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From Social Policy to an Open-Economy Social Contract in Latin America

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Abstract

After a decade of economic and political reforms that dramatically altered the structure of economies in Latin America, poverty and high inequality remain deeply entrenched. Integration into the global economy in the 1990s brought increased prosperity only to a small minority of households in most countries, primarily those in which adults had some university education. The reforms in themselves did not hurt the poor, but they left behind both the poor (using the international definition of those living on less than $2 a day), but the great majority of middle-income households who are, as I show, surprisingly poor by Western middle-class standards.

What does this imply for future social policy in the region? I suggest in this paper the logic of going beyond the standard, poverty-targeted, elements of good social policy to a modern social contract adapted to the demands and the constraints of an open economy. A modern open-economy social contract would extend current social policy in two ways. First, it would be explicitly based on broad job-based growth. Second, it would be politically and economically directed not only at the currently poor but at the near-poor and economically insecure middle-income strata. I discuss critical elements of an open-economy social contract. These include unusually good fiscal policy; increasing effective taxation of the rich, making job mobility an explicit public policy goal, and a regional strategy for better access to rich country markets.

From Social Policy to an Open-Economy Social Contract in Latin America[1]

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Introduction

After a decade of economic reforms that dramatically altered the structure of economies in Latin America, making them more open and more competitive, and a decade of substantial increases in public spending on education, health and other social programs in virtually all countries, poverty and high inequality remain deeply entrenched. By the 1990s, most countries of the region had adopted in some form the recipe that had earlier produced dramatic rates of growth and poverty reduction in East Asia: an emphasis on competitive, market-based growth and substantial commitment of public resources to investment in human resources.[2] But the proportion of the poor, in most countries 40 percent or higher, failed to decline much if at all. Chile, with a reduction from an estimated 32 to 16 percent between 1990 and 1998, and Uruguay from an estimated 23 to 13 percent were the only exceptions. Not surprisingly the proportion of poor actually increased in countries that had low rates of growth, such as Venezuela. But the proportion also increased in countries such as Mexico and Peru where there was growth, at about 2 percent per capita annually. In no country was there any obvious improvement in what are generally very high rates of income inequality.[3]

What's wrong and what can be done to alter this bleak picture? Obviously higher rates of growth would help. But these continue to elude most countries – even Chile in the last few years – and in the last decade, even the small positive effects of growth in reducing poverty have been undermined by slight increases in inequality.[4] The ingredients of good social policy -- continuing emphasis on investments in basic education and on targeting of poor households for health, nutrition and training programs – are improving people's lives and might raise incomes eventually. But without growth they seem unlikely to make a real dent in high rates of poverty, now or later; even in the years of some growth in the 1990s they apparently failed to address the deep and structural inequalities that inhibit poverty reduction. Furthermore, adequate social investments are not easy to sustain when growth is low, public debt is high, and government budgets are not expanding.

In this paper I emphasize the need to go beyond the standard elements of good social policy in Latin America, to the old idea of a broader social contract, but in an updated form: a social contract explicitly designed for competitive, open, globalizing, and thus vulnerable economies. Such a post-modern social contract would extend current social policy in two ways. First, it would be explicitly based on broad job-based growth. It would not only rely on growth; it would be designed to help deliver growth. Second, it would be politically and economically directed not only to the poor but to the increasingly unhappy and insecure middle-income strata (who are in fact at constant risk of becoming poor). It would start from the observation that integration into the global economy is currently helping only a small minority of households; and that heavy reliance on external savings and the resulting vulnerability to financial and other crises is creating instability that particularly hurts not only the poor but a much larger swath of

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[2] Of course comparing Latin America in the 1990s to East Asia in the 1970s and 1980s, there were many differences in economic and social policy. Some would argue that Latin American economies were even more open by the 1990s than the East Asian tigers were when they experienced rapid export-based growth. It is certainly the case that by the 1990s spending on social programs as a percentage of GDP was as great in Latin America as it had been and was in the tigers of East Asia, though of course it was much lower per person in absolute terms. See Birdsall, Ross and Sabot (1997) for a discussion of differences between East Asia and Latin America in social policy.

[3] The data on poverty and inequality to which we refer are set out in Behrman, Birdsall and Szekely, 2001a. The data are from household surveys in the late 1980s and 1990s.

[4] Attanasio and Szekely (2001) . See Appendix I.

non-rich households.[5] An open-economy social contract would be based on policies and programs explicitly geared to job creation for the large majority of the non-rich, including many who have completed primary and even secondary schooling but not more. It would do so by necessity in a manner that supports the steady private-sector-driven growth needed to create those jobs, and needed to finance domestically the public investments to prepare more people adequately for them.

In Section 1, I review the evolution of social policy in the region in the postwar era, drawing largely on an earlier paper co-authored with Miguel Szekely.[6] In Section 2, I discuss three points meant to motivate my argument for a new job-based social contract that is addressed to the needs of the middle-income majority. In Section 3, I outline the implications of this redrawn social contract for specific macroeconomic and sectoral policies. I emphasize the difficult but unavoidable logic of a social contract grounded in some fundamental pillars of the benighted Washington Consensus.

Section 1. The Social Contract in Postwar Latin America

Social policy in the region today is a healthy combination of reasonable spending on basic investments in health and education; an emphasis on reaching the poor, which though far from perfectly implemented, is a substantial improvement over earlier periods; and an impressive array of administrative reforms, including decentralization to more accountable local governments, and institutional innovations such as cash subsidies to poor households that keep their children in school. But this healthy combination does not in any sense represent a meaningful social contract which protects the vast majority of people in the region and to which the vast majority of voters in the region's democracies have committed themselves.

Today's social policy evolved over what might be considered four phases or periods. The first covers the period between the Second World War and the late 1970s, the "golden years" of Latin America in terms of economic growth. The industrial sector in most countries was growing vigorously, fueled by the import substitution development strategy that prevailed in those decades. The urban middle-income group was expanding[7]. During this period, social policy was a fundamental part of the overall development strategy. Social policy consisted mainly of the widespread provision of subsidies for goods and services, from which the expanding urban middle-income groups benefited most. Some of the subsidies - like those to fuel consumption - were justified as supporting higher real industrial sector wages. Rural areas played the role of providing primary goods and natural resources for industrial production at low prices, as well as low cost goods for urban consumers. This implied in many cases subsidizing rural production, and in a few cases, land redistribution, to minimize idle resources and the underutilization of land. For the most part, however, the needs of the structurally poor were

[5] In Latin America, this distinction between the small minority and the large majority of households can probably best be drawn between the 10 percent or so of those with and the 90 percent without some post-secondary education – an issue I return to below.
[6] Birdsall and Szekely, forthcoming.
[7] See for instance Székely (1998) for a description of the case of Mexico.

neglected, though of course many households that began the period poor benefited from the overall growth in incomes. Indeed, there were healthy declines in poverty and inequality in this period. [8] But the industrial growth strategy and the subsidies relied heavily on public borrowing, and were ultimately unsustainable. This ended in the early 1980s with the debt crisis.[9]

In the second period, under the new macroeconomic constraints of the early 1980s, social policy in effect went underground. With escalating inflation rates, devaluation, and GDP declines, the policy priority was to stabilize the economy at all costs. Widespread subsidies and social transfers were seen as an obstacle to growth, rather than a powerful engine of development as in the past. Fiscal pressures and the burden of debt combined with low growth to severely restrict new investments in health and education. Spending did not decline as a proportion of the budget in most countries, as the political pressure to sustain civil service jobs and wages, which take up the bulk of social spending, was considerable. However, spending in absolute terms per child and per health client declined since overall government spending was declining. Moreover, uncertainties and the lack of any new investment contributed to overall deterioration in health and school systems as teachers and health workers coped with limited access to complementary inputs – books, medicines and so on. The systems no doubt lost some of their better personnel and suffered from constantly changing leadership. The remnants of a social contract provided limited but insecure job guarantees for that portion of the middle-income group that was lucky enough to hold a civil service or state enterprise job; and few if any services to the rural and urban poor. By the end of the 1980s, there was increasing evidence of growing inequality, and most worrying, of substantial increases in poverty.[10]

The third period began in the mid- to late-1980s with the acknowledgement that structural adjustment programs and economic reform were not addressing the needs of the large number of poor –30 to 40 percent of populations of most countries.[11]. Social policy became focused on protecting the poor in the unfavorable macroeconomic environment, and in the face of increasingly global competition. It was recognized that the poor generally have fewer means of protecting their incomes from unexpected shocks and from the erosion of liquid assets that high inflation brings. The poor were also seen as the most disadvantaged in terms of their chances of engaging in high productivity sectors with the best chances of surviving external competition. The policy solution was the introduction of compensatory policies through the implementation of safety net programs, including social emergency and social investment funds (which became favored programs for support by the multilateral banks). In the face of continuing fiscal pressures the approach became one of targeting resources to the poor, that is allocating limited budget resources in order to obtain the largest possible poverty reduction per *peso* spent. Poverty maps and poverty profiles were developed to identify the population with the highest

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[8] See Londoño and Székely (2000) for evidence on poverty and inequality trends for Latin America during the 1970s.

[9] The public subsidies, including to industry through import protection, relied heavily on foreign and domestic public borrowing, not domestic public savings, and could not be sustained once access to and the cost of borrowing rose.

[10] See Morley (1995). The argument that adjustment programs were undermining social policy was made forcefully in Cornia, Jolly and Stewart (1987).

[11] Using as a benchmark $2 day in purchasing power parity terms.

poverty rates. Resulting programs were designed as small, specific and tightly focused.[12] In that sense, social policy abandoned altogether the idea of a larger social contract between the state and society as a whole. Social policy and overall development and growth strategies of countries became totally disconnected. As in the second period, emphasis remained on the fiscal tradeoff between macroeconomic policies and social programs, with social programs seen as a potential threat to public deficits and to macroeconomic stability.

By the mid 1990s, with the recovery of positive economic growth in most countries of the region, a fourth phase of social policy had emerged. Though growth in the region was still modest, with the exception of Chile and perhaps Uruguay, it was sufficient to encourage governments and the policy community to implement real increases in public spending on broad social programs – in a manner seen as fiscally responsible. Public spending on education and health increased in most countries of the region by at least 20% between 1990 and 1996[13]. The opening of Latin America's economies to world markets, which had begun in the mid-1980s in most countries, created more interest in ensuring economies could compete effectively in the global economy, and thus in ensuring that a larger proportion of the workforce could be more productive. Having an army of unskilled workers with low wages was no longer seen as a basis for global competitiveness. Emphasis on meeting the needs of the poor continued, but with much more attention to increasing their productive capacity, consistent with the view that competitiveness in open economies required much greater investment in human capital. In many countries, the increases in spending on health and education favored primary and secondary education relative to university spending (for example in Brazil and Mexico; this change and other reforms began in the 1980s in Chile and was reinforced in the 1990s).[14] New programs such as Progresa, recently renamed Oportunidades, in Mexico, Bolsa Escola in Brasilia, the capital of Brazil, and Chile Joven in Chile[15], though targeted to the poor, were designed not only

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[12] Social policy became focused on the problem of balancing between the administrative (and political) costs of finding the poor and avoiding leakage of benefits to the non-poor, on the one hand, and undercoverage of the poor on the other hand.

[13] Birdsall and Londono (1997).

[14] These efforts probably led to reduced gaps in the 1990s between schooling of children from rich vs. poor households, based on a lower gap in most countries for 15-year-olds than for 21-year-olds – though the evidence is not yet clear or convincing, since there is a natural tendency for the gaps to increase with age. (Data from Filmer and Pritchett, 1999). But the gaps in many countries remained dramatically high – consistent with other evidence that for the most part, differences in education of parents by income group in Latin America are replicated in differences in the education of children in the next generation (Behrman, Birdsall, and Szekely, 2000; and Birdsall 2001.)

[15] *Progresa* is the Spanish acronym for the Programa de Educacion, Salud y Alimentacion (Education, Health and Nutrition Program). The program provides cash transfers and a nutritional supplement to families in extreme poverty in rural areas. Cash transfers are conditioned on children's school attendance rates of at least 85%, and regular attendance to health clinics for checkups and follow-ups. The cash transfer is given to the mother, who also has to attend a series of talks and courses on health practices. *Bolsa Escola* is a similar program which provides scholarships for disadvantaged children. Part of the cash transfer is held in a special account, which the beneficiary can access after completing a schooling cycle. Chile Joven is also a program of cash transfers, but in this case they are provided to young adults to incentive training. A detailed description and evaluation of the *Progresa* program can be found at www.ifpri.org/country/mexico.htm. A description of the *Bolsa Escola* program can be found at http://www.mec.gov.br/home/bolsaesc/default.shtm. See De Janvry and Sadoulet (2002) for a discussion about Progresa's targeting.

as safety nets protecting consumption capacity, but as investments in the poor's human capital. Increases in social spending were accompanied in some countries by major new efforts to deal with reforms of the structure of health and education systems, particularly through emphasis on decentralization and on greater parent and community control of schools (for example in Minas Gerais, Brazil, in El Salvador, and in Bolivia).

This fourth (and for all practical purposes still current) generation of social policy is thus essentially focused on programs to address the needs and increase the human capital of the currently poor. That makes good sense in a region where at least 30 percent of the population is poor, and where reduced poverty and future growth rely heavily on harnessing the potential for increasing the poor's productive engagement in the economies. Moreover, with its emphasis on building the human capital of the poor, this approach to social policy is more visibly a part of an overall development strategy.

But there are drawbacks of this approach. First, it is highly vulnerable politically; social programs have to compete fiercely for public resources and have not been institutionalized in any country so far. Social programs are seen primarily as long-term investments in uncertain future growth, given the demands of the global market. But as growth falters and the sense of unreasonable vulnerability to external markets increases, this approach to social policy, sound as it is, is at risk of unwinding – threatened by another necessary round of fiscal austerity, or by a return to populist-style broad and fiscally irresponsible programs and subsidies.

More fundamentally, this approach to social policy does not effectively address the underlying causes of continued high poverty and stubborn inequality. For instance, increased spending on education has increased schooling levels among poor children, but (as I will show below) has not raised their expected future income much, because low growth and high real interest rates continue to limit job creation; because the average return to primary and secondary education has remained low; and because in some countries continuing ethnic, racial, and gender discrimination and its historical effects have kept wage returns to some poor low. Nor will social investments raise incomes if the poor cannot accumulate physical and financial capital, or if recurrent economic downturns force periodic de-cumulating of their limited assets. Social policy alone, as currently conceived, cannot change the economic environment or the underlying elements in the structure of the economy that are contributing to poverty, and slowing overall growth.

Section 2. Three Salient Facts

1. *Job growth in the region has been even slower in the 1990s than economic growth; wages have increased much faster for those with more than secondary education than for the majority of those with less education.*

The rate of increase in jobs in the region in the 1990s was lower than the rate of growth (an estimated elasticity of .79 reported by ECLAC). Looking across sectors, jobs increased at a faster rate than overall growth in the low wage "commerce" sector, and at close to the rate of

growth in "basic services", but at far below the growth rate in "manufacturing" (an elasticity of about 0.3) (see Table 1a).[16] Data by type of job tell a similar story; the median rate of employment growth in the region was greater in low wage jobs in domestic services and the self-employed categories than in the wage earner category (Table 1b).[17] These aggregate data on job growth across sectors and types of jobs are consistent with productivity gains in some sectors, but limited increases in jobs in those sectors for workers without university education. Graham and Sukhantar (2000) show that across the region, workers with secondary education and not more are more likely to be unemployed than either those with primary education only, and much more likely to be unemployed than those with at least some university education.[18] The aggregate data are also consistent with other evidence that much of the gains in productivity in the manufacturing sector during the 1990s were due as much to firms (and the public sector and former public enterprises) shedding jobs as to increases in output for given inputs.[19]

Table 1(a): Job Growth by Sector during the Nineties in Latin America (Median Across Countries)

Sector	**Rate %**
Agriculture	-0.1
Manufacturing	1.6
Construction	2.8
Commerce	**5.8**
Basic Services	**4.1**
Financial Services	6.6
Social Services	3
Other	-1.1
Total	**3.5**

Source : ECLAC (2001)

[16] ECLAC tables based on Stallings and Weller (ECLAC, 2001).
[17] This outcome is dominated by the south; in Mexico and much of Central America, growth of jobs among wage earners was relatively faster.
[18] They report that the difference in the proportion of secondary graduates in the general population (22.3 percent) and among the unemployed (24.7 percent) is great than for other groups, and is statistically significant.
[19] Stallings and Peres (2000).

Table 1(b): Job Growth by Type of Job during the Nineties in Latin America (Median Across Countries)

Wage Earners	2.7
Self-Employed	**4**
Domestic Service	**3.2**
Unpaid Family Workers	-1.9
Others	0.2
Total	**3.4**

Source : ECLAC (2001)

Evidence from household surveys also suggests limited increases in wages for those with at most secondary education. Behrman, Birdsall, and Szekely (2001b), using wage and education data from eighteen countries of the region spanning the 1990s, show that the marginal return to primary and secondary education has fallen during the 1990s while it has risen to higher education (Figure 1a). This evidence is in line with the dramatic increases in wages for those with higher education relative to primary and secondary education, a result of skill-biased technological change that is familiar worldwide but unusually dramatic in Latin America (Figure 1b). Similarly, Morley (2001) found that virtually all the increase in inequality in the 1990s can be explained by the increase in the numbers and salary gains of university graduates, apparently due to the skill – intensive nature of recent growth. More worrying is the decline in the relative wages of those with secondary education compared to primary education. Since secondary completion rates are still relatively low, this result is surprising as well as worrying, because it suggests that labor demand for secondary school graduates is limited, given Latin America's positioning in the global economy.[20] The relative decline for secondary school graduates suggests that only a limited number of members of the labor force – those with post-secondary education – gained (especially in relative terms) from the growth that most countries enjoyed in the 1990s.

2. *Middle-income households are not "middle class" at all; they are actually rather poor.* That's because inequality in the region is not only high but unusually top-heavy, with the top decile of households in income terms capturing 50 percent and more of total income. Latin America's high levels of inequality reflect primarily the tremendous concentration of income at the top. If the top decile of income is ignored, the Gini coefficient (and other measures of income inequality) is virtually the same for the U.S. as for most countries in Latin America.[21] There are two corollaries of the region's top-heavy income distribution. The first is the extraordinarily low income relative to "average" income of households in the middle of the income distribution. Figure 2 shows the difference between an estimate of the income of the

[20] Tendler (2002) provides some insight into this problem, based on surveys of employers in the northeast of Brazil.

[21] Inter-American Development Bank (1999), p. 16..

median household[22] (measured in terms of household income per capita) and the mean or average income calculated from the same household survey, for various countries in the region during the nineties. In Brazil, the median is about one third of average earnings. In Honduras, the median is about half the average income. On the other hand, in the United States, median national income is about 90% the average national income[23].

In Birdsall, Graham and Pettinato (2000), we defined a "middle stratum" of households as those with income per capita within 25 percent of the median-income household. This enabled us to assess the "size" of the middle stratum and its share of total income. That share is in the range of 9 percent (Brazil, 1996) to 18 percent (Costa Rica, 1997) in Latin America, compared to about 35 percent in the transitional economies, and a range in the advanced economies between 18 percent (U.S., 1999) and 42 percent (Belgium and Denmark, 1992).[24] In Brazil, the income per capita of the richest household in the middle stratum was about $2200 (1996, purchasing power parity conversion); that was less than one-half of the average household income per capita of $4500.

The other corollary is that middle-income households in Latin America, even in the middle-income economies, are in absolute terms on the edge of the poverty line, using the World Bank standard of $2 per day (or $730 per year). Our estimate (Appendix II) of median household income per capita for Mexico in 1992 is $1,148. The income of the middle stratum in Mexico ranges between $1000 and $1700 per capita; the range in Mexico's NAFTA partner the U.S. is between $13,000 and $21,000. Figure 2 shows, in the case of Brazil, that median income was less than the poverty line (60$ per month at PPP) between 1986 and 1989, remaining close to poverty levels between 1989 and 1996. In Honduras, median income per capita was lower than the poverty line between 1989 and 1996. In Venezuela, median income has decreased almost continuously, approaching poverty line levels.

The near poverty of middle-income households is reflected in their low levels of health and education. Figure 3 shows health indicators for several countries of the region for the top, middle, and bottom quintiles of the estimated distribution of wealth.[25] The indicators for the middle quintile illustrate the extent to which the group is closer to being poor by most standards than being "middle class". In Bolivia, the average infant mortality rate is 99.1 per thousand. Infant mortality for middle income households is over 146 per thousand (see Figure 3). That is higher than the average infant mortality rate reported for Ghana (132.8 per thousand) and Tanzania (139.4 per thousand). In Peru, during 1990, almost 20 percent of children under age

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[22] Our estimate is derived using available estimates of Gini coefficients and assuming a lognormal distribution of overall income to obtain an estimated median. See Appendix II.
[23] United Stated median earnings were estimated using data from the World Development Indicators (World Bank, 2002).
[24] Table 1 of Birdsall, Graham and Pettinato, 2000. The data reported there cover six countries of Latin America only.
[25] These quintiles are based on estimates of household wealth per capita derived from a set of indicators including such information as the type of floor, possession of radio, bicycle, car etc. See sources for the figure.

five in middle- income households were stunted. In Guatemala, children in the middle stratum were more likely to be stunted than the children in Ghana's poorest quintile of households. In Peru and Bolivia, children in the poorest quintile were more likely to be stunted than the children in Ghana's poorest quintile households.

Education levels of adults in the middle stratum are also well below anything one would expect for the "middle class" in the Western sense. Among working age adults in Brazil, the average number of years of education is about 4.5; in Costa Rica, with a long history of investment in education, it is still only about six. In the U.S. it is 13.[26] The average education of working age adults has increased in most countries of the region from about three to about five years since 1960. That low figure is often cited in unhappy comparison to the increase in the fast-growing economies of East Asia in that period, from about four to nine years. Still the averages, low as they are, are misleading as a measure of the education of households in our middle stratum. Figure 4 shows that the median level of education among adults in Bolivia and Brazil is still below two years; in Argentina it is just above five years – that is, incomplete primary schooling.[27]

These estimates of the median level of education among adults make particularly worrying the evidence that the wage gap between those with more vs. less than post-secondary education noted above increased in the 1990s. The great majority of the region's households remain far behind in terms of the education needed to have enjoyed any "average" gains (limited as even they were) in wages.

There are two implications of the middle stratum being so close to the definition of "poor" using education and health indicators as well as the international $2 day poverty line. The first is that the growth process itself is limited by the low level of assets (physical and financial assets and education) of such a large proportion of all households.[28] The emphasis in current social policy on building the productive assets of the poor, including through education, is likely to be benefiting the middle stratum. That is most obvious in a country like Brazil, where secondary education enrollment rates have increased rapidly in the last decade, thanks to concerted policy effort, particularly by the central government. But it is not a quick process. I return only briefly to the challenge of improving the distribution of assets in the conclusion, in large part because that challenge is already being addressed.

The second implication is that even short economic downturns can easily drive middle-income households into poverty.[29] These households are highly vulnerable to becoming poor,

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[26] Author's calculations, based on Barro and Lee data (World Bank Data Sets,2002).

[27] Of course these numbers are better for the younger members of the working-age group, reflecting the progress of the last two decades. But middle-stratum households include households in which many adults are over 40 years.

[28] Aghion et.al. (1999) provide a model in which average returns to investments are lower in economies in which a limited number of members are able to invest (only those with assets as collateral, given credit market implications.)

[29] Cline (2001) examines the impact of financial crises in emerging markets over poverty, concluding that at least 40 million people were placed in poverty during the crises in Mexico (1995), Thailand and Indonesia (1997), Korea and Russia (1998), Brazil (1999), and Argentina and Turkey (2001). Poverty increased significantly more in countries that had very unsuccessful crises management (Indonesia, Russia, and Argentina).

via temporary income loss and worse, loss of limited assets, due to economic instability. Because so many middle stratum households are close to the poverty line, economic downturns that raise prices and reduce employment, even for relatively short periods, are particularly painful for those households. During the 1980s, the poverty headcount doubled in Greater Buenos Aires (from 10 to over 20 percent) and rose from about 32 to 50 percent in urban Peru (Lustig, 2000). The situation today in Argentina is admittedly extreme; still the reported increase in the poverty headcount – to as much as 53 percent in urban areas (INDEC, 2002), drives home the point all too well.[30]

Even for cases where increases in the number of poor are small, it is likely that middle-income households reduce their permanent income by running down some of their financial and other physical assets to sustain consumption levels. The value of financial assets, including small businesses and bank accounts, can be quickly dissipated during economic downturns or in the case of the bank accounts, by inflation, implying downward mobility for households with limited assets even if not a plunge into poverty. Comparing evidence on income mobility of households (relative to other quintiles) in Peru and the United States, Birdsall et al (2000) find a much greater likelihood of downward mobility for the middle quintiles of households in Peru (48 percent moved down) compared to the U.S. (34 percent moved down), over a shorter period (six compared to 10 years). The resulting sense of acute insecurity for so many middle-income households is probably behind the sense of growing skepticism about the benefits of the economic reforms (the so-called Washington Consensus reforms) of the past 10-15 years.[31]

3. *The economic reforms of the 1990s (the so-called Washington Consensus reforms) have not hurt the poor. But they have not helped the poor either, nor the middle stratum. Their benefits have pretty much been captured by the rich.*

The glass, first of all, is half full. Econometric analysis using household survey data covering most countries of the region for multiple years over the last three decades, combined with country-based indices of economic reforms, suggests that trade liberalization and as a group such other structural economic reforms as privatization, labor and tax reforms, have not hurt the poor (and that the dramatic reduction of inflation has helped). The only exception is liberalization of the financial sector, which has hurt the poor at least in relative terms.[32]

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[30] More generally it is the case that many more households are "poor" in most countries at one time or another than poverty headcount rates imply. Pritchett et.al (2000) report that in Indonesia, assuming 20 percent of households are poor, another 30 percent are likely to have been or to be poor over a three-year period. For example, Baulch and Hoddinott (2000) report that the proportion of poor in China was .2 percent during 1985-1990, but as much as 48% of the population was poor at some point during 1985-1990. The analogous numbers are 3% and 55.3% for Pakistan and 10.6% and 59.6% for Zimbabwe between 1993-1996.

[31] See Graham, 2002, for evidence based on Latinobarometro survey data, that attitudes toward the economic reforms of the 1990s are increasingly negative. Birdsall, Graham and Pettinato (2000) use earlier Latinobarometro survey data on attitudes toward reform to assess the extent to which attitudes differ among the poor, the middle, and the rich. They report regression results indicating that the middle income respondents are more supportive of reforms in countries early in the process, and are the least supportive in countries later in the process – i.e. drive an increasingly negative overall attitude. See their Table 8.

[32] Behrman, Birdsall and Szekely (2001a) use household survey data covering most countries of the region for multiple years in the 1980s and 1990s, combined with country-year indices of six economic reforms developed by

On the other hand, the reforms have not helped the poor either (in most countries the bottom 30 percent of households) and based on analysis of the effects of the reforms on inequality, it is unlikely that they have helped the middle stratum. Behrman, Birdsall and Szekely (2001b) show that overall the reforms (trade liberalization, privatization, tax and labor market reforms, financial sector liberalization, and the opening of the capital account) have increased wage inequality, with the real wages of those with less than at least some post-secondary education actually declining on average, as well as declining relative to the wages of those with some post-secondary education. That implies that our middle stratum, most of whose adult members have less than post-secondary education, has gained little if anything in absolute terms from the reforms and has certainly lost relative to the rich (and best-educated). The "villains" among the reforms have not been trade liberalization or privatization, but financial sector reform and the opening of the capital account.[33]

Behrman et al. (2001a) also show that the poor and the near-poor middle stratum have been helped by reductions in inflation and macroeconomic volatility (Appendix III, Table 2). Declines in the terms of trade have not mattered much, and appreciation of the exchange rate in itself seems to help. Looking at the effects of economic reforms and changes in the macroeconomic environment over the period on the change in the incomes of the richest 10 percent of households compared to the poorest 30 percent, in relative terms the poorest have lost from inflation and macro volatility and from financial sector liberalization. In the case of financial sector liberalization, it may be that a lower cost of capital or improved access to borrowing favors skilled over unskilled labor, possibly because greater capital investment (in newer technologies, for example) requires greater use of skilled labor. The poorest have gained as a result of exchange rate appreciation, and (though the result is less statistically robust) of improvements in the terms of trade.

What is the overall picture that emerges from these analyses? The poor and the middle income stratum are not particularly worse off as a result of the economic reforms, and certainly not because of the opening of the economy defined narrowly in terms of trade liberalization. But they are worse off as a result of the continuing instability; indeed it may not be a coincidence that the one reform that seems to have had negative effects on the poor, financial sector liberalization, and the two reforms that have increased wage inequality, financial sector liberalization and the opening of the capital account, are likely to have played a central role in short-term economic instability.[34]

Morley and updated by Lora. The estimates are reproduced in Appendix III. Table 2 of Appendix III suggests that financial sector liberalization increased the income gap between the middle group and the poor, and increased the poverty gap, i.e., the total difference in income between all those counted as poor and the poverty line. On the same approach to assessing the effects of reforms on wage inequality, see Behrman, Birdsall and Szekely (2001b).

[33] Behrman et.al. (2001b) report that the effect of the reforms in increasing the wage gap does not persist over time, but fades, consistent with the likelihood of market adjustments. Thus the reforms have not necessarily hurt the poor or the middle stratum in any permanent way, but neither have they helped those groups.

[34] Gavin and Hausmann (1996) document the sources of volatility in Latin America. Kose, Prasad, and Terrones (2002) show the impact of financial liberalization on consumption volatility for some low income countries.

Section 3. The Ingredients of a Job and Growth-Based Social Contract

What are the implications in terms of policies that would constitute a broader, open-economy social contract? I consider four. Three have to do with domestic fiscal policy, and one with policies of the advanced economies.[35]

First, brilliant fiscal policy is the central ingredient of an open-economy social contract. It is difficult to avoid this conclusion, despite its apparent banality. I use the word "brilliant" because the standard for the emerging market economies of Latin America is, ironically, higher than it is for the United States and European economies. That is because the emerging market economies of Latin America have two problems: more shallow domestic financial markets that are less resilient to downturns, and bad history. Shallow financial markets make it more difficult for governments to manage instability.[36] Bad history (of mismanaged borrowing and resulting inflation and currency crises) means that creditors, domestic and foreign, remain skeptical of the political ability of governments to manage their budgets without, in the face of crisis, resort to printing money or new rounds of excessive and costly borrowing.

Brilliant fiscal management implies among other things a willingness and political ability during good times to reduce public debt. Unless public debt is already declining, fiscal deficits have to be viewed as bad social policy, as violating the social contract, unless a government has already run surpluses for several years, and the deficit spending is clearly countercyclical and temporary. With the sole exception of Chile, every country in the region has run an overall fiscal deficit in every year since 1993.[37] If the overall deficit is negative relative to growth prospects, even a primary surplus with an overall deficit (in good times) is not sustainable. It is tempting to borrow for good investments (including in health and education) during good times. But only countries that have already managed to avoid instability for the last decade (Chile, perhaps El Salvador, Costa Rica) can escape the burden of sustaining surpluses during years of growth for many years to come.

For most countries in the region, surpluses are critical to the social contract for at least two reasons. First, they are the key to holding down real interest rates. Real interest rates have been very high in Latin America during the nineties, reaching more than 10%, on average, for the majority of countries, whereas real interest rates have been generally below 10% for other developing countries and about 5.6% in the United States (see Table 2). Lowering interest rates is a key to generating jobs for the vast majority of the workforce with limited education.[38]

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[35] This section relies in part on the policy ideas set out in Birdsall and de la Torre, 2001, where the emphasis is on policies that directly address equity while not sacrificing growth. See also de la Torre, 2002.

[36] Inter-American Development Bank (1995).

[37] International Monetary Fund (2001).

[38] In the OECD, higher real interest rates have been shown to contribute to higher unemployment (Blanchard and Wolfers, 1999). Estimates of the relationship show no statistically robust effect in Latin America; the data are, however, much "noisier" on real interest rates (due to non captured inflation volatility itself); the credit markets are much more segmented; and employment and unemployment data are less reliable.

Table 2: Comparison of Average Real Interest Rates (90's): Latin America, Other Developing Countries, and the United States

Average Real Interest Rates Nineties			
Latin America		**Other Developing Countries**	
Argentina (1990-2000)	11.02	Algeria (1994-2000)	-1.62
Belize (1990-2000)	12.61	Angola (1995-2000)	-55.68
Bolivia (1990-2000)	33.49	Bangladesh (1990-2000)	10.27
Brazil (1997-2000)	65.01	China (1990-2000)	2.61
Chile (1990-2000)	11.82	Croatia (1992-2000)	11.11
Colombia (1990-2000)	13.46	Egypt (1990-2000)	6.45
Costa Rica (1990-2000)	9.01	India (1990-2000)	6.52
Dominican Rep. (1991-2000)	14.65	Indonesia (1990-2000)	7.66
Ecuador (1990-2000)	1.36	Korea, Rep.(1990-2000)	4.51
El Salvador (1990-2000)	8.33	Malaysia (1990-2000)	4.43
Guatemala (1990-2000)	7.80	Mauritius (1990-2000)	12.40
Honduras (1990-2000)	6.77	Morocco (1990-2000)	8.59
Mexico (1993-2000)	9.49	Philippines (1990-2000)	6.73
Nicaragua (1990-2000)	-12.19	Singapore (1990-2000)	4.72
Panama (1990-2000)	8.85	Sri Lanka (1990-2000)	6.58
Paraguay (1990-2000)	14.45		
Peru (1990-2000)	25.91		
Uruguay (1990-2000)	40.06	**Developed Countries**	
Venezuela (1990-2000)	0.47	United States (1990-2000)	5.64

Source : World Bank, World Development Indicators (2001)

Second, public savings (i.e. a fiscal surplus) are key to governments' ability to use countercyclical fiscal and monetary policy to protect the large middle stratum as well as the poor during economic downturns. During recessions in the developed countries, governments can issue debt to finance unemployment insurance, to ramp up spending on food stamps, school meals, and public health, and to take other measures that constitute a social safety net for their citizens. Their domestic financial markets and confidence in their currencies enable them to finance countercyclical deficits during economic downturns. For practical purposes in the foreseeable future, few Latin American governments – with the possible exception of Chile- have local financial sectors able to absorb more debt, except at high costs, and few command sufficient confidence in external markets to borrow in bad times. Ironically, the fact that they are "emerging" not emerged markets, with their history of inflation and poor debt management, requires more sustained and deeper fiscal discipline than creditors, domestic and foreign, expect of developed country governments. There is no way to avoid this asymmetry if countries are to participate in the benefits of global integration.

In short, the ability to drive down real rates of interest and to implement countercyclical policy are at the heart of an open-economy social contract. That ability relies on brilliant fiscal policy.

Voters in Latin America have demonstrated, in the last decade, their suspicion of populism and support for candidates they saw as ensuring macroeconomic stability; this is not all that surprising given the evidence that the costs of instability are high for most households. But the collective memory of hyper-inflation as a state-induced burden on its citizens may be fading, and instability is now associated with financial crises that are externally triggered. With the growing evidence of reform fatigue,[39] once again there seems to be a tradeoff between good social policy and good fiscal policy. That unfortunate outcome can be avoided only if the link between good fiscal management and a job-based social contract is drawn.

Second, brilliant fiscal policy implies difficult reforms on the expenditure and tax side. On the expenditure side, most countries manage a distribution of expenditures, especially on social investments, that is much more progressive than the distribution of income.[40] But in some countries, for example Brazil, some major areas of expenditures such as pensions for civil servants and the military are both inefficient and unfair. (On the other hand, in Brazil the elimination of fiscal and quasi-fiscal deficit spending at the state level was a huge step in the right direction – a step not taken in Argentina.[41]) Creditors will remain suspicious of the long-term ability to manage budgets until these structural barriers to expenditure reduction are eliminated. The best "emergency" management to cut fiscal expenditures, even where it is convincing[42], is too subject to individual leadership, which in turn for creditors, is too politically uncertain (as the market reaction to the candidacy of Lula in Brazil indicates). Because of the effect of creditor wariness on interest rates for public borrowing, expenditure reform is key to lower interest rates for the private sector, and to job growth, and thus to an open-economy social contract.

On the tax side, there are at least two issues. One is that in most countries, the richest 10 percent of households pay little in taxes. Loopholes and evasion are the norm.[43] In Argentina, the richest households face an average tax rate of 8 percent.[44] The limits on overall revenue collection when households that control more than 50 percent of income pay little taxes are obvious.[45] Second, the region relies heavily on the value-added tax, which along with other

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[39] See Graham (2002) for evidence of changing political attitudes toward the economic reforms of the 1990s, and the growing sense of economic insecurity in the region. She reports (based on LatinoBarometro surveys) that in Latin America only 16 percent of survey respondents feel they live better than their parents, compared to 64 percent in the United States. She also reports that people's level of wealth is positively correlated with support for "productivity" vs. "redistribution" in the region.

[40] Birdsall and de la Torre, 2000.

[41] In Brazil, civil service and military pensions take up at least 25 percent of annual public revenue. Pensioners receive 100 percent of their highest salary with full inflation adjustments and full adjustments calibrated to minimum wage increases.

[42] I think of the benefits of such optimal emergency management, irreverently, as the "Pedro Malan" benefits, referring to Brazil's Minister of Finance from 1995 through 2002. But even they are limited.

[43] Birdsall and de la Torre (2001) cite some evidence.

[44] Inter-American Development Bank (1999) shows the incidence of taxation by decile for several Latin American countries. The source for Argentina's tax incidence is Centro de Estudios Bonaerense (1997).

[45] In the boom years of the late 1990s in the United States, an estimated 60 percent of all income tax revenue came from the top 5 (check) percent of households in per capita income.

direct taxes generates 90 percent of all revenue compared to 60 percent in Europe. As a tax on consumption the value-added tax is not in itself progressive (though it can be and is administered in a manner to limit its regressive impact). Moreover, like the payroll taxes (because of the way they are generally administered) it is an invisible tax; citizens are unaware of its burden. It cannot embody for citizens the flip side of the social contract between the state and citizens, which is that citizens take responsibility for financing the state and expect accountability from the representatives of the state for responsive and responsible government.[46]

Reform of tax systems in the region to better embody a social contract would imply implementing more visible and more progressive tax policies. That need not imply raising marginal tax rates. It would imply, in some countries, increasing overall revenue by eliminating loopholes and reducing evasion (and increased revenue would allow increased expenditures which as noted are more progressive in their distribution than is income). It might imply an increase in the sales tax on luxuries or a reinstatement of a modest tax on imports, done across the border for revenue not for protection. The resulting revenue would be stabilizing, rising in booms and falling in recessions.[47] In most countries, these reforms would reduce heavy reliance on less visible consumption and payroll taxes which place a heavy burden on the middle stratum.

Third, a social contract implies a new emphasis on jobs and on protecting the rights of workers. Behind the fact that middle-income groups have very low income is the difficulty experienced by most countries in the region in generating massive formal employment. Moreover, a job-based social contract cannot ignore the insecurity and lack of protection against economic downturns faced by the vast majority of the region's workers. As Figure 5 illustrates, reform of labor markets is the least advanced in Latin America compared to the other economic reforms associated with the Washington Consensus, presumably because the emphasis on labor market "flexibility" has been so politically threatening to the remnants of the pre-1980s social contract based on industrial sector job protection. An open-economy job-based social contract implies putting a heavy premium on creating as well as protecting jobs, and thus on the income and consumption of the great majority of households. That can best be accomplished in several ways: guaranteeing collective bargaining rights along with regulatory programs to ensure workers' own bargaining capacity in democratic unions; shifting emphasis from ensuring individuals' stability in particular jobs in the formal sector to greater and easier job mobility; and emphasizing new protections of jobs and income in the informal sector.

Protecting job mobility need not rely on unemployment insurance of the type common in the richest economies, which requires greater capacity to finance counter-cyclically than most governments in the region have now. It can be built on a partially self-financed program of mandatory employee and employer contributions to individual accounts, which can be rolled over into retirement funds. Chile has developed such a funded and portable system of individual worker accounts that can be used for unemployment insurance as well as a limited set of other worker initiated withdrawals, e.g. for purchasing a home.[48] This approach can eventually provide

[46] This point is discussed in Birdsall and de la Torre, 2001, and convincingly elaborated in De la Torre, 2002.
[47] I am grateful to Samuel Morley for suggesting this point.
[48] Marquez (2000) and Cortazar (1995).

a real substitute for high minimum wage levels, excessive severance payments, rigid pension benefits, and other prerogatives that inhibit formal employment due to their high impact on labor costs. In addition, health insurance, unemployment insurance, and pension systems can be designed for informal sector workers. Spain has had success in implementing programs in these areas for the self-employed.[49]

Finally, access to rich country markets should be viewed as central to the open-economy social contract. A job and growth-based social contract for an open economy relies on openness, not only of the region's economies but of its external markets. At least some of the instability that has been so costly to the middle stratum and the poor would be reduced for the region were its access to the U.S. and European markets better; higher export growth and reduced external borrowing needs would insulate economies more from financial instability.[50] Moreover, it is likely that jobs created in sectors such as agriculture (soybeans in Brazil), shoes, and textiles would increase demand for less-skilled labor. The benefits of joining the global economy would then be increased for the vast majority of households where adults still have relatively little education.[51] Without that access, it may not be impossible but it will certainly be difficult to imagine that the region can forge the kind of social contract I have outlined. That puts a social premium on the need for Latin American countries to be strategic as a region in the context of negotiation of the Free Trade Area of the Americas (FTAA), and to find a set of common goals to take into the global discussion in the Doha round.

Concluding Remarks

I have only indirectly alluded to the underlying problem of the poor distribution of productive assets in the region, which is reflected in and reinforces the highly unequal distribution of income. The reason is that the broad outlines of social policy are already addressing this problem, via the increased attention to education (the people's asset[52]); growing efforts to expand programs of micro-finance (to provide credit and increase asset accumulation among the poor); and land reform (especially in Brazil and Colombia where sensible innovations are proving market-based land reform is eminently possible). These are all not only central to good social policy; they are key to increasing the sustainable level of long-run growth in the region, by increasing the productivity of the vast majority of the region's citizens. There is good evidence that in economies with relatively weak capital and other markets, where the regulatory arrangements to compensate for the inherent imperfections of markets are themselves not always adequate – in those economies, the inequality in access to access itself undermines growth.[53]

[49] International Labour Organization (1999).

[50] Trade liberalization has been too much a one-way street, with subsidies, quotas, dumping laws, and technical requirements (phyto-sanitary, environmental, and so on) contributing to make it difficult for exporters in Latin America to reach United States, European, and Japanese markets.

[51] The fact is that reducing fiscal deficits and improving job security are not alone likely to give the region a new growth momentum. Even better access to markets for growing exports will probably need to be complemented by public investment in infrastructure, agriculture, and other sectors to jump-start gains in productivity in non-tradable sectors.

[52] I emphasize this point in Birdsall, 2000. See also Birdsall and Londono, 1997.

[53] The literature on the effects of inequality on growth is much more clear on this point than is often conveyed. The

(The classic example is the inability of the poor to borrow, which limits not only their own income but overall economic growth). Nor should a social contract in any country of the region ignore the continuing costs of ethnic and racial discrimination.

I have chosen instead to emphasize a problem that has received less attention, namely that not only the poor but a large majority of the workers and households in the region are not yet gaining, or certainly not gaining much relative to their highly educated neighbors, from the opening of economies and the other reforms of the last decade. In effect, the standard and sensible emphasis on addressing the needs of the poor has created blinders (especially in the international development community) about the reality that households in the middle of the income distribution in Latin America are far from the level of income and security associated with the "middle class" in advanced economies. They may not be counted as poor today, but they may well have been poor recently, and may well become poor tomorrow. In terms of their ability to accumulate assets, and the likelihood of their receiving an adequate return to those assets, they are better thought of as the near-poor than as the "middle class" that would constitute the bulwark of a democratic system in an open economy. An emphasis on a social contract that attends to the needs of this hidden majority of populations and not just to the currently poor, would probably, ironically, benefit the poor more too, since we know that the poor benefit so much from growth itself, and especially from stable, job-based growth.[54]

The region has undertaken one set of changes in the direction of more open and competitive market economies. The growth benefits of that first large step need now to be complemented and reinforced by a second step – a social contract focused heavily on jobs and growth, and thus on brilliant fiscal management, protection of workers' rights, and pressure on the United States and the other the advanced economies to increase access to their markets.

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best single assessment (Barro, 1999) is one that distinguishes carefully between developed and developing economies. In the former inequality may actually foster growth; in the latter it has a negative effect. Birdsall and Londono, 1997, show that inequality of education and land measured at the the economy-wide level reduces the income growth of the poorest quintile twice as much as it reduces the income growth of the average household, and that taking into account inequality of those two assets, Latin America is not at all "special"; it is its asset inequality that accounts for its being an outlier in the distribution of income.

[54] Nelson, 2000, discusses the politics of this kind of alliance. Ravallion (2002) shows that in Argentina, as well as Bangladesh and India, the targeting performance of safety net programs deteriorates when the programs contract. That suggests "an underlying tendency in the political economy to protect spending of the non-poor"(page 18). A corollary, ironically, is that expanding spending to reach more people is likely to help the poor disproportionately.

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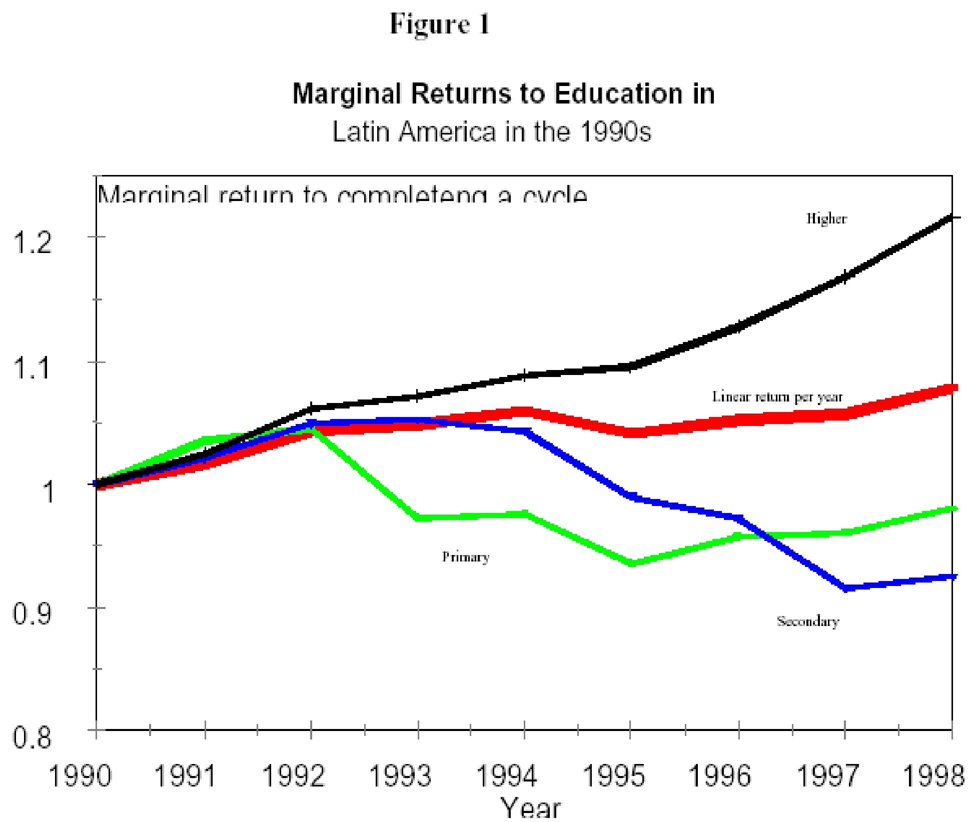
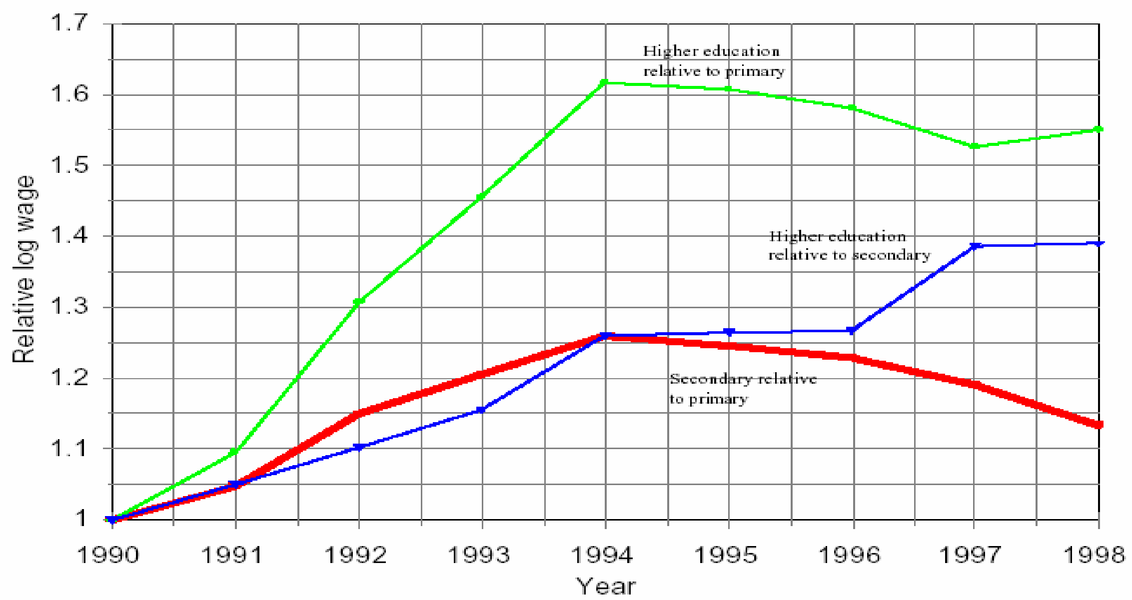
FIGURE 1(A): CHANGE IN MARGINAL RATE OF RETURN TO EDUCATION ACCORDING TO COMPLETED CYCLE, 1990-1998 IN LATIN AMERICA.



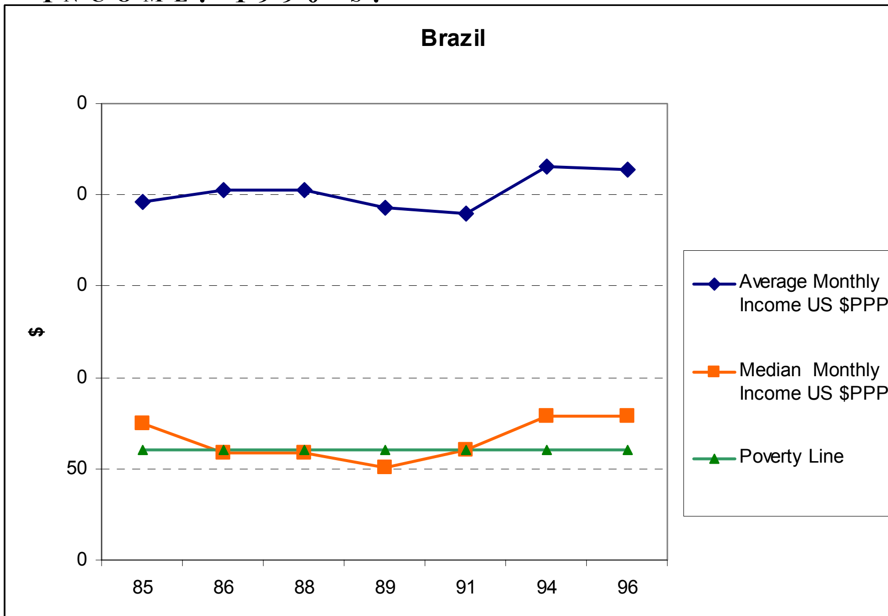
Source: Birdsall, Behrman, and Szekely (2001b)

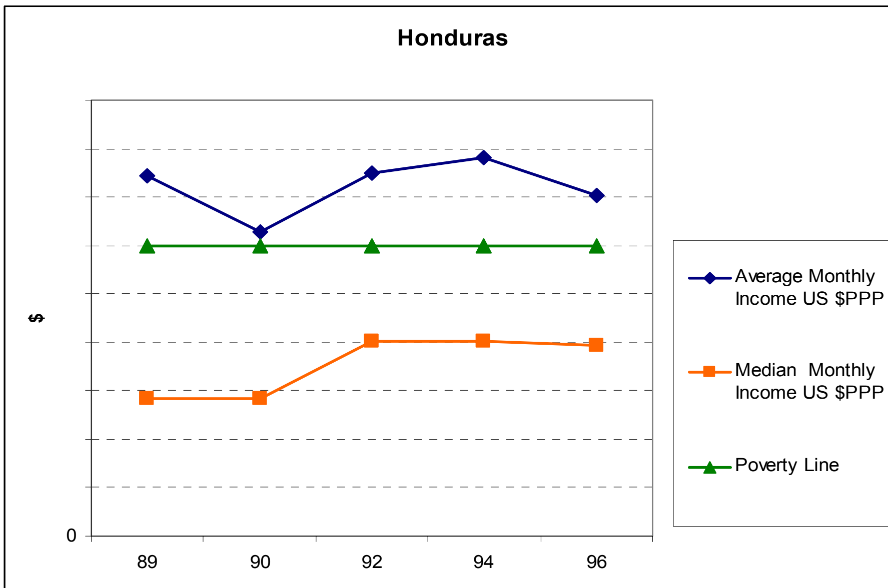
FIGURE 1(B): WAGE DIFFERENTIALS IN LATIN AMERICA

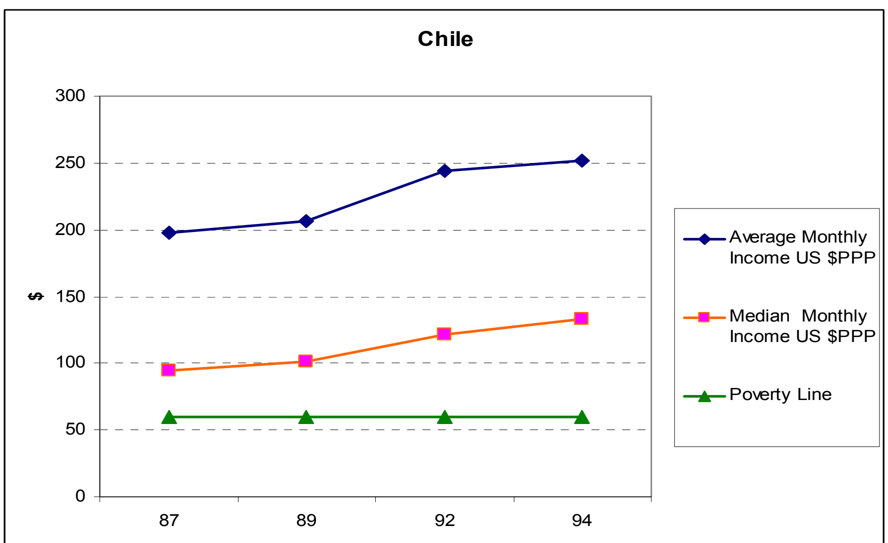


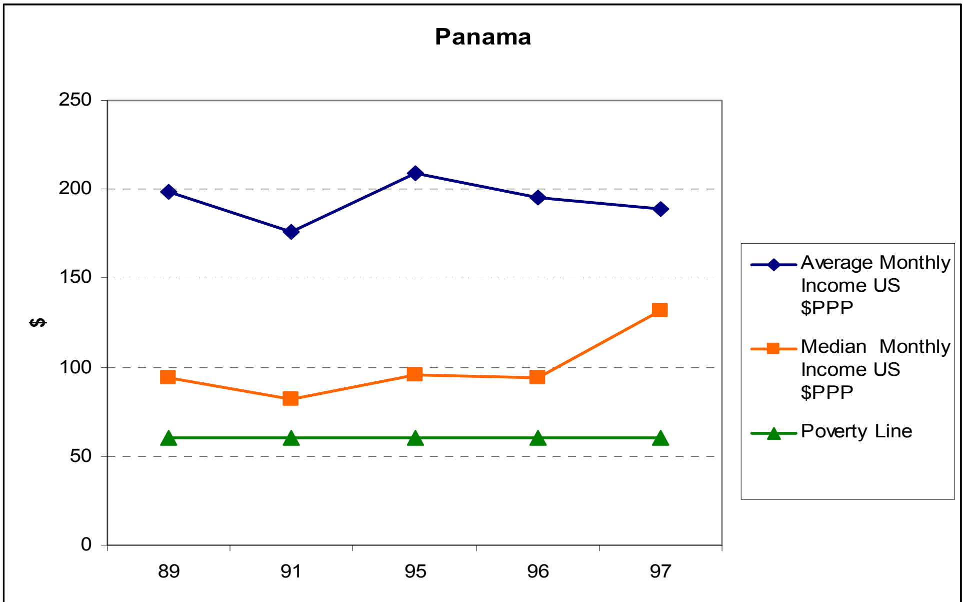
Source: Birdsall, Behrman, and Szekely (2001b)

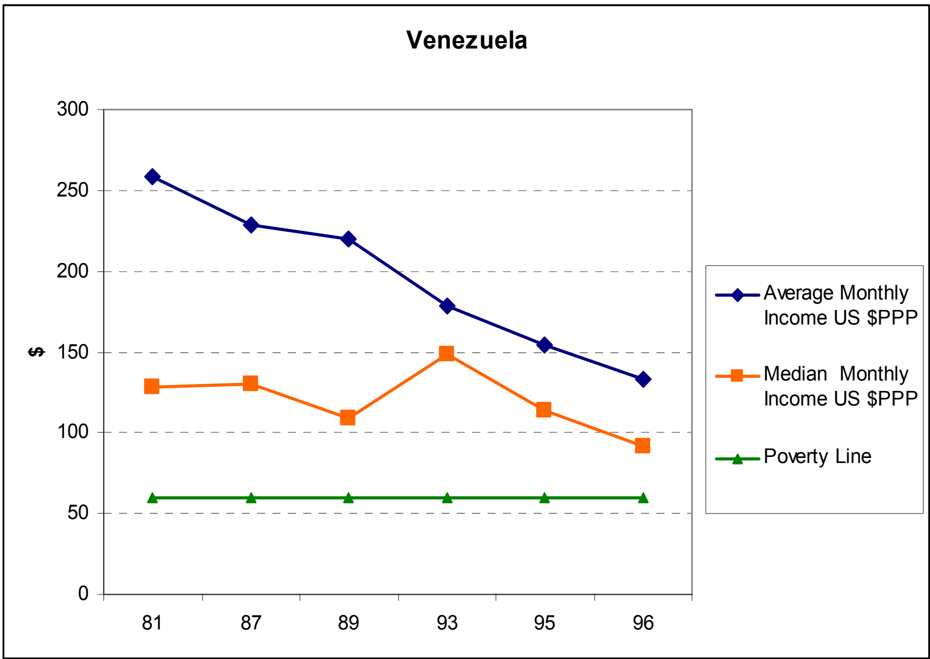
FIGURE 2: MIDDLE INCOME GROUPS IN LATIN AMERICA. AVERAGE HOUSEHOLD INCOME AND MEDIAN HOUSEHOLD INCOME. 1990'S.





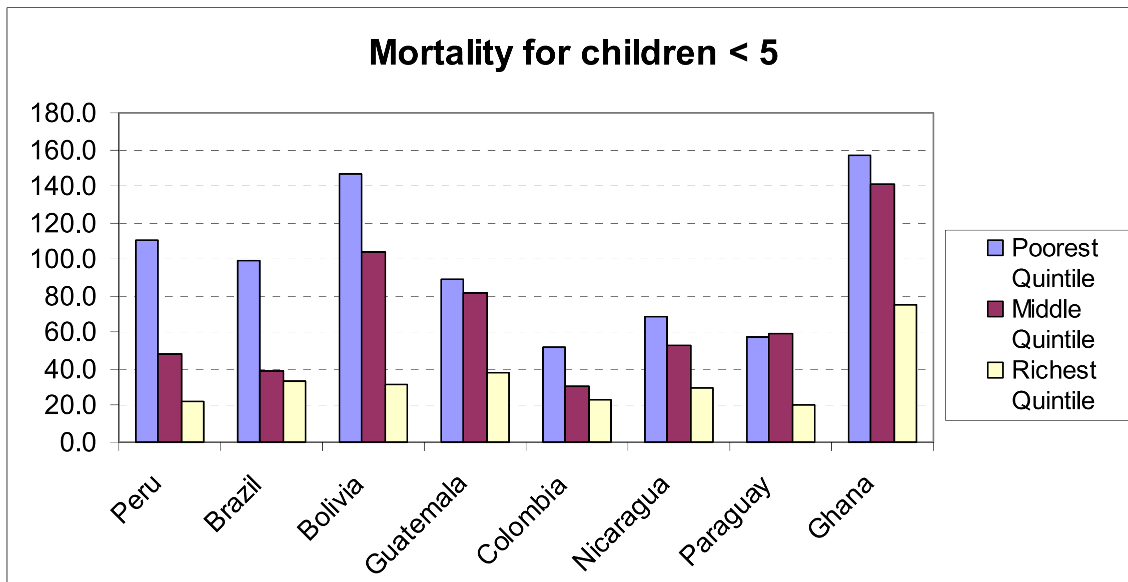




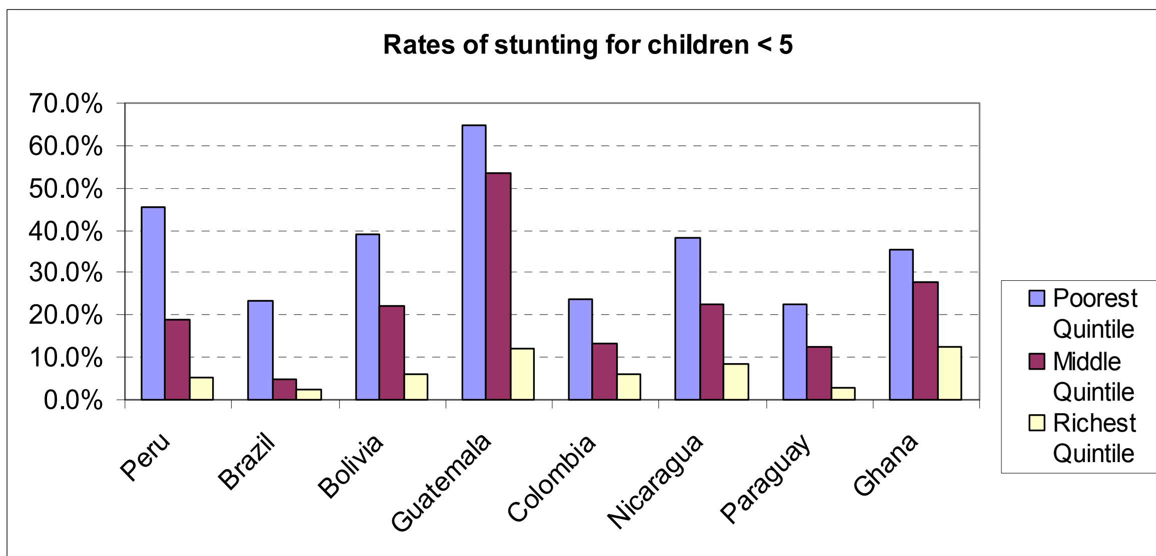


Source : Own estimations from World Bank Data Sets (2002)

F I G U R E 3 : H E A L T H I N D I C A T O R S F O R S E V E R A L L A T I N A M E R I C A N C O U N T R I E S B Y I N C O M E G R O U P . 1 9 9 0 ' S .

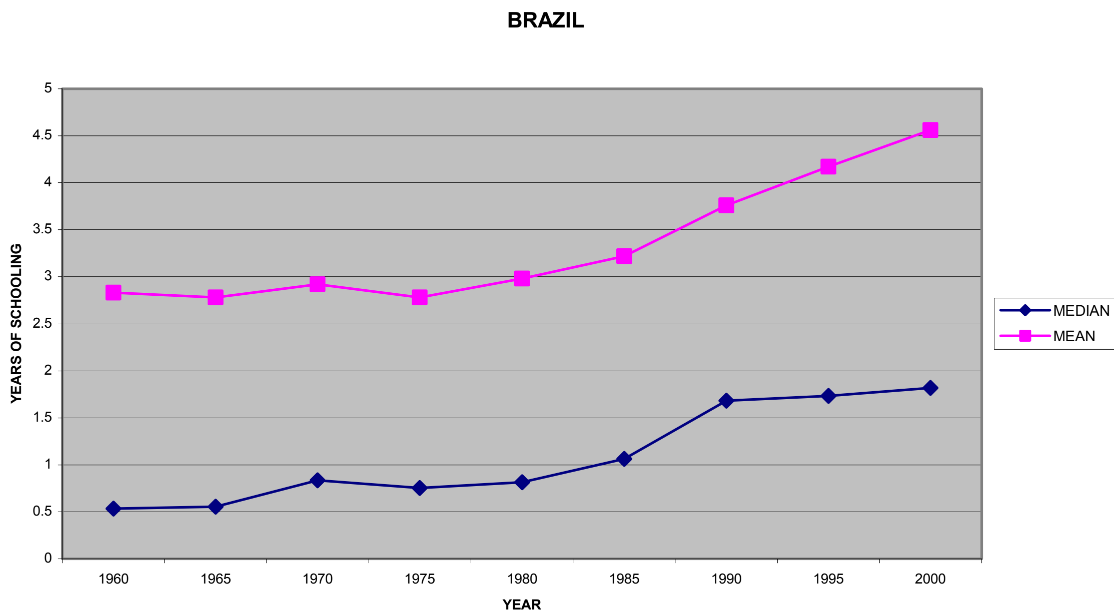


Source: World Bank's Health and Population Advisory Service. Demographic and Health Surveys: Peru (1996), Brazil (1996), Bolivia (1998), Guatemala(1995), Colombia (1995), Nicaragua (1997), Paraguay (1990), Ghana (1993). http://www.worldbank.org/poverty/health/data/index.htm

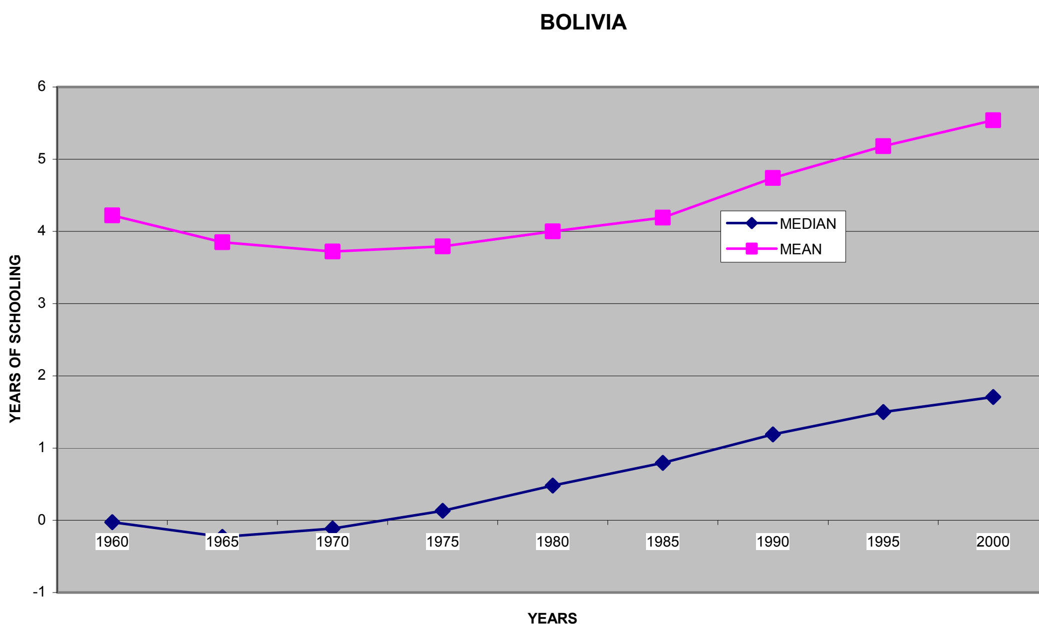


Source: World Bank's Health and Population Advisory Service. Demographic and Health Surveys: Peru (1996), Brazil (1996), Bolivia (1998), Guatemala(1995), Colombia (1995), Nicaragua (1997), Paraguay (1990), Ghana (1993).
http://www.worldbank.org/poverty/health/data/index.htm

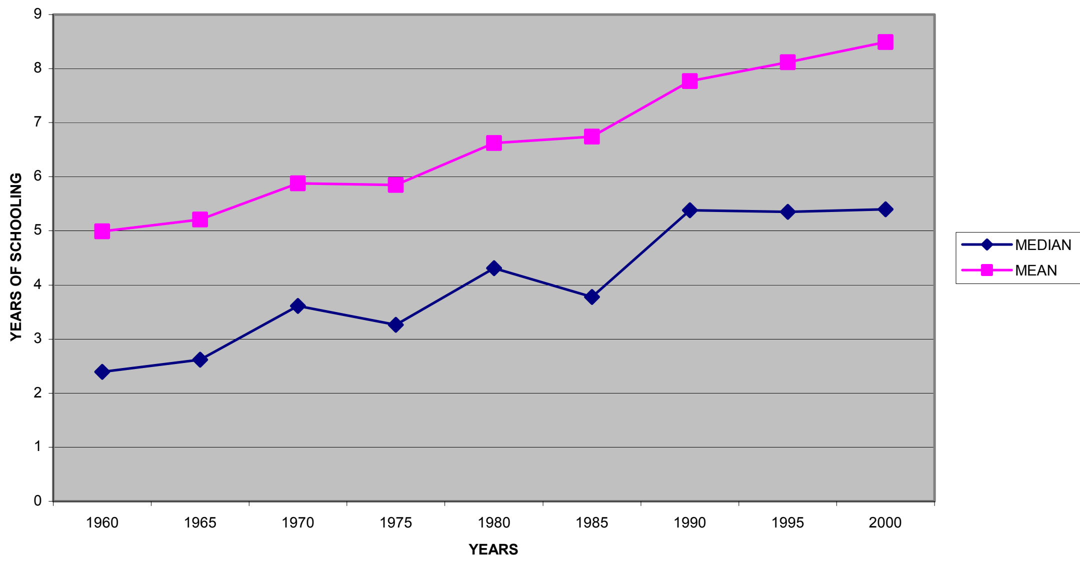
FIGURE 4: AVERAGE LEVELS OF EDUCATION AND MEDIAN LEVELS OF EDUCATION IN LATIN AMERICA



Source: Own estimations, based on Barro and Lee Data Set (World Bank Data Sets, 2002).



Source: Source: Own estimations, based on Barro and Lee Data Set (World Bank Data Sets, 2002).



Source: Own estimations, based on Barro and Lee Data Set (World Bank Data Sets, 2002).

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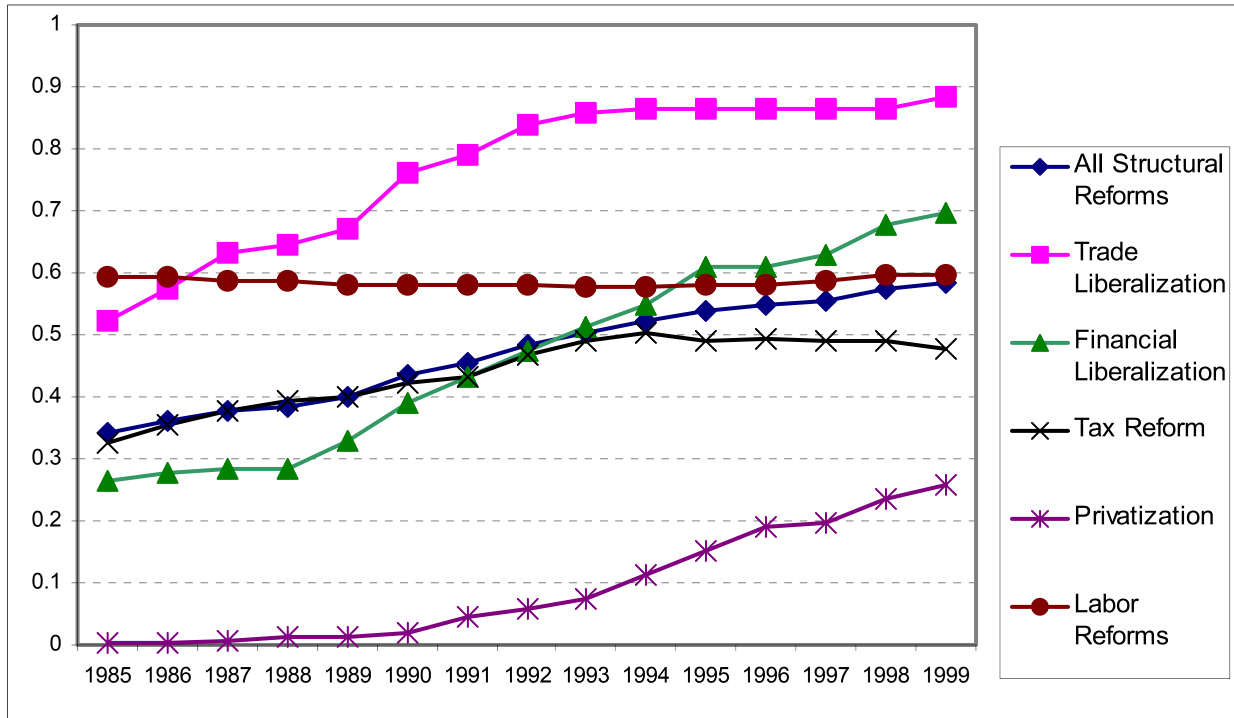
FIGURE 5: EVOLUTION OF REFORMS IN LATIN AMERICA. REGIONAL AVERAGE* STRUCTURAL REFORM INDEXES (1985-1999)



Source: Lora (2001)
Notes: * The regional average does not include the Dominican Republic, Honduras and Nicaragua ** Reforms Indexes 0-1 (1 higher reform depth)

Appendix I: Effects of Growth and Inequality on Poverty in Latin America

Country	Period	Poverty Line	Initial Poverty Rate	Final Poverty Rate	% Change Total	% Change due to Growth	% Change due to Redistribution	% Change Residual
Brazil	1985-1995	Extreme	10.03	11.05	10.2%	-40%	145%	-5%
		Moderate	30.42	28.02	-7.9%	-40%	-70%	10%
Bolivia	1990-1995	Moderate	52.4	47.1	-10.1%	-147%	44%	3%
Chile	1987-1996	Moderate	45.1	23.2	-48.6%	-85%	-7%	-8%
Colombia	1991-1995	Moderate	58.5	58.46	-0.1%	-103%	6%	-3%
Costa Rica	1986-1995	Moderate	29.4	25.6	-12.9%	-117%	17%	0%
Peru	1985-1996	Moderate	43.1	50.5	17.2%	99%	-27%	28%

Source: Attanasio and Szekely (2001)

APPENDIX II : MEDIAN INCOME ESTIMATION

The estimation follows Cline (2002) and Bourguignon (2002).The median is the value *m* of a variable X such that:

$$\Pr ob(X \leq m) \geq \frac{1}{2} \quad \text{and} \qquad (1)$$

$$\Pr ob(X \geq m) \leq \frac{1}{2}$$

Where Prob= probability function

Thus, median income is the value of income for the individual or household right at the middle of the whole range of the income distribution. Most income data by country includes average income and some measure of inequality (dispersion), but not the median. In order to estimate the median, as defined in equation (1), using the average and the dispersion, it is necessary to use a probability function .Assuming that income (y) has a log normal probability distribution, its probability distribution can be specified as follows:

$$f(y) = \frac{1}{\sqrt{2\pi}\sigma y} e^{-\frac{(\ln y - \delta)^2}{2\sigma^2}} \qquad (2)$$

Where δ = mean of ln y

σ = standard deviation of ln y

The log normal distribution can be expressed as a standard normal distribution after normalizing y:

$$f(x) = \frac{1}{\sigma x}\psi\left(\frac{1}{\sigma}\ln x + \frac{\sigma}{2}\right) \qquad (3)$$

Where ψ = Standard Normal Distribution

X= normalized y

The cumulative distribution function of x is :

$$F(x) = \Pi\left(\frac{1}{\sigma}\ln x + \frac{\sigma}{2}\right) \qquad (4)$$

Where Π = Standard Normal Cumulative Distribution

For a log normal distribution the parameter σ can be obtained from the Gini coefficient:

$$\sigma = 2\{\Pi^{-1}(\frac{G+1}{2})\}^{2} \qquad (5)$$

Where Π^{-1} = is the inverse function of the cumulative standard normal distribution
G = Gini Coefficient

We used a World Bank (2002) data base from household surveys. The data includes average income and Gini coefficients of Latin American Countries during the nineties. We first calculated σ using the Gini coefficients and then used the function in (4) to estimate the median.

APPENDIX III: TRADE LIBERALIZATION, MACROECONOMIC CONTEXT, INEQUALITY, AND POVERTY IN LATIN AMERICA

Table 1: Trade Liberalization, Macroeconomic Context and Inequality in Latin America.

Variable	Variable		
	Preferred estimation	Others estimation	
Independent	LogR-LogP (P= poorest 30%)	LogR-LogP (P= poorest 10%)	Gini Index
Trade Liberalization	**-0.39**	**-0.60**	**-0.43**
	-1.32	*-0.91*	*-2.40*
Financial Liberalization	**0.16**	**0.18**	**0.06**
	2.33	*1.60*	*2.91*
Other Reforms	**-0.09**	**-0.12**	**0.40**
	-0.41	*-0.41*	*2.06*
Macroeconomic Volatility	**0.13**	**0.14**	**0.04**
	2.65	*1.66*	*3.47*
Inflation	**0.09**	**0.12**	**0.02**
	2.43	*1.52*	*3.24*
Terms of Trade	**-0.35**	**-0.31**	**-0.14**
	-1.47	*-0.86*	*-2.38*
Real Exchange Rate*	**-0.30**	**-0.40**	**-0.10**
	-6.17	*-4.27*	*-7.58*
Constant	**2.16**	**2.57**	**1.34**
	6.95	*4.25*	*15.01*
Number of Observations	75	75	75
F(7, 46) =	15.22	8.53	20.31
Prob > F =	0.000	0.000	0.000
R-squared	0.297	0.141	0.485

Source: Authors calculations from households' surveys.
*'t' proof at parenthesis

Source: Behrman,Birdsall and Szekely, 2001a
Note: *Real Exchange Rate is measured as US $ per local currency unit

Table 2 : Trade Liberalization, Macroeconomic Context and Poverty in Latin America.

Variable Independent	Dependent Variable: Preferred Estimation	Others Estimations			
	LogM-LogP (P=2 daily dollars)	LogR-LogP (P=2 daily dollars)	Poor people Ratio	Poverty Gap	Index FGT(2)
Trade Liberalization	**-0.03**	**-0.12**	**-0.38**	**-0.43**	**-0.60**
	-1.21	*-1.68*	*-1.18*	*-1.53*	*-1.66*
Financial Liberalization	**0.27**	**0.21**	**0.26**	**0.26**	**0.34**
	2.54	*2.02*	*1.25*	*1.70*	*1.75*
Other Reforms	**-0.03**	**-0.04**	**0.46**	**0.33**	**0.38**
	-1.64	*-0.73*	*1.21*	*1.03*	*0.92*
Macroeconomic Volatility	**0.18**	**0.23**	**0.26**	**0.42**	**0.51**
	2.10	*1.79*	*3.62*	*5.42*	*4.83*
Inflation	**0.21**	**1.16**	**0.05**	**0.08**	**0.09**
	2.99	*3.88*	*0.91*	*1.83*	*1.71*
Terms of Trade	**-0.22**	**-0.38**	**-0.60**	**-0.83**	**-1.05**
	-0.10	*-0.19*	*-1.98*	*-2.22*	*-2.32*
Real Exchange Rate*	**-0.37**	**-0.35**	**-0.20**	**-0.25**	**-0.32**
	-2.23	*-4.38*	*-2.13*	*-3.53*	*-3.57*
Constant	**1.09**	**1.25**	**1.39**	**1.83**	**2.17**
	29.90	*12.77*	*3.06*	*3.45*	*3.30*
Number of Observations	75	75	75	75	75
F(7, 46) =	4.82	7.65	10.51	13.01	11.49
Prob > F =	0.000	0.000	0.000	0.000	0.000
R-squared	0.321	0.395	0.363	0.459	0.437

Source: Authors calculations from households' surveys.
*'t' Proof at parenthesis

Source: Behrman, Birdsall and Szekely, 2001a
Note: *Real Exchange Rate is measured as US $ per local currency unit

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