The Political Economy of Distributional Equity in Comparative Perspective

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ABSTRACT

Growing income inequality within a country is caused by socioeconomic factors and inadequate government policies and ultimately leads to social and political instabilities. The ideology of supply-side economics in the United States and the United Kingdom during the 1980s, for instance, induced policies of inequality which were then perceived as a way to stimulate economic growth. The demise of East European socialism since the late 1980s also led many developing countries to pursue market reforms as a way to resuscitate their moribund economies. There is evidence, however, to indicate that the distribution of income in these countries is becoming more unequal with attendant and frequently grave social and political consequences.

RESUMEN

La creciente desigualdad en la distribución del ingreso en un país es causada por factores socioeconómicos y por políticas gubernamentales inadecuadas y, finalmente, conduce a la inestabilidad política y social. La ideología de la economía de la oferta en los Estados Unidos y Gran Bretaña durante la década de los años ochenta, por ejemplo, produjo políticas que propiciaron una mayor desigualdad, políticas que fueron percibidas en ese entonces como una manera de estimular el crecimiento económico. La desaparición del socialismo en Europa oriental a partir de finales de los años ochenta, también condujo a muchos países en desarrollo a buscar con afán reformas de mercado como una manera de resucitar sus economías moribundas. Sin embargo, hay evidencia que indica que la distribución del ingreso en estos países se está haciendo cada vez más desigual, trayendo consigo graves consecuencias políticas y sociales.

Although many economists continue to believe that equity follows growth, an increasing number of them argue that inequity follows growth, which in turn can hamper further growth. Income disparities, especially when accompanied by continued increases in poverty as is the case in the United States, will lead to high economic costs. Since low-income households spend a larger proportion of their income, growing inequality leads to less aggregate demand. Inequality also leads to increased costs of social programs and lost productivity due to reduced access of the impoverished to health care and training. Moreover, real costs in a highly inequitable society may come with increased political instability and social conflicts between the 'haves' and the 'have-nots.'

This paper reevaluates from an international comparative perspective the relationship of distributional equity to growth. While economists mostly look at the measurement, nature, and causes of equality or inequality, the question that is given special attention here concerns the social and political consequences of income distribution. The paper compares the broad implications of income distribution for the economy and society by observing cross-country experiences, and collects insights for policy that can be gleaned from the comparisons. The main part of the paper compares the regions of the global economy in terms of levels of and changes in distribution, the relationship of equity to growth, and the distribution's social and political consequences. The concluding section highlights policy implications.

I. DISTRIBUTION EQUITY: A GLOBAL PERSPECTIVE

Over the past fifty years since the end of World War II, world income in real GDP has risen sevenfold and threefold in terms of per capita real GDP. But the fruits of economic growth have not been shared evenly. Between 1950 and 1990 the gap between the industrialized countries (OECD nations) and the rest of the world widened by 60% (World Bank 1992, 218–19). The richest quintile of the global population now earns income on a per capita basis about 50 times that of the poorest quintile and accounts for well over four-fifths of global income. One of our greatest contemporary paradoxes is that although current worldwide production of grain, for instance, could provide every person on earth with more than sufficient calories and protein for a healthy daily life, one person in five still lives in hunger and is malnourished (Harvard School of Public Health 1988).

Growing inequality among nations is accompanied by that within national boundaries. Many developing nations—more recently, several developed nations as well—are experiencing a widening gap in income as well as wealth holdings between their rich and poor citizens. In terms of asset distribution, De Garcia and Johnson (1988) calculated that in the 83 poorest countries of the world, a meager 3% of their people control more than 80% of the land. Severity in inequality and its consequences has varied from region to region of the global economy. Income inequality is on the whole relatively less severe in the industrialized West, which is a common heritage of political democracy. Recently, diverging trends in levels of inequality within the industrialized group have emerged: beginning in the 1980s, inequality in the United States has steadily increased, accompanied by more than its share of poverty-related social violence and instability. In the case of emerging democracies in Asia, Africa, Latin America, and the former East bloc, increased income inequalities caused by abrupt market reform threaten the very process of transition to democracy. Distribution inequity in these countries has frequently deepened social crisis by heightening the tensions and conflicts among classes, which has retarded sustained economic development. In what follows, the trends in distribution and its sociopolitical consequences will be examined in different regions of the global economy.

1. Industrialized Democracies

Trends in Growth and Distribution

Rich, industrialized countries are generally known to have more equal income distribution than low-income, developing countries. Beginning in the early 1980s, however, some diverging trends in income equality have appeared among industrialized democracies. Growth in trade with and investment in the developing countries, coupled with rapid technological advance, has reduced demand for unskilled workers, thereby depressing wages in much of the industrialized world (Wood 1994).

Among the OECD nations, the United States—economically the most powerful country in the world—has recently emerged as the least equal country (Atkins, Rainwater, and Smeeding 1995). Japan, the second most powerful economy, provides a sharp contrast in terms of income equality: postwar Japan had an equitably shared economic growth, which paved the way for its social and political stability.

During the 1970s the Japanese economy expanded at an average annual rate of close to 10% and had perhaps the most even distribution of income among industrialized countries. As shown in Table 1, in 1975 the income share of the lowest income class in Japan exceeded that of the welfare-oriented Nordic and other Western European countries and was about twice that of the United States. As for the US, the decades of the 1960s and 1970s saw greater equality of incomes; the Gini index fell steadily from a high of 0.364 in 1960 to 0.356 in 1980. The trend then reversed throughout the 1980s, with the Gini coefficient rising to 0.401 in 1989 and to 0.426 in 1990. During the 1980s supply-side policies were introduced in the US, which turned out to reward the well-to-do and extact heavier tolls from more vulnerable groups of society. The US reversal is reflected by the widening of inequality gap between the US and Japan, as shown in Figure 1.[1]

Table 1

International Comparison in Family Income of Lower Income Groups as Percent of the Total Average (1975) (unit = %)

Country	Bottom 10% of all families	Bottom 20% of all families
Japan	32	34.5
Germany (West)	29	32.5
The Netherlands	28	32.5
England	27	31.5
Norway	25	31.5
Sweden	24	33
Australia	21	33
Canada	15	25
USA	15	22.5
France	14	21.5

Source: Agnew (1987, 138).

The experiment of Reaganomics moved the US steadily toward a two-tiered distributional structure of haves and have-nots. In 1990 the gap between rich and poor reached an all-time high since family income statistics were first published in 1947. According to government estimates,[2] between 1980 and 1990 the richest fifth of American families were the only ones whose income share increased while the share received by the other 80% declined. Among the well-to-do, the top 5% received 17.4% of all family income, earning more income than the poorest 40% combined.[3] The wealthiest 1% received an astounding 60% of the growth in after-tax income between 1977 and 1990.[4] On the other hand, the families at the median of income distribution saw their income go up only 4%, to $36,000. The bottom 40% of families experienced actual declines in income. In particular, the lowest 20% group's income fell by as much as 9% during the period between 1977 and 1990.[5]

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1 Both the Japanese and US data are the total household money income before taxes and exclusive of capital gains. Comparison of the trends using after-tax income shows similar results.

2 US Department of Commerce, Bureau of the Census.

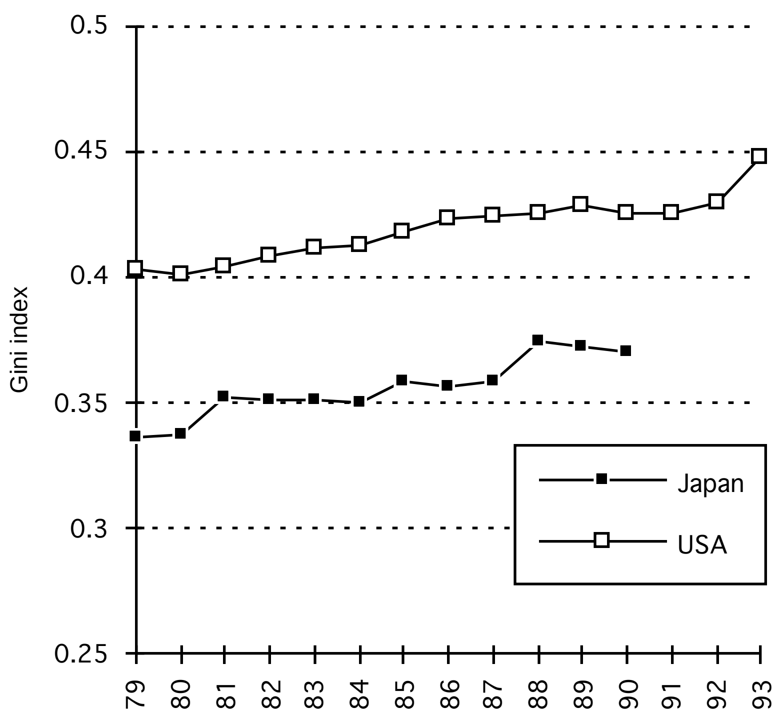
3 From the perspective of an alternative measure, in 1980 the richest 25% of the American population had 6.3 times as much income as the poorest 25%. By 1992 the richest 25% had eight times as much as the poorest 25%.

4 In 1977 there were 660,000 families each of which had an annual income of at least $310,000 for a household of four. The average pre-tax income of families in the top 1% swelled to $560,000 annually from $315,000, for a 77% gain in 12 years (in inflation-adjusted dollars).

5 *The Congressional Budget Office Annual Report* 1992 (Washington, DC). See also *The New York Times*, 5 March 1992.

Figure 1

Trends in income distribution: US and Japan



Source: For US data, Bureau of the Census; for Japanese data, see Mizoguchi (1992).

In Japan the land reform initiated by the Allied Occupation Forces at the end of World War II and subsequent improvements in the agricultural terms of trade gradually eliminated rural poverty.[6] Japan's central and local governments quickly enforced a universal education system at the basic and secondary levels. The economic success of the earlier postwar era made it possible for governments to implement comprehensive social security and national health programs. Japan now is considered as one of the most developed countries in these fields. Over 90% of the population consider themselves middle class.

6 Mizoguich and Takayama (1984) claim that poverty in Japan is a sociological and political problem rather than economic. The existence of poverty pockets in the Japanese community is largely due to social segregation of ethnic minority and psychologically handicapped groups.

Political and Social Consequences of Inequality

The recent deterioration in income distribution in the midst of economic slow-down in a number of countries of the industrialized West has prompted damaging changes in each nation's economic and social fabric, frequently threatening changes in political regime. In the United States the deterioration in the distribution was accompanied by a rise in the incidence of poverty.[7] The proportion of the nation's population officially counted as poor rose from 11.7% in 1980 to 13.1% in 1988 and to 14.2% in 1991.[8] Racial minorities, in particular, blacks and Hispanics, have been especially hard hit by economic changes.[9] The uneven impacts of economic changes have not been confined to the working poor. The burden of the recession in the late 1980s, for instance, fell heavily on middle America as well: Job displacement became prevalent among blue- and white-collar occupations, which was then reflected in the rapid increase in the number of the homeless on city streets.

Neoliberal economic policies have had grave sociopolitical implications in the United States. According to the UN-developed Human Development Index (HDI), which provides a broader measure of social well-being in addition to income,[10] the US, which ranked second in per capita income in 1987, fell to nineteenth place, or last among the OECD nations, in 1990 (UNDP 1990). Japan had the best overall rating, followed by Sweden, Switzerland, the Netherlands, Canada, and so forth.

A serious issue in the US, which is not considered in the HDI, is the problem of social unrest and violence. Past failures of US government policies to safeguard equitable sharing of the benefits from growth are a major cause behind the rise in economic-incentive-related crimes and social unrest. The racial riots that have scarred American cities in the recent past may have been fueled by race-related issues, but their root cause can invariably be traced to economic inequality and deprivation. In terms of social violence, over the period from 1983 to 1992 the crime rate per population rose 19.2% with the violent types of crime[11] increasing by 40.9% (Federal Bureau of Investigation 1992). Property crimes, which account for more than 85% of crimes in the American community, also increased over the period, though at a somewhat slower rate of 5.7%. The majority of violent crimes included robberies which can be considered as related to economic incentives for criminality.

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7 This indicates the proportion of the population whose income falls below a government-defined poverty level. The poverty income for the US household is defined on an annual basis at the level of three times its inflation-adjusted, normal expenditure on food.

8 US Bureau of the Census. See also *The New York Times*, 4 September 1992.

9 In 1988, the incidence of poverty was 10.1% for whites, 31.6% for blacks, and 26.8% for Hispanics.

10 The HDI compares life expectancy, literacy rate, and other health-related variables.

11 According to the FBI classification scheme, violent crimes consist of murder, rape, robbery, and aggravated assault; and property crimes of burglary, larceny-theft, and motor vehicle theft.

Many state and local governments in the US have been rapidly increasing expenditures on the upkeep and construction of prisons. As of 1993 the number incarcerated reached 1.9% of the male work force and 8.8% of the black male work force (Freeman 1994). Massive imprisonment of criminals has not deterred violence, as the victims of growing inequality and economic deprivation continue to seek redress through violent means. In tandem with rising trends in incarceration, the propensity to commit crime among the noninstitutionalized population has persistently risen.

The contemporary American experience contrasts with Japan's. From a historical perspective, Japan's industrialization strategies in the pre–World War II era led to a concentration of wealth with consequent widespread poverty. Estimates of the Gini coefficient for prewar Japan have ranged from a high of .62 in 1923 to .49 in 1937 (Minami, Kim, and Yuzawa 1994, 360). During the 1920s and the first half of the 1930s the rural-urban income gap in Japan widened, accompanied by frequent disputes between urban landowners and tenant farmers. The government, which was allied with the conglomerate of family-owned businesses, *zaibatsu*, largely failed to resolve the disputes. This climate triggered interventions from Japan's young military faction in sympathy with the distressed farmers. Though two mutinies by young officers—one in May of 1932 and the other in February of 1936—failed, a large segment of the Japanese population began to sympathize with the rebels, paving the path to the rise in Japan's militarism. Thus, Minami (1986, 149–50) points out that behind the move toward militarism in prewar Japan were increasing income inequality and growing dissatisfaction among the working population.

Post–World War II Japan, after successfully implementing policies for the redistribution of assets, has been relatively free from the epidemic rise in criminality that has accompanied industrialization and urbanization in other industrialized democracies, having had one of the lowest crime rates in the industrialized world. The earlier comparisons, as shown in Table 2, are particularly striking. Although different country definitions of crimes and accuracy of crime reports render international comparisons less meaningful, the contrast in magnitude and the trends in crimes rates as reported in the table is nonetheless striking. More recent data show similar trends: the average number of offenses committed per 100,000 inhabitants in 1986–88 was 1.3 in Japan, as against 5.7 in the United Kingdom and 8.4 in the United States. The corresponding figure for crimes against property is 1,135 per 100,000 as against 4,432 in West Germany, 5,634 in the United Kingdom, and 4,943 in the United States.

There are certainly social and cultural factors contributing to low crime rate in Japanese society: the cultural and ethnic homogeneity in Japanese society leads to fewer internal conflicts than in societies with diverse ethnic origins. In Asian societies traditional institutions like family, school, and local community are able to exert social control over the behavior of community members with reasonable effectiveness. Nonetheless, the fact that crime rates, particularly of economic-related crimes, declined during the period of rapid growth with sustained equitable distribution in the 1970s reveals that Japanese were generally satisfied with economic conditions.[12]

Table 2

Crimes on Police Records in Selected Countries, 1975
(Rate per 100,000 population)

Country	Total	Murder	Rape	Robbery	Theft
United States	5,282 (+233)[a]	9.6 (+125)	2.6 (+226)	218 (+331)	4,800 (+230)
England	4,278 (+193)	2.3 (+100)	2.1 (+102)	2.3 (+462)	2,483 (+151)
West Germany	4,721 (+44)	4.8 (+143)	11 (+6)	33 (+252)	3,111 (+123)
Japan	1,101 (-11)	1.9 (-21)	3 (-42)	2.1 (-56)	927 0

[a]Figures in the parentheses show percentage changes from 1960 to 1975.

Note: For the United States, the total crime rate in 1992 was 5,660.2 (Federal Bureau of Investigation, 1992), which shows an additional increase of 60% over the period from 1975 to 1992.

Sources: Japan: Ministry of Justice, *Hanzai Hakusho* (Annual, 1977).

2. The Developing World

Income distribution varies distinctly by regions in the developing world; East Asian Newly Industrialized Countries (NICs) have attained rapid economic growth with equity. In most of Latin American and African countries the distribution of income has worsened, coupled with increased impoverishment of more vulnerable classes in society. Distributional inequity in these countries has been an important cause of heightened social tensions and conflicts among economic classes, frequently resulting in social unrest and political instabilities. In a number of emerging democracies in Asia, Africa, East Europe, and Latin America, increased inequality exacerbated by recent market reforms threatens the very process of democratization.

[12] A slight increase in the crime rate in the recent years of the bubble economy may be attributable to the changed economic conditions.

2.1 Sub-Sahel Africa

Trends in Growth and Distribution

No region is poorer than Sub-Sahel Africa. In the recent past many African governments have embraced market realities and embarked on market reform measures. Although several countries experienced marked gains in economic growth, those adjustment polices have not successfully reduced poverty. Poverty in Africa is largely a rural phenomenon, since most poor people (about 60% of the continent's population) depend on agriculture for jobs and income. According to a recent United Nations (1993–94, 8) estimate, the self-sufficiency rate in cereals for Sub-Sahel Africa fell from a high of 97% during 1969–71 to 86% in 1988–90 in comparison to the self-sufficiency rate of 91% for all developing countries in 1988–90. The UN data also show that during 1988–90 some 175 million Africans went hungry and, in the absence of viable alternatives to drastically boost production of food crops and livestock products, in 2010 some 300 million people, one-third of the continent's population, would suffer the "scourge of chronic undernutrition."

African poverty is shaped by social forces reflecting imbalances in resource allocation. Progress in redistributive land reform is limited by political constraints; the rural poor have limited access to credit, land, and extension services; lack of both genuine political commitment and strong public sector support for rural producers is another major factor exacerbating rural poverty. In this context, the impacts of structural adjustment policies which typically focus on macroeconomic financial problems have often failed to reach the rural poor and are in some instances blamed for the exacerbation of poverty. The World Bank acknowledges that after a decade of implementing structural adjustment programs, not many African countries have succeeded in a sound macroeconomic policy.[13] The Bank considers Ghana to have the most effective adjustment policies but predicts that the poor in Ghana will not cross the poverty line for another fifty years.

African countries will face a further deterioration in their economies as trade liberalization on a global scale unfolds. The new General Agreement on Trade and Tariffs (GATT) will likely diminish African export revenues as existing tariff preferences for Africa are eroded under multilateral trade liberalization. In particular, food-importing countries in Africa will be hit hard by higher world food prices brought on by reductions in agricultural subsidies in European countries. Furthermore, because of the failure to bring the Multi-Fibre Agreement under GATT discipline, many African countries are likely to experience reductions in growth rates of textile exports.

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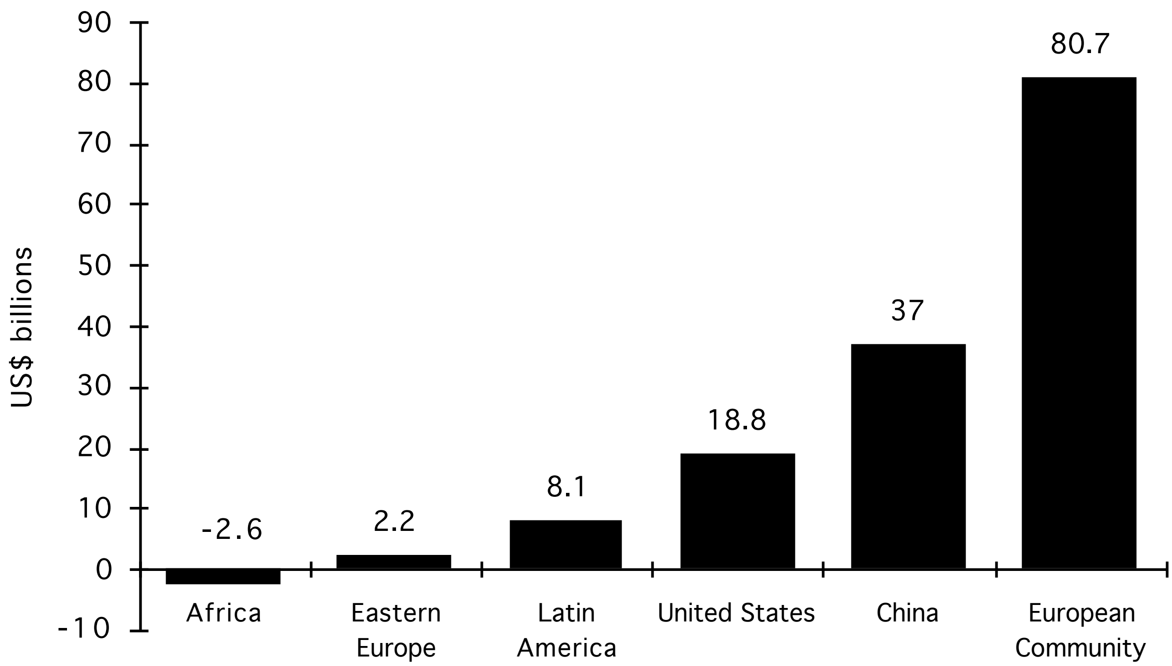
13 See also United Nations (1993–94, 18).

Recent OECD calculations, as shown in Figure 2, show that net annual losses for Africa could reach $2.6 billion in the period to 2002. In contrast, the OECD countries reap $135 billion or 64% of total annual gains in world income from the new GATT (Goldin et al. 1993).

Figure 2

GATT Winners and Losers (Projections to year 2002)



Source : UN Department of Public Information, *Africa Recovery*, December 1993–March 1994, 9.

Political and Social Consequences of Inequality

The gravest concern in Africa over the past two decades has been the biological survival of humanity. According to a UN Food study (1993–94), undernutrition and disease is more widespread today in Sub-Sahel Africa than it was 30 years ago and could remain 'rampant' in the absence of a major effort to increase indigenous food production. The continent is already deep in financial crisis and heavily dependent on food aid, and faces the prospect of net cereal import needs which are expected to more than double to some 20 million tons a year by 2010.

The extreme poverty for the masses is exacerbated by a lopsided distribution of resources to a few elites, which largely reflects ineffective and corrupt systems of governance.

Widespread hunger in Africa often escalates into famine, political violence, and armed conflicts. The recent armed conflicts in both Somalia and Rwanda are illuminating cases. In Somalia, as the grazing land and water points diminished due to accelerating environmental degradation, disputes over resource use became a major factor in the clan rivalries that eventually led to political violence. In Rwanda the ruling regime of the Hutu tribe attempted to constrain the use of land by the rival clan, the Tutsi. Ultimately this led to the formation of a rebel army by the Tutsi, which took power in Rwanda through force of arms after hundreds of thousands of civilians had been killed.

2.2 East Asia

Trends in Growth and Distribution

As in any other region of the developing world, income inequality is a serious problem in most Asian countries, with the possible exception of Japan, Taiwan, and South Korea. According to World Bank estimates (1990),[14] however, a large number of Asian countries—in particular, Southeast Asia's newly industrializing countries, Malaysia, Indonesia, and Brunei—have made significant economic progress since the mid–1980s, which has resulted in substantial reduction of poverty as these governments have been able to channel relatively larger public resources into human development.

In contrast, one of the newly industrializing Asian countries facing serious problems with income distribution is China. Since 1976, when full-scale economic reform started, the Chinese economy has expanded at dazzling rates of growth, frequently at a double digit rate. Its strategy, centered on urban-based growth poles, especially along selected coastal areas, has led to a widening of the income gap among regions of the country and between cities and farming villages within regions. According to a recent estimate,[15] as disposable income per urban resident has steadily increased in real terms whereas that of farmers has remained unchanged, the ratio of farmers' income to that of urban residents has plunged from 58% in 1985 to 39.4% in 1993. Taking more specific examples, in 1992 average per capita income in Guizhou, the poorest province in China, was about one-fifth of that of Shanghai, China's richest city, having fallen from the corresponding figure of 26.6% in 1984. To take an example at the regional level, in 1993 per capita income in Longchuan County, the poorest region in Guangdong Province, was only 7.6% of that in Shenzhen, the province's richest city.

The case of South Korea, as a country in rapid transition to political democracy and economic liberalization, deserves special attention. The distribution of income in Korea drastically improved in the 1960s when government policies emphasized the development of labor-intensive exports. It began to worsen in the mid–1970s when the government resorted to wage

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14 Refer to Appendix Table 1.

15 Ryoshin Minami, *The Nikkei Weekly,* 5 June 1995, p. 11.

suppression and probusiness policies in order to promote exports. After a slight improvement in the early 1980s (Choo and Yoon 1984), it steadily deteriorated until the reversal in 1990 (Ahn 1991); the Gini coefficient rose from .3472 in 1981 to .4318 in 1989. Ahn's estimates deviate somewhat from other studies which claim improvements in distribution in the late 1980s (Choo 1993). Ahn claims that other studies underestimate income inequalities in the nonworker sector, which causes the Gini estimates to appear smaller. The growing inequality in the late 1980s reflected increased wealth concentration among large corporations and uneven developments among sectors and regions. Soaring real estate prices in the context of highly uneven assets distribution further worsened the distribution of income: between 1987 and 1989 land price rose 93% and landowners, who comprised some 30% of the population, saw their capital gaining 1.7 times the nominal GNP (Lee 1990).

With the installment of a civilian regime in 1993, there was a policy shift that rapidly defused the state's support of big businesses and allowed greater participation of small and medium firms. Income inequality consequently fell markedly. Although the lopsided gain by a few rich in the 1980s skewed the inequality index, it is remarkable that the country's poverty incidence was low and continued to fall. Nor did the middle-income class appear to have lost grounds in absolute terms of real income during the 1980s.

Political and Social Consequences of Inequality

Asia's newly industrializing nations have a relatively short experience with democratization. The members of society who actively support political democracy in these countries consist mainly of the urban middle classes, especially the white-collar groups. In Thailand the civilian government of Chan was able to assert itself in the wake of the bloody military violence in 1992 on the strength of a political coalition essentially supported by Thai's middle-income classes.

More illuminating cases linking political liberalization to equitable growth are those of South Korea and Taiwan. In these countries rapid industrialization transformed the social structure by gradually broadening the middle classes. This transformation has had significant political consequences because middle and working classes support democratic systems of government. Taiwan's important steps toward political liberalization were more peaceful in procedure. Taiwan's Lee Tenghui, who became the island's first native president in 1988, appointed Lien Chan, a civilian professional, as premier to replace the military officer turned bureaucrat Hau Peitsun, a conservative Nationalist leader who was regarded by many as an obstacle to democratization. All Lien's predecessors in the premiership had been mainland Chinese who had fled to Taiwan after losing the Civil War to the Communists in 1949. The appointment defied the objections of the Kuomintang party and reflected the island's new initiative toward political democratization. Lien was expected to pursue democratic reforms. Taiwan's per capita income already exceeded US $10,000 and the rapid growth of the middle-income class led to the formation of strong political support for democracy.

South Korea, the largest and most dynamic economy among East Asian NICs, illuminates the political and social implications of distributional equity. The election of Kim Yong-sam as a civilian president in 1992 reflects the changed situation in Korea where the middle-income class has emerged as a dominant political force. The middle classes, which steadily grew in numbers during the previous period of rapid industrialization, comprise more than 60% of the Korean population. Kim has responded to this class by following a middle-of-the-road approach: Economic policies have focused on securing continuous flows of income to wider social groups, especially to small businesses and farmers.

This is a case where the success of rapid growth with equity raised the possibility of the inauguration of democracy in a country that had been under authoritarian rule (Muller 1988). The future of democracy in Korea will depend critically on successfully continuing to avoid excessive income inequality. Bipolarization in income distribution could diminish the middle-of-the-road influence of the middle social classes, allowing the substitution of a repressive regime for political democracy.

In addition to political implications, growing inequality in wealth and privilege engenders social dislocations and disturbances. In China, as the country has become more affluent, disparities in income also widened, eliminating the sense of security that stemmed from 'equality in poverty.' The growing regional disparities—particularly serious between the highly developed eastern coastal regions and the backward inland areas—portends potential social and political disturbances. Movements of the population have already been restricted by the government, which will worsen interregional income gaps and exacerbate ethnic tensions since many minorities live in low-income inland regions. In South Korea, during various periods in the late 1970s and the early 1980s, the situation of economic inequity led to a wave of industrial unrest on the part of workers and other forms of social strife initiated by students, which eventually resulted in the fall of Chun's military regime in 1986 and the subsequent restoration of the civilian regime. The realities as well as the perception by the lower groups of extreme inequities between workers and property owners prevailed in Korea. The so-called 'prosperity strikes,' based on the concept that workers deserve to share the benefits of business prosperity, occurred more frequently during the times when the distribution was more uneven. The Korean case tells us that equitable development constitutes a functional requirement for the country's political and social stability.

2.3 Latin America

Trends in Growth and Distribution

Postwar development in Latin America started with wide income inequalities across the area. Available data circa 1979 (Altimir 1987) indicate that the Gini indexes were relatively high in Latin American countries compared with other parts of the developing world: for instance, Brazil .605; Colombia .618; both Mexico and Venezuela .500; and Peru .568. The import-substitution strategy in Latin American countries failed to generate patterns of sustained growth the fruits of which could be equitably shared.[16] For instance, Mexico and Brazil both had very rapid industrialization without any significant reduction in under- and unemployment. The working poor did not necessarily become poorer, but the fruits of growth reached them very slowly with the consequence that income distribution became more unequal. The political and social instabilities seen today in many Latin American nations have a historical resonance that precedes the revitalization policies adopted in the wake of the debt crisis in the 1980s.

That the earlier import-substitution industrialization strategy in Latin America led to income inequality can be seen from an international comparison as shown in Table 3. The table compares the income shares of the bottom 60% of the population in selected developing countries. Two East Asian countries—Taiwan and South Korea—exhibit high growth rates with the poorest 60%'s income share exceeding 30%. The Asian experiences contrast with those of such Latin American countries as Mexico, Brazil, and Peru (though Costa Rica is a notable exception). The growth rates of the poorest group's income in all three Latin American countries were substantially below the respective national average growth rates during the period in consideration.

The aftermath of the debt crisis in 1982 witnessed Latin America's first extended depression; throughout the remainder of the decade income inequality continued to rise. The indebted Latin American countries began to embrace neoliberal adjustment policies of smaller government, open markets, trade liberalization, privatization, and deregulation, which resulted in ever larger contingents of the critically poor, low-paid workers, underemployed and unemployed, while middle-income classes saw their living standards and quality of life deteriorating. Throughout the 1980s external debt servicing, reverse resource transfer abroad, diminution of domestic investment, deterioration of human and physical capital stocks, and inflation became part of the functioning structure of the Latin American economies. The already impoverished situation of more vulnerable groups of society deteriorated further as international donor agencies' adjustment policies called for the contraction of welfare programs and a rise in the

16 Felix (1983) observed that income distribution in Latin America generally worsened during prosperity, when there were more gains to share, and leveled off or improved during depressions, when rents and profits tended to take relatively greater hits. Cyclical fluctuations in the distribution aside, income inequality in Latin America has risen secularly.

relative prices of basic needs goods. In addition, as the devaluation of the domestic currency, aimed at switching expenditures to tradable goods, triggered inflation, it began to affect more vulnerable groups such as wage-earners, self-employed workers, and retirees, who had less capacity to negotiate or protect themselves against price increases of imported goods.

Table 3

Growth in Income for the Lowest 60 Percent in Selected Countries

Country	Period of observation	Income share (Initial year)	Income share (Final year)	Growth rate of income for bottom 60%	Growth rate of national average income
Taiwan	1964–74	0.369	0.385	7.1	6.6
South Korea	1965–76	0.349	0.323	7.9	8.7
Sri Lanka	1963–73	0.274	0.354	4.6	2.0
Costa Rica	1961–71	0.237	0.284	5.1	3.2
India	1954–64	0.310	0.292	1.6	2.3
Philippines	1961–71	0.247	0.248	2.3	2.2
Turkey	1963–73	0.208	0.240	5.1	3.6
Brazil	1960–70	0.248	0.206	1.2	3.1
Mexico	1963–75	0.217	0.197	2.4	3.2
Peru	1961–71	0.179	0.179	2.3	2.3

Source: Chenery (1979, Table 11.5).

During the recent economic recovery (1990–92), some gains in the real incomes of the lower economic classes have been made in a few Latin American countries, but these are the exceptions. According to the ECLAC report (1994, 37), the relative inequality of income distribution in the urban areas of Argentina, Honduras, Mexico, Panama, and Uruguay declined slightly. On the other hand, the households in the upper strata of these countries also increased their income. The continent's income distribution structures are now more uneven than they were in the late 1970s. This can be seen in Figure 3 and Appendix Table 2, which show changes in real income by income strata over the 1980–92 period for Latin American countries. In Mexico the lowest and the lower-middle-income groups made virtually no gains in real income while the richest gained more than 50% over the period. Brazil, Venezuela, and other Latin American countries display similar results: overall average per capita income declined with the burden of the decline falling heavily on the lower income groups.

Table 4 presents the comparisons of real per capita income for 1992 calculated as a multiple of the country-defined poverty line income. Real income of the poorest 40% in most Latin American countries declined throughout the 1980s and despite the recovery in the early

Figure 3

Changes in Income Distribution in Latin America (Urban Areas) during the 1980s and the 1990s.

Gini Coefficient in 1992

Gini Coefficient in 1980

[a] The data correspond to 1979 and 1990. No information available for 1992.

[b] The data correspond to 1984 and 1992. No information available for 1980.

Notes: VEN: Venezuela; CRI: Costa Rica; MEX: Mexico; ARG: Argentina; PAN: Panama; CHL: Chile; BRA: Brazil; COL: Colombia; URY: Uruguay.

Sources: ECLAC, on the basis of tabulations of data from household surveys in the countries.

1990s still remained below the poverty line in 1992: income of the poorest as a percentage of the poverty line income ranged from 84% in Costa Rica to 28% in Honduras. Moreover, the ratio of income of the richest 10% to that of the lowest 40% was in the range of 10–20 in Latin American countries (Table 4). It is worth noting that this figure is substantially above a typical East Asian NIC's.

Table 4

Real Per Capita Income by Income Strata in 1992[a]

	(1) Low Income	(2) Middle Income	(3) High Income	Ratio of (3) to (1)
Argentina (Buenos Aires)	1.40	3.79	18.36	3.11
Bolivia	0.52	2.03	9.55	18.37
Brazil[b]	0.56	2.67	15.37	27.45
Chile	0.81	2.63	12.77	15.77
Colombia	0.58	2.31	10.52	18.14
Costa Rica	0.84	2.79	8.55	10.18
Honduras	0.28	1.16	4.96	17.71
Mexico	0.79	2.55	11.43	14.47
Panama	0.64	3.21	11.64	18.19
Paraguay (Asunción)	0.65	2.31	7.23	11.25
Uruguay	1.51	4.22	11.83	7.83
Venezuela	0.71	2.30	8.44	11.89

[a] Real income is measured by a multiple of the respective per capita poverty line. The low income stratum consists of the poorest 40%; high income, the richest 10%; and middle income, the remaining in-between groups.

[b] Brazil data correspond to 1990.

Source: ECLAC (1994, 36).

For the Latin American region as a whole, between 1980 and 1987 the average real income of wage/salary earners fell 15% in the formal private sector and 30% in the public sector, while the combined employment of the two sectors rose a bare 3% (PREALC 1990a). The numbers of the economically active population in the urban informal sector rose 55% while their average real income fell 42%. As a result, the proportion of the population classified as 'poor' rose to 43% by the end of the 1980s (World Bank 1990, 14). Over the decade almost 40 million people were added to the ranks of officially defined poverty. In Brazil alone, between 1980 and 1988 the incidence of poverty rose from 24.3% to 39.3% (Faria 1994, 7, citing Romão 1991). In Mexico the incidence of poverty rose from 40% in 1980 to 54% in 1987 (Kim 1991), and the real minimum wage rate in the urban sector continued to fall 26.6% over the period from 1988 to 1994 (Lazaroff 1995, 49). At present, close to 60% of Mexico's population of 86 million is under age

30. These statistics translate into a work force that will grow by more than a million people each year. With the prospect of fewer jobs, wages will be likely to stay flat or possibly be scaled back.[17]

While the urban labor force faces serious difficulties, the situation is worse in the countryside of many Latin American countries. In Mexico, for example, imports of US fruits and vegetables since the reductions in tariffs beginning in the late 1980s have pushed down domestic prices, causing the failure of almost 40% of Mexico's small agricultural businesses (Lazaroff 1995, 49). Privatization of communal farms into competitive businesses have been difficult given the high prices of imported machinery and bank loans.

Political and Social Consequences of Inequality

Growing inequality and the impoverishment of large segments of the Latin American population have been accompanied by rapidly deteriorating conditions in health care and basic education. In Mexico alone, for instance, as much as 66% of the population is estimated as currently suffering from malnutrition (Rothman 1995, 41). Taking the continent as a whole, its educational and health care standards today are substantially below the levels that would be expected, given the region's current per capita income. During the early 1990s only a little over a half of those entering primary school reached the fourth grade (Inter-American Development Bank 1994, 13). Enrollment rates in secondary school were less than half the eligible age group. When compared to China, which had only one-sixth the average per capita income of Latin America, the burden of disease in the region was also about a third greater. This divergence between the actual situation and the expectations based on the region's average income is attributable to the extreme income disparities prevailing in Latin America.

In a number of Latin American countries, the prolonged impoverishment of the working poor coupled with the deterioration in income distribution has led to labor unrest, drug trafficking, and even political violence. In Central America the exacerbation of inequalities has played a key role in social and political violence. Since the mid–1970s large-scale revolts in three out of the five Central American countries have erupted against their governments. In 1979 a popular revolution toppled Nicaragua's Somoza regime. A resurgent guerrilla rebellion has continued in Guatemala since 1980, while in El Salvador crippling political violence lasted some twelve years. Booth (1991) contends that government policies for agricultural exports and rapid capital-intensive industrialization in these countries marginalized landless peasants, the urban poor, and wage laborers, and in the absence of policies that could have mitigated the exacerbation of poverty, these groups began mobilizing for a rebellion.

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[17] Many companies are currently laying off workers, including Dina, the heavy-truck manufacturer, and Pemex, the oil monopoly. Nissan and Ford have been slowing automobile production.

In Venezuela, despite a respectable economic growth in 1990 and 1991, the country became more unequal, with an attendant rise in the number of destitute people. The rise in basic goods prices in February of 1989 eventually triggered a riot in the capital city with the record of deaths exceeding 300. The frequent labor strikes that ensued were followed by 1992's twice aborted military coups to overthrow democratically elected President Perez's government. Perez was the continent's leading neoliberal policymaker.

Brazil in 1985 had a democratically elected civilian government for the first time after twenty years of military regime. Eight years after the new democracy was inaugurated, it faced a new crisis. Brazil's first directly elected president, Fernand Collor de Mellor, was ousted amidst a scandal involving illegal use of campaign funds. The underlying cause of people's disaffection with the government was the inability of his administration to address the ever-aggravated issue of income distribution and poverty. In Brazil, according to a 1990 census, over 24% of the working population received a minimum wage income. The necessary income to maintain a subsistence living standard was estimated at five times the minimum wage. This implies that some 70% of the working population earned below the effective subsistence income.[18]

In Mexico, which to begin with has one of the most skewed income distributions in Latin America, the income gap between capital and labor widened throughout the 1980s, accompanied by increased concentration in wealth. During Salinas's presidency 25 Mexican families controlled some 55% of Mexican assets; about half of them are still held by six conglomerates consisting of Grupo Carso, Visa, Vitro, Telmex, Alfa, and Grupo México (Rothman 1995). Some 37 million Mexicans live in poverty and the Mexican Social Security Institute, the country's largest provider of public health care, covers only a little more than a third of the working population. Economic inequality and deprivation are making Mexican politics more heated than ever. The middle class, which had high expectations of the economic reform, is frustrated with economic conditions. The working masses' ceaseless demands for political participation have been fueled by the continuous process of economic liberalization. The ruling Institutional Revolutionary Party (PRI), which had never lost national or local elections since 1929, showed the beginning of a loss of wide popular support as it lost the governor's elections in Baja California in 1989, Chihuahua in 1990, and Guanajuato in 1991.

Mexico's economic reform, nonetheless, continues in a top-down fashion. Its political system remains tightly controlled under the absolute power of the presidency of the ruling party, which has created an impetus towards rent-seeking. The extent of rent-seeking has been highlighted most recently by the arrest of Raul Salinas, the brother of the former president, on

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18 The government raised the minimum income by 140% in May 1992 to appease the masses of the population who were impoverished, but the wage hike policy led to financial bankruptcy and accelerated inflation.

charges of plotting the murder of rival leader Luis Massieu. Also, the revelations of links between Mexican elites and seven drug cartels and the speculation of drug involvement in three recent assassinations have shed serious doubts on the political system.

A number of clashes, including the recent Chiapas uprising in rural Mexico, have taken place between the existing political structures and the popular forces clamoring for democratization and economic equity. The political imperative of future Mexican governments will be to gain greater popular support for completing economic and political reforms. Securing popular support will, on the other hand, depend on the ability of the government to implement alternative strategies for more equitable economic growth.

In summary, prospects for stable political democracy in Latin America hinge critically on governments' ability to engineer a sustained growth path with equity. The challenge to create a vibrant, equitable economy looms much larger for the emerging democracies in Latin America than elsewhere. In Latin America growing economic inequality has over time solidified the formation and preservation of distinct social classes, planting the seed for social unrest and political instability.

II. DISTRIBUTION AND GROWTH: A POLITICAL-ECONOMY PERSPECTIVE

Economists have long disagreed in their views on the relationship between income distribution and economic growth. The earlier supply-siders and more recent neoliberal economists have argued that current inequality must be endured for the sake of future growth and equity, since the benefits of economic growth would eventually filter down to the masses. They claim that redistributive policies would reduce the incentives for work and investment.

Empirical evidence, nonetheless, has not been conclusive in supporting the rising-tide-lifting-all-boats theory (Michaely et al. 1991, 103–12). In a number of advanced industrial economies during the past decade, income inequality rose during economic expansions as well as economic contractions. During 1989–92 the expansion of industrial production in such countries as Sweden, Finland, the United States, the Benelux countries, and England was accompanied by rising unemployment, which further deepened income inequalities in these countries. In Ireland, under the neoliberal, export-oriented strategy, the government for a long time benignly neglected the once prominent agricultural sector. With the failure to create sufficient numbers of high value-added jobs, growing occupations have shifted to low-paying service industries. Low wages, combined with the already highest unemployment rate in the developed world (Callan and Nolan 1994, 3), have been a recipe for rising poverty. At present the government is not likely to do much to help the poor as excessive borrowing in the past will continue to constrain future government activities. The lesson: economic expansion does not necessarily engender equity.

Turning to the tradeoff between equity and efficiency, the recent, cross-sectional study by Glyn and Miliband (1994), which includes a large number of both industrial and developing countries, indicates a positive correlation between the countries with better distribution and those with higher growth rates, as shown in Figure 4. During the 1980s countries with relatively faster labor productivity growth, such as Japan, Finland, Germany, the Netherlands, Belgium, and Sweden, were more equal in income distribution (as measured by the ratio of the income of the richest 20% of the population to that of the poorest 20%). On the other hand, countries with slower productivity growth, such as New Zealand, Australia, Switzerland, and the United States, were relatively less equal. A positive correlation between growth and equity can also be discerned from the World Bank's (1991, Table 30) much larger sample of both developing and developed countries. The study by T. Persson and G.Tabellini (1994) on the basis of cross-sectional data from industrial democracies also reveals a roughly positive correlation of income equality to growth.[19]

It is well to note that, given the paucity of data and the difficulty of disentangling cause and effect, these findings must not be construed as a generalizable conclusion. Nonetheless, the supply-side presumption that an initially unequal distribution is likely to lead to more rapid economic growth later is simply not borne out by the data. On the contrary, such data as we have suggest that rapid economic growth is compatible with an equitable pattern of income distribution in a wide-ranging number of countries.

If the conventional theory relating distribution to growth is to be debunked, how do we then explain the positive growth effects of increased equality? The economists leaning toward Keynesian economics would look at the role of aggregate demand in a market economy and deduce the positive effects of increased equity on demand and economic growth.[20] Other economists have related increased income equality to increased access to health care, training, and education for the population at large, which in the long term should raise worker productivity and improve the performance of the economy. In particular, income inequality in poorer societies is accompanied by increased incidence of poverty, which directly affects the nutritional level of the workers and therefore their productivity.

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19 Interestingly, a negative correlation of growing inequality to growth is found in the context of the domestic economy. A recent study examining growth in income and employment in 85 US cities shows that cities with high levels of urban/suburban inequality have poorer growth rates of jobs and income than cities with milder income disparities (Albelda et al., 1995, 8).

20 Greater income equality leads to greater demand, since the propensity to spend tends to be greater with low-income families.

Figure 4

Income Inequality and Labor Productivity: 1979 to 1990

Source: Abelda et al. (1995, 7).

Another reason that inequality hampers growth relates to the potential economic costs of inequality on productivity. If inequality is allowed to persist and worsen, eventually it may come to threaten social stability. The government may be forced to implement at least some redistributive policies in order to avert social chaos. Persson and Tabellini (1994) argue that in a society with a widening income gap, policies to improve the distribution will most likely result in taxing investment and growth-promoting activities. If poverty has become widespread, the economic cost of providing a baseline of support for the welfare, health care, education, and training of the populace will be considerable, diverting resources that could otherwise have contributed to growth, but the social costs of failing to provide such a safety net may be unacceptably high. Moreover, growing inequality leads to increased expenses of enforcing law and order in order to protect property rights and the market system. As the 'haves' possess more to protect and the 'have-nots' less to lose and less prospects for a better future through work, crime increases. In this regard, it is illuminating to compare the economic performance in the recent past of East Asia and Latin America. In East Asia, because of the relative income equality in their societies, governments had a greater degree of freedom to pursue economic policies that promoted growth. In contrast, the extreme inequality in Latin America continued to give rise to intense political pressure to implement expansionary economic policies just to stave off unrest among the marginalized groups. The rich in Latin America, on the other hand, exercised their power to avoid fair taxation that could have led to fiscal balance. As a result, it has been difficult for these Latin American countries to successfully implement a stabilization program that could protect savings and investment and induce stable growth. Economic and political instability became recurrent as the countries could not break out of their cycle of self-defeating policies. In a somewhat different context, in highly unequal societies such as the United States the growing number of the incarcerated population has been exacting enormous costs for prison upkeep, which in turn reflects a monumental loss of valuable human resources.

In summary, the relationship of growth to distribution is not one of automatic cause and effect. Equitable growth in a market economy is not only a moral imperative; there is compelling reason to believe that it must become an economic imperative.

III. CONCLUDING REFLECTIONS

This paper has argued that economic growth with equity is vital to long-term political and social stability in a democracy and, most importantly, to the very preservation of politically democratic institutions in countries already enjoying full democracy as well as in countries in transition to it. As Lipset (1969, 27) notes, without the continued presence of a viable middle class in society, a genuine, stable democracy would be difficult to preserve. Sustained political democracy thus requires the maintenance of a well-developed and balanced economy, where the majority of the country's population remains in the middle class.

Although systematic cause-effect relationships between types of polity and economy are not easily discernible, history is replete with examples of societies with extreme bipolarization of groups that inevitably led to a rule of one group by another. Such instances of a group's usurping resources to preserve its privileged position have been witnessed in the past movements of Bolshevism, Nazism, or Tojoism. By the same token, economic prosperity shared by wider sectors and social groups in some East Asian experiences released impulses for broader political participation, leading to the path toward political democracy.

Economic equity must be seen as a prerequisite to sustained economic growth. There is telling evidence for the mutually reinforcing relationship that can exist between distributional equity and growth of the economy. Available evidence also tells us that the blind pursuit of unfettered market systems is not helping to reduce economic inequalities in society. The search for equitable development calls for bold new visions of development strategy. For the emerging democracies in the developing world, unless better governance is complemented by more comprehensive and more radical efforts for increased equality, there simply is no assurance that the tide of democracy will be irreversible. For American society, the urgent question that must be addressed is how to attain balanced combinations of societal forces and processes that will sustain a reasonably equitable income distribution in a competitive market system.

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Appendix—Table 1

Selected Economies in the ESCAP Region: Per Capita and Household Incomes and Distribution

Sources: World Bank, *World Development Report 1990* (New York, Oxford University Press, 1990) and *World T*
1987, 4th Edition.

Appendix—Table 2

Latin America (12 countries, Urban Areas): Percentage Variations in Real Average
Per Capita Income of Households of Different Strata, 1980–1992

Source: ECLAC, on the basis of special tabulations of data from household surveys in the countries.

[a] Data correspond to 1994, 1989, and 1982.

[b] As a multiple of the respective per capita poverty lines.

[c] Corresponds to 1990.

[d] Corresponds to 1991.