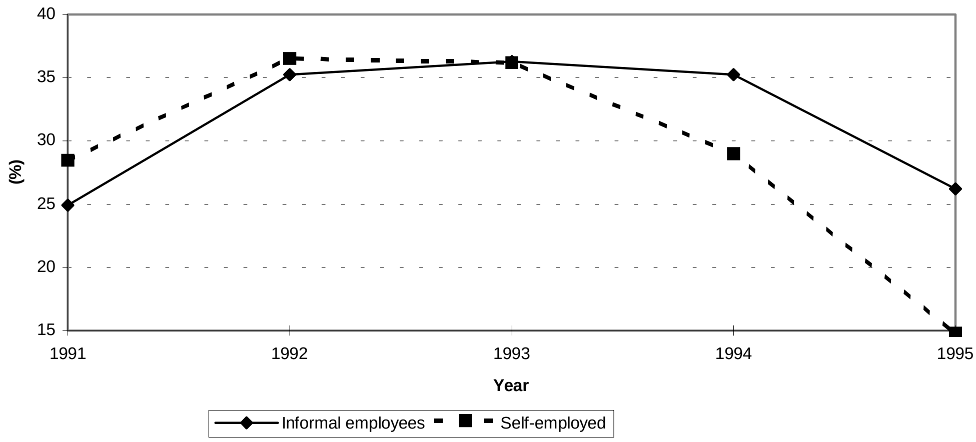
The evolution of average real earnings, however, hiddens significant contrasts of behaviour among the different segments of the labor market.

[23] These data concern the six main Brazilian metropolitan areas, i.e.: Porto Alegre, São Paulo, Rio de Janeiro, Belo Horizonte, Salvador and Recife. See Urani (1994) for more details.

In the Chilean case, for istance, the increase of real wages was far more important in the more modern sectors — where the workers were able to merge productivity gains to their earnings through decentralized collective bargaining — than in the less protected ones.[24]

Formal/informal segmentation, however, can be — in some cases (as the Brazilian) — even more important than the one inside the formal sector. It is well known, in the literature, that if the informal sectors act as buffers, their average income differentials towards the formal tend to increase during recessions and **vice-versa**. It is typically what happened in Brazil during the first half of the 1990's, as one can see in Figure 11.

Figure 11
Formal/Informal income differentials in Brazil



Source: IPEA (1996b).

Another important effect is however very seldom considered: when stabilization is obtained through exchange rate overvaluation and indulgent demand managing policies, the effect depicted above is magnified, given that:

- the combination of fixed nominal exchange rate and increasing aggregate demand tends to provoke an increase of non-tradable sectors relative prices;

- informal workers (both self-employed and informal employees) are likely to be more represented in the non-tradable sectors; and

- their incomes are determined through market forces rather than by specific policy rules.[25]

[24] There was a continuous increase of the minimum wage in real terms, but still considerably under the average productivity gains; the overall increase in the real minimum wage during the 1990's did not exceed 10%.
[25] See Camargo and Ramos (1988), Urani and Winograd (1994) and Urani (1995.a) for further details.

6 - SOCIAL OUTCOMES

6.1 - Income Inequality

We have seen above that the effects of the reforms as a whole on income distribution are ambiguous. On the one hand, they reallocate workers from the formal/protected sectors to unemployment and/or to the informal labor sectors, where average earnings are lower. On the other — at least in the short run — not the structural reforms themselves, but the stabilization that accompanied them, gives rise to an increase of the overall average earnings and a decrease of the formal/informal wage gap.[26]

A first remark to be done is about the need to separate — as far as possible — the effects of stabilization from those of the structural reforms.

Much of the international literature on these issues enhances that stabilization produces an increase of income inequality.[27] The main reason for this is that this literature is focused on what happened in the early 1980's, when they consisted in a combination of fiscal and monetary austerity with exchange rate devaluation. Income inequality increased because:

- exchange-rate devaluation produces an acceleration of inflation, which hits the poorest more than the richest; and

- cuts in aggregate demand induces an increase of unemployment (or of the informal sectors' share on employment) in the non-tradable sectors, while they maintain the average real wage in the formal sectors (both tradable and non-tradable) untouched.

As we have seen above, however, the stabilization policies which were adopted during the 1990's can be considered as the opposite of the ones of the 1980's, in the sense that most of them relied on exchange-rate overvaluation and on increases of aggregate demand. They produced, hence, a decrease of income inequality through:

- a sharp diminution of the inflationary tax, which uses to hit more the poorest than the richest; and

- the increase of the non-tradable/tradable sectors' relative prices that — as we have already seen — benefits the informal workers, and therefore the poorest.

Notice, however, that while the first effect is a "once-and-for-all" one, the second is ephemeral, specially in those countries where the government is not able to accomplish the reforms that are necessary to the recovery of sustainable growth. If, in the medium-run, the government has to sustain tight aggregate demand

[26] See Addisson and Demery (1994) for a theoretical framework which arrives to very similar results.
[27] See, for instance, Urani (1993) and Hoeven (1995).

policies to sustain the stabilization effort, income inequality will increase again, since formal employment in the non-tradable sectors will decline.

For what concerns structural reforms, their overall effect on income inequality is ambiguous, once:

- trade liberalization should induce a more efficient resources' allocation — at least in the long-run. According to Stopler/Samuelson postulate, in the Latin American countries this should increase the demand for the low-skills intensive sectors, and thus reduce income inequality, once human capital results to be one of the main determinants of wages dispersion in the continent. It happens that — at least in Brazil the tradable sectors — are (and increasingly after trade liberalization) high-skills intensive;[28]

- the overall package of reforms (trade and financial liberalization, privatization etc.) tends to increase productivity (and therefore welfare) in the long-run; in the short-run, however, they can — as we have seen above — induce an increase of open unemployment and/or of informality, and thus an increment of income inequality.

In practice, the patterns of the countries analyzed here were very different throughout the period.

Argentina and Brazil are cases of increasing income inequality throughout the 1980's (with hiperinflation), and decreasing after stabilization. Nevertheless, it is important to notice that there are no avaliable data to analyze what happened after the short-run expansive effects were over.[29]

In the case of Mexico, structural reforms impacts on income inequality prevailed on those of stabilization: according to ECLAC, in fact, from 1984 to 1989 the Mexican Gini coefficient for urban areas went from 0.321 to 0.424. From 1989 to 1992, however, it decreased slightly, reaching 0.401.

In the Chilean case, income inequality was maintained roughly constant from 1987 to 1992 (during which the Gini coefficient was reduced from 0,459 to 0,452).

[28] See Barros **et alii** (op. cit.) for further details.

[29] Argentina experienced an augmentation of its income inequality during the 1980's. According to ECLAC (1994), its Gini coefficient in urban areas went from 0.365 in 1980 to 0.423 in 1990. After stabilization, however, it started its way-back, reaching 0.408 in 1992. The performance of income inequality in Brazil was definitely more erratic. First, it decreased significantly during the 1990/92 recession. Then, it increased with the recovery of growth and of inflation in 1993/94. Finally, it decreased sharply, once again, after stabilization.

6.2 - Poverty

At this point, the pattern of poverty is not difficult to explain.[30] In fact, for a given income inequality, the proportion of poors is negatively correlated to GDP growth; inversely, for a given GDP, it is directly related to income inequality.

It is also interesting, nonetheless, to identify the groups of poor that were the most affected by stabilization and structural adjustment.

In the case of Chile, the reforms themselves clearly augmented poverty when they started, in the mid-1980's, since they produced sharp sectorial shifts towards the tradable sectors and then a drammatic increase in overall open unemployment.[31] After that, however, it was possible, to that country, to recover sustainable growth maintaining a constant income inequality.[32] Thus, the proportion of households living under the poverty line started to decrease year after year, from 38% in 1987 to 28% in 1992.

In Argentina, the late 1980's "hyperstagflation" provoked an increase of inequality and a decrease of **per capita** GDP; hence, the proportion of poor households was increased from 9% in 1986 to 16% in 1990. Most of the new poors were wage-earners, the more sensible to accelerations of the rate of inflation. This trend was reverted thanks to the diminution of income inequality induced by stabilization and by the recovery of growth: in 1992 the proportion of households living under the poverty line was already back to the same rate recorded in 1986 (9%) — and possibly also to a very similar composition. Notice, however, that most of the structural reforms (as the greater part of privatization) had, at that time, still to be done. In the following years, with the consolidation of trade reforms (and particularly of Mercosul Agreements), privatization, increasing mergers and aquisitions in the banking sector and so on, the unemployment rate started — as already noticed — to grow exponentially. Most of the new unemployed, in this case, came from those which were, during import-substitution, the "protected workers" (that, in this particular case, are likely to be in the non-tradable sectors more than in the tradable). This effect was magnified, in 1995, with the cut of aggregate demand that was done in order to sustain the fixed nominal exchange-rate anchor of the stabilization policy.

In Mexico, until the end of the 1980's the impacts of increasing inequality on poverty was greater than that of GDP growth: the headcount increased from 34% in 1984 to 39% in 1989. Among the new poors, the most represented were possibly those which were hurted by the sectorial shifts provoked by the reforms. After that, however, thanks both to economic growth and to the falling inequality, it fell back to 36% in 1992. There are not available data to check this, but one should expect that the poverty continued its decreasing path until 1994 and then increased after the crisis. The reasons for this augmentation of poverty are more

[30] Whatever is the measure of poverty which is chosen. The data analized in this section are from ECLAC (1994).
[31] That reached around 25% of the labor force.
[32] Which resulted from a combination of increasing inequality among employed and the declining share of unemployed.

complex than in Argentina -- and very similar to those (already depicted) recorded throughout Latin America during the early 1980's, i.e.:

- devaluation augmented the rate of inflation, hitting the poorest more than the richest; and

- cuts in aggregate demand provoked an increase of unemployment (or of the informal sectors' share on employment) in the non-tradable sectors.

In Brazil finally, the augmentation of poverty during the 1980's had the same roots that in Argentina — even if it was not so deep as in that case, thanks to more moderate stagflation. From 1990 to 1992, despite of the diminution of income inequality, poverty augmented, as all the deciles of income distribution recorded losses in their average real incomes.[33] Among the new poors, one could find predominantly those which had lost their jobs both because of structural reforms and of the sharp diminution of aggregate demand. From 1993 to mid-1994, the proportion of poors stood roughly constant:

- on the one hand, some of the poors became non-poor, thanks to the decline of unemployment induced by the recovery of GDP growth; and

- on the other, as the rate of inflation augmented significantly, some of the non-poor (wage-earners) became poor.

The instantaneous effect of stabilization was an intense decrease of poverty, both through the increase in the rhythm of GDP growth and through declining inequality.[34] Finally, as it happened in Argentina, the need to adopt contractionary demand policies to maintain the stabilization effort meant increasing poverty through an augmentation of the rate of unemployment.

7 - CONCLUSION: WHAT'S NEXT?

Structural reforms as a whole can reduce poverty in Latin America in the long-run: they are likely to decrease functional income inequality and to offer an alternative (which does not exist any more in the import-substitution framework) for the recovery of GDP growth. Nonetheless, in practice they have implied, in the short-run, significant sectorial shifts, and consequently important social costs. These costs were actually substantially reduced, however, when the reforms were accompanied by a successful stabilization policy, since it induces high GDP growth and decreasing inequality — at least in the short-run. This is basically why the reforms have to be implemented at the same time than stabilization.

The success of stabilization itself, though, can represent an obstacle to the pursue of the reforms, specially when the governments are not able to make their citizens

[33] See Urani (1994) for more details.
[34] See IPEA (1996.a) for further details.

foresee their long-term benefits and/or are not prepared to face their short-term social costs.

The Latin American experience depicted above shows that the recovery of sustainable growth is only possible if the reforms are completed. Hence, as in the absence of GDP growth the reduction of poverty becomes extremely difficult, since it has to be induced through a decrease of income inequality, for most of the countries analyzed here (except Chile), the main task is that of accomplishing the reforms.

It is important to recognize, however, that even when they are accompanied by stabilization, the reforms can have short-run negative effects on poverty, that can inhibit their rhythm. In most cases, the social security nets that were in place to face these costs were extremely weak and based upon institutional frameworks that were not build for that purposes. They have thus to be significantly reformed and reinforced, towards public employment systems where unemployment insurance, retraining and reallocation mechanisms would have to act together.

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