CHAPTER 9

Changes in Income Distribution and Poverty from the 1970s to the 1990s

Income distribution has once again become a major issue in Chile. This is healthy because problems cannot be understood and solved unless their existence is acknowledged. Despite effective efforts made in the 1990s to reverse the deterioration of the 1970s and 1980s, poverty is still a fact of life for one in every five Chileans, and inequality in opportunities and income is still manifest. Lack of equity is a marked feature of the Chilean economy and society.

Distribution has changed significantly over the last thirty years. There is clear evidence that the situation worsened markedly in the 1970s and 1980s, with both inequality and poverty rising. In the 1990s, poverty fell sharply. The information regarding distribution, however, is less conclusive. Some data, such as those from the National Socio-Economic Survey (CASEN), show some improvement in income distribution in the early 1990s, compared to the late 1980s, which remained relatively stable during the rest of the decade. Other information, such as the National Bureau of Statistics (INE) household budget survey, shows a substantial improvement between 1988 and 1997. What all the information signals, though, is a significantly worse distribution than in the late 1960s and a continuing high level of poverty. It can be said with certainty, then, that in the 1990s (1) the deteriorating trend seen during the Pinochet regime was brought to a halt, (2) poverty was reduced sharply, and (3) income distribution became less unequal than in the 1980s. But despite this, the net balance indicates that Chile lost ground over the last thirty years rather than progressing toward greater equity. Equity is an essential ingredient of modernization.

In this chapter, we shall review the most important developments in

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distribution over recent decades. We shall concentrate on three aspects. Two of them are structural: the need to improve the quality and quantity of investment in people, or human capital; and the need to enhance productive investment and its link to productive employment. Both factors contribute to raising productivity across all sectors of society and thus to spreading opportunities to larger segments of the labor force. The third aspect, to which I attach enormous importance, is the attainment of sustainable macroeconomic balances.

The efficient approach for obtaining both growth and equity implies a comprehensive definition of macroeconomic equilibria. This includes far more than low inflation and structural fiscal balance (though both are necessary and convenient). It also requires real economy equilibrium, that is, making full use of available productive capacity, avoiding excessively fluctuating and outlier interest and exchange rates, and securing a favorable macroeconomic environment for productive investment.[1]

The biggest setbacks in distribution and poverty have been caused by critical macroeconomic imbalances: the hyperinflation of 1973 and the recessions of 1975 and 1982. To these should be added the cases in which macroeconomic "balances" have been achieved at the expense of other balances, such as the cases of macrosocial imbalance in 1985–87 and external imbalance in 1997. During the last episode, the subsequent recession in 1998–2001 – though notably mild compared to those of 1975 and 1982 – represented a severe setback with social, economic, and political costs. The distribution of household income per capita worsened in 1999–2001 with respect to the 1990s, even though it was somewhat less uneven than it had been in the 1980s (Larrañaga 2001). I argue that consistency between different objectives is essential if macroeconomic balances are to be sustainable over time and provide the required environment for socioeconomic development (see Ffrench-Davis 2000, chap. 6).

Trends in Income Distribution and Poverty

Good measurements are important because they provide information on the effectiveness of socioeconomic policies aimed at reducing the inequalities and poverty characteristic of underdevelopment. Nonetheless, the measurement of poverty and income distribution is beset with great difficulties.

The definition of *poverty* is a conventional one. The generally accepted definition of *the poor* is that they are "those whose income per

1. As illustrated in Ffrench-Davis 2000, Latin America was characterized in the 1990s by strong macroeconomic disequilibria, in their real meaning. Chile was an outstanding exception in the first half of the 1990s, but the quality of its environment began deteriorating to some degree in the following years (see chap. 10).

capita is lower than the cost of two baskets of food and basic nonfood needs" (ECLAC 1997, box 1). This is the dividing line between the poor and the nonpoor used in the CASEN survey in Chile. The definition does not tell us anything about how far the many people who ceased to be numbered among the poor between 1987 and 1998 have risen above the poverty line or about the previous position of those who might have returned to poverty in 1999. It is not an indicator of distribution, although CASEN obviously provides a great deal of valuable information for a number of distributive indicators and for an understanding of poverty and the strategic points from which to combat it.

Income distribution is much harder to measure, particularly at the poorest and richest extremes. Again, even if the figures available are correct, there are still many alternative ways of organizing the information, for example, by income or expenditure per household or per household member, and the differences are substantial.[2] Once the information has been classified, there are also different ways of measuring distribution; indicators range from the more cryptic (such as the traditional Gini indicator) to simpler ones such as the ratio between the shares of the richest and poorest decile or quintile. This latter indicator is quite widely used; its drawback is that it does not take into account the 60 or 80 percent in the middle and it gives great weight to the richest income bracket, where measurements are very defective.

There are different sources of information on distribution in Chile. The one of longest standing is the employment survey of the University of Chile, which has been collecting information on incomes in Greater Santiago once a year since 1958. The CASEN survey is conducted by the Ministry of Planning (MIDEPLAN), with data available for 1987 and then every two years since 1990 for all Chile; both the coverage and the survey itself were improved in the 1990s, so that comparability with 1987 is limited. Once a decade or so, the INE carries out a detailed survey of household budgets in Greater Santiago, which represents 40 percent of the population of Chile. Data are available for 1969, 1978, 1988, and 1997. INE also collects income data in a survey that supplements the employment study. Some results differ radically between the various sources, and there is considerable disagreement among specialists about the merits of each one.

The debate over which variables best determine distribution patterns and developments is also open. The information provided by the surveys themselves has been used as a basis for recent research, interpretations, and policy proposals. Here I shall mention four strong variables,

2. It would seem advisable to adjust for the number of household members, but two problems need to be dealt with first: (1) spending needs vary by age (one way of attempting to correct this would be by working with an "adult equivalent" as the unit of account); and (2) there are "economies of scale" in the household (Contreras and Ruiz-Tagle 1997).

which are ultimately the result of socioeconomic structures and public policies.

First, income levels have a highly positive relationship with years of schooling. Nonetheless, this relationship is subject to two qualifications, which have deep implications for public policy in this specific area. On the one hand, the quality of education and the matching of supply and the demand for skills are essential (Bravo and Contreras 1999; Larrañaga 2001). This is illustrated by the fact that, although the average worker had 3.5 years more schooling in 1992 than in 1970 (Hofman 1999), the average wage was similar, having been depressed in the intermediate years. Furthermore, schooling is measured on the basis of the number of years of traditional education, without taking the training accrued during people's working lives into account. Training is essential as a way of enhancing the productivity of workers with little education or schooling whose quality does not match the current demand for labor.

Second, increasing the participation of women in the labor force is a key factor in reducing the number of households in poverty. Data produced by Beyer (1997) on the basis of the CASEN survey of 1994 and the 1992 population census show that in the poorest quintile of households only a fifth of all women are in the labor force; in households in the fifth, or richest, quintile, half of all women participate. Of women with thirteen or more years of education, 57 percent participate in the labor force, while less than 14 percent of those with three or fewer years of schooling are reported as being active. The extent to which women participate in the labor market determines which proportion of household members receive pay, the figure being 22 percent in the bottom quintile and 51 percent in the top one, with an almost linear progression in the intermediate brackets. Improving opportunities and facilities (such as day nurseries) for working women with lower incomes is a key factor in increasing equity.

Third, unemployment is another very influential factor. In the CASEN survey of 1998, the unemployment rate was ten times as high in the first quintile as in the fifth, and its sensitivity to the economic cycle, and even to slight fluctuations such as those of the 1990s, is very high. In the first quintile, unemployment fell from 22 percent in 1990 to 14 and 15 percent in 1992 and 1996, respectively, rising to 28 percent in 1998 (MIDEPLAN 1999). Unemployment is also substantially higher among young people and those with less schooling. Consequently, policies intended to strengthen the demand for labor and make the supply more flexible and better able to adapt to technological changes—with sustainable macroeconomic stability, vigorous physical capital formation, and increasing investment in people—play a very significant role in improving the distribution of opportunities.

Fourth, social expenditure has a progressive incidence, representing a rising share of the access of the poor to goods and services in the 1990s.

The Historical Record up to 1973

By 1970, social development in Chile was among the highest of all Latin American countries. The level of education, the national health system, the system for constructing low-rent housing, and the massive school meals program were among the most advanced in the region. A large middle class had also emerged, although it was concentrated initially in urban areas. Progress also extended to unionized workers and the rural sector, where it was associated with the land reform carried out between 1965 and 1973 (Ffrench-Davis 1973).

These advances were the result of a continuous process that had become entrenched in the 1920s and had accelerated under the social democratic (Radical Party) governments that held office between 1939 and 1952 and then under presidents Ibáñez, Alessandri, Frei, and Allende (1952–73).

Notwithstanding the social gains made in the 1950s and 1960s, the distribution pattern that existed around 1970 was regarded as highly unsatisfactory. Consequently, a number of proposals for improving the situation were put forward by the parties of the Center and Left. Several of these were put into practice during the administration of President Allende. As a result, income from labor (minimum and average wages) and social spending (pensions, family allowances, the education and health budgets, etc.) increased massively in 1971, although in a way that was obviously unsustainable. The inflationary surge of 1972–73, with annual rates in excess of 200 and 600 percent, respectively, led to drastic reversals in the pattern of distribution on a number of these fronts in comparison with 1970 (see chap. 1).

Progress and Setbacks during the Pinochet Regime (1973–89)

Some social indicators continued to improve during the Pinochet regime, while others went sharply into reverse.

The illiteracy rate, already down to 20 percent in 1952, fell to 10 percent around 1973 and to less than 6 percent in 1989, while the number of students enrolled in primary schools, as a percentage of the population aged six to fourteen, rose from 65 percent to almost 100 percent in 1973 and remained at this level until the early 1980s. In the second half of the 1980s, however, coverage fell to 95 percent, which suggests that a

dropout problem arose as a result of the 1982 crisis. As for secondary education, the proportion of fifteen to eighteen year olds enrolled rose from 10 percent in 1952 to 51 percent in 1973 and 75 percent in 1989.[3]

Developments were very positive with regard to life expectancy and general and infant mortality, improving yet further the trend these indicators were showing in the 1950s and 1960s. In particular, infant mortality fell markedly, showing for Chile the lowest level in Latin America in the 1980s, along with Costa Rica, Cuba, and the English-speaking Caribbean. This good performance was the result of public efforts to improve mother and child care, including nutrition programs for children at the nursing stage; to a decline in the number of births; and to irreversible factors such as improvement in the education of mothers (Monckeberg 1998; Raczynski and Oyarzo 1981).

Nonetheless, the performance of other indicators was negative (see table 9.1). This was essentially a reflection of great macroeconomic instability, a low rate of gross investment per member of the labor force (involving a negative impact on productivity per worker) and laws that were biased against labor, as a result of which average earnings in 1989 were 8 percent below their 1970 level. In other words, over nearly two decades average wages, rather than increasing as is natural, fell, and something similar happened with pensions. The minimum wage declined by a similar percentage over the period, and its coverage narrowed considerably, with lower levels being applied to workers under twenty-one (later to those under eighteen) and over sixty-five (Cortázar 1983). Similarly, family allowances, which had played a progressive role, growing continuously in importance until the early 1970s (Ffrench-Davis 1973), went into a steady decline after 1974, until by 1989 they were 72 percent below their 1970 level.

Public spending per capita on health, education, and housing also fell. The decline in these three components reached around 22 percent in comparison with 1970.[4] Spending on the National Health Service dropped substantially. Only social security spending increased, owing to a rising number of pensioners. However, some social spending (though not the bulk of it) was targeted at the poorest members of society, which would appear to have partly offset the decline in their work income.[5]

3. Figures are from ECLAC, *Statistical Yearbook*, based on official Chilean information.

4. Public spending is financed by fiscal funds, the contributions of beneficiaries, and changes in liabilities. A large discrepancy between the official and "corrected" figures for social spending in the 1970s is discussed in Marshall 1981.

5. Sometimes faulty targeting implied the crowding out of the middle class or even the poor, for example, from the university after the elimination of free access without a comprehensive system of scholarships. As a consequence, public expenditure in higher education is concentrated in quintile 5.

TABLE 9.1. Wages, Family Allowance, and Public Social Expenditure, 1970–2000 (real indices, 1970 = 100)

	Average Wages (1)	Minimum Wage (2)	Family Allowance (3)	Per Capita Public Social Expenditure		
				Education (4)	Health (5)	Total (6)
1970	100.0	100.0	100.0	100.0	100.0	100.0
1980	89.0	130.0	81.6	88.6	82.3	90.1
1981	96.8	135.7	80.9	92.1	74.7	97.5
1985	83.2	86.1	54.6	76.0	64.0	90.5
1986	84.6	82.1	45.7	71.5	62.5	86.9
1987	84.3	77.1	38.1	65.7	61.5	84.7
1988	89.8	82.3	33.2	64.1	70.4	86.0
1989	91.6	91.8	28.4	62.5	69.6	83.7
1990	93.3	98.0	33.7	58.8	65.3	81.6
1991	97.8	107.2	41.4	64.7	75.7	87.8
1992	102.2	112.2	42.4	73.1	87.0	95.4
1993	105.9	117.7	43.2	78.2	95.9	102.9
1994	110.7	122.1	43.9	83.9	104.0	107.4
1995	118.3	127.5	45.3	92.3	106.7	113.9
1996	123.2	133.0	47.2	102.7	114.3	123.2
1997	126.1	137.8	49.7	111.6	119.4	128.1
1998	129.5	146.2	51.9	122.6	127.5	135.7
1999	132.6	159.6	53.3	129.4	129.6	144.3
2000	134.4	170.4	53.7	138.4	138.5	151.0

Sources: Instituto Nacional de Estadística and Jadresić 1990 for wages; Cortázar and Marshall 1980 for corrected CPI; Cabezas 1988 and Budget Office (since 1986) for social expenditure.

Note: Column 1, general wage index until April 1993 and later hourly wage index. Column 2 represents liquid income. Column 3 is family allowance of blue-collar workers in 1970, then the uniform allowance, and later that for the low-income bracket. Column 6 includes expenditures on education, health, housing, and pensions. All are average figures for each year.

Many of these indicators deteriorated during the 1970s, made a partial recovery in 1979–81, and worsened again between 1982 and the end of the decade (Ffrench-Davis and Raczynski 1990); average and minimum wages began to rise only in 1988, family allowances in 1990, and public social spending in 1991.

The decline in labor income and monetary social expenditure, as well as the regressive bias of the tax reforms in those years, were reflected in a worsening distribution of consumer spending. The most systematic and highest quality information available is from the household budget surveys conducted in Santiago.[6] The figures for 1969, 1978, and 1988

6. We have made efforts to seek a possible bias in the EFP associated with the facts that Santiago includes only 40 percent of Chile's population and that it is essentially urban. After comparing the results of the CASEN surveys for Santiago and the entire country, we find that concentration coefficients are relatively similar in the five surveys recorded

TABLE 9.2. Distribution of Expenditure per Household, 1969, 1978, and 1988 (percentages of total)

Quintile	1969	1978	1988
1	7.6	5.2	4.4
2	11.8	9.3	8.2
3	15.6	13.6	12.6
4	20.6	21.0	20.0
5	44.5	51.0	54.9
Total	100.0	100.0	100.0
Q5/Q1	5.9	9.8	12.5

Source: Instituto Nacional de Estadísticas. *Encuestas de Presupuestos Familiares*, for Greater Santiago.

Note: Households are ranked according to household expenditures.

show a steady decline in household spending in the three lowest expenditure quintiles. Furthermore, the poorer the sector of the population the greater is the decline (see table 9.2). For example, the share of the poorest 40 percent of households (the first and second quintiles) fell from 19.4 percent in 1969 to just 12.6 percent in 1988; in other words, their share of total expenditure in Santiago dropped by a third. By contrast, the relative situation of the richest quintile improved consistently, with its share rising from 44.5 percent in 1969 to 51.0 percent in 1978 and 54.9 percent in 1988. Furthermore, this is the only quintile in which spending per family rose in real terms between 1969 and 1988.

This information on the distribution of spending shows that the second stage of the Pinochet government (1982–89) was also regressive, so that the concentration of wealth and income observed during the first stage, from 1974 to 1981, was accentuated.[7] Information from the University of Chile employment survey, which is also for Greater Santiago, likewise shows deterioration in income distribution, though differing in scale and with large fluctuations from year to year. Between 1974 and 1987, the situation worsened steadily, stabilizing temporarily during the upswing of 1977–80 only to deteriorate again afterward. The bottom was reached in 1987, whether measured by the Gini coefficient or the ratio between the first and fifth quintiles (Ruiz-Tagle 1999).

In chapter 2, we examined the role that a number of the reforms and policies of the military government played in exacerbating the severe crises that Chile faced. The dogmatic approach, particularly during the first half of its rule, increased the country's vulnerability to external

during the 1990s, with an average Gini coefficient of 57.2 percent and 57.4 percent for Santiago and for Chile, respectively (Feres 2001).

7. The years of the surveys do not exactly match those of the economic cycles.

shocks and worsened the ensuing losses. Among the worst consequences of the resulting recessions was the chronic unemployment that prevailed in the country (see fig. 9.1). By 1975, the percentage of unemployed already stood at 15.7 percent, a figure that rises to 17.6 percent if those working in the PEM (minimum employment program) and the POJH (employment program for heads of households) are included. By 1983, the number of unemployed stood at 740,000 (around 19 percent of the labor force); emergency job programs absorbed another 500,000 (nearly 13 percent of the labor force),[8] for a total of 31.3 percent. The problem was later alleviated by the economic activity recovery, but only in 1989 was there a return to single-digit unemployment rates, with open unemployment of 8 percent. In a situation in which unemployment hit the lowest income groups the hardest, with a lack of adequate unemployment insurance and weakened public social networks, the decline in the welfare of largest sectors of the population is easily explained.

Income Distribution and Poverty after the Return to Democracy (1990–2000)

Since 1990, three periods with different socioeconomic results can be distinguished. During the first years, there were noticeable improvements in the average and minimum wages and social expenditure, which meant a recovery from the depressed levels of prior decades. Then, from 1996 onward, progress in poverty reduction slowed and wages experienced smaller increases, while other social indicators kept improving. Finally, the environment worsened dramatically in 1999–2000, with a sharp rise in unemployment. However, the minimum wage—which is set by the government—rose significantly with the establishment of a triannual program for 1998–2000. Similarly, wages of teachers and workers in the National Health Service and public pensions experienced special raises. The associated higher fiscal expenditure was duly financed.

The return to democracy brought with it greater concern on the part of the state for equity and poverty issues and an understanding that efforts to achieve macroeconomic balance needed to be accompanied by the pursuit of macrosocial balance, whence the goal of "growth with equity." Consequently, in the 1990s the authorities began to make systematic efforts to improve the social situation and introduce *reforms to*

8. Although the job creation programs were originally designed for a work week of only fifteen hours, in practice full-time work was required. The wage paid, meanwhile, was only a fraction of the minimum wage; it eventually fell to less than a third with no social security coverage. Unemployment benefits were virtually nonexistent, although the PEM performed partly as a subsidy in exchange for work. Earnings from the POJH varied between 1.6 and 2 times those from PEM (Ffrench-Davis and Raczynski 1990, table A.13).

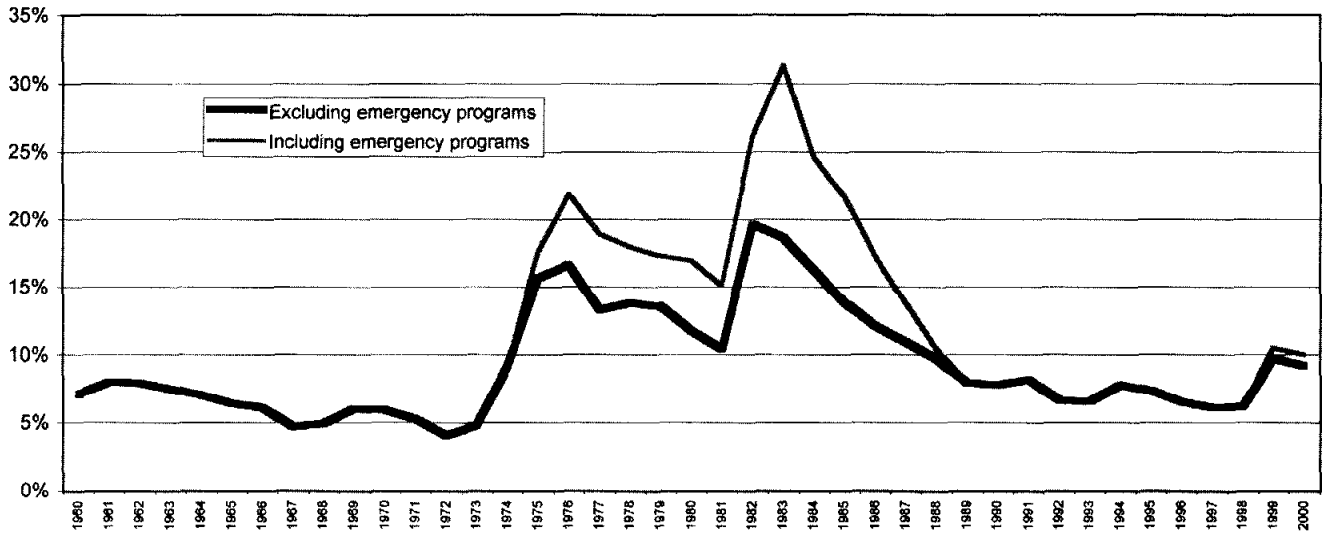

Fig. 9.1. National unemployment rate, 1960–2000 (percentage of labor force). (Data from National Bureau of Statistics and Jadresić 1986, annual averages.)

the reforms (Ffrench-Davis 2000, chap. 7). Public spending was restructured to provide more funds in social areas, and tax revenues were increased for this purpose by means of a fiscal reform that raised the VAT rate and progressive taxation. In the labor market, important agreements were reached, leading to a substantial improvement in the minimum wage and to *reforms to the reforms* that reduced the imbalance of power between workers and employers. Again, significant reforms concerning macroeconomic management had major effects on productive employment and the sustainability of macroeconomic balances. The introduction of the unremunerated reserve requirement and other prudential mechanisms for regulating volatile capital inflows played a key role (see chap. 10; and Ffrench-Davis 2000, chap. 10).

The result of this set of policies was substantial growth in real average earnings, which in 2000 were 34 percent higher than in 1970 (the 1970 level was never attained during the Pinochet regime) and 47 percent higher than in 1989, a minimum wage that was 86 percent higher than in 1989, and family allowance increases that have made up some of the ground lost during the 1980s (see table 9.1). The unemployment rate also improved considerably, averaging 7.3 percent in the 1990s compared to 18.1 percent in 1974–89 (see table 1.1 and fig. 9.1). Naturally, the macroeconomic conjuncture has had a significant impact on the unemployment rate. This is revealed in the rate of 6.1 percent during the 1997 boom compared to 10.2 percent in the depressed 1999–2000 period.

These policies, together with more efficient macroeconomic management for most of the decade—which laid the foundations for faster growth and large-scale job creation—enabled a drastic reduction of poverty and indigence up to 1998. In 1987, 45 percent of the Chilean population was living in poverty.[9] Subsequent measurements by the CASEN survey, summarized in table 9.3, show the steady progress that was made in this area, the figure having fallen to 21 percent by 2000.

It is clear that poverty was reduced in the 1990s. What is the outcome in income distribution? It is less clear-cut and in some ways contradictory. Some data show an improvement while others suggest no change; according to several sources, the picture was significantly better in the earlier years, with subsequent reversals in some sources. In any case, while the information available generally points to an improvement compared to the 1980s, it is clear that distribution is still very

9. Previous studies that had the same poverty indicator but used methodologies that are not totally comparable reveal that in 1969 some 17 percent of households were poor, a figure that stood at 45 percent in 1985 and 38 percent in 1987 (Altimir 1982; ECLAC 1991). The figure for poor households in 1987 is consistent with the 45 percent of the population shown in the CASEN survey of 1987 to be living in poverty.

TABLE 9.3. The "Indigent" and Other "Poor" Populations, 1987–2000 (percentages)

	1987	1990	1992	1994	1996	1998	2000
Indigent	17.4	12.9	8.8	7.6	5.8	5.6	5.7
Other poor	27.7	25.7	23.8	19.9	17.4	16.1	14.9
Total poor	45.1	38.6	32.6	27.5	23.3	21.7	20.6

Source: MIDEPLAN and national data from the CASEN surveys.

regressive. A major national effort will be required, then, to correct this sharp inequity.

The most consistent source of information on income distribution is the INE's household budget survey (HBS). The results of the HBS for 1997 are not directly comparable with the three prior surveys because of methodological differences, which highlights the difficulties of processing and comparing surveys.[10] For instance, the 1997 survey shows that quintile 1 concentrates 3.93 percent of household expenditure, if imputed rent is excluded and the data are ranked by household, while it concentrates 8.80 percent of expenditure if imputed rent is included and data are ranked by per capita income. Likewise, the Gini index can vary by up to nine points, depending on which criteria are used to order and aggregate the data (Feres 2001). This sizable sensitivity is not significant when one is analyzing sharp changes in income distribution, such as the strong regressive setbacks of the 1970s and 1980s. On the contrary, when changes are rather slight, different methodologies can diverge in the sign of the results.

The availability of estimates of imputed rent for homeowners is a remarkable advance recorded from the 1988 survey on. The significant progress in housing programs attained by Chile has had a growing effect on quintile 1 by raising its share in total expenditure by 0.5 to 1.5 percentage points between the 1988 and 1997 surveys. This effect reinforces a progressive distributive change between the two surveys (table 9.4). Thus, the lack of this imputation represents a clear shortcoming in accurately estimating the welfare of poor households that became owners of their homes.

Demography also has played an important role that must not be ignored. The average number of members of households fell in all quintiles between 1988 and 1997, with a 6 percent drop in the total average (from 4.09 to 3.84 persons). In general, this change has been stronger

10. These three surveys rank households by expenditures, excluding imputed housing rent. The 1997 survey records acquired expenditures and generated disaggregated data on imputed housing rent.

in quintile 1 than in quintile 5. Consequently, operating with per capita data is much more accurate than using total household income or expenditure.[11] Therefore, I have opted to use per capita data, including imputed rent figures. Among the six different methods of classifying information with imputed rent, presented in table 9.4, the Gini index shows an improvement in distribution between 1988 and 1997. The table presented also presents six cases in which figures are not corrected by imputed rent; in two cases the Gini index and the quintile 5/quintile 1 ratio indicate a worsening while in the remaining four cases they show an improvement in 1997.[12] Therefore, the entire set of information strongly supports the hypothesis of distributive improvement between both surveys.

The income data from the University of Chile employment survey for Greater Santiago are consistent with those from the INE household expenditure survey. The ratio between the first and fifth quintiles shows a statistically significant improvement in the 1990s (an average of 16.3 in 1991–97) compared to the 1980s (an average of 20.3 in 1982–90). It is also better than it was in the 1970s (17.1 percent in 1976–81), although the difference is not statistically significant. Despite the improvement in the 1990s, however, income distribution is still significantly more concentrated than it was in the 1960s (at 13.4).[13]

These data suggest that the deterioration of the 1980s was partially repaired in the 1990s, the distribution being close to that recorded in the late 1970s. Consequently, the sharp deterioration generated in the 1970s has not yet been reversed.

Prior to 1992, most indicators pointed to an improvement. The best-known one, the CASEN survey, shows an increase in the share of monetary income received by the poorest quintile of households between 1987 and 1992 and a decrease in the share of the richest quintile. From that time onward, however, the survey depicts stagnation and even some deterioration. But, still in 1996, all available data, both original and

11. We are aware that it would be more accurate methodologically to use "adult equivalent" (see footnote 2), but available data from the HBS survey do not allow it.

12. Other information, collected in the 1997 survey, shows very high indebtedness in the first quintile, with spending exceeding income by a third. Quintiles 1 to 7 register indebtedness, while quintiles 8 to 10 reveal savings (INE 1999, table 11).

13. The figures are based on a classification by household income per capita. The source (Ruiz-Tagle 1999) also provides data for total family income and income per capita adjusted by economies of scale and per adult equivalent. The ranking for the averages of the subperiods into which I have grouped the information is similar among the three categories. The results are also similar if the Gini coefficient is used. Nonetheless, the annual observations suffer from a great deal of "noise." Likewise, there are major differences in the levels of the coefficients depending on the criteria used to rank the information. This reminds us how careful we should be when drawing comparisons among different sources, methodologies, and stages of the economic cycle.

TABLE 9.4. Greater Santiago: Expenditure and Income Distribution per Household, 1987–88 and 1996–97 (percentages per quintile)

	Distribution of Expenditure per Household				Distribution of Income per Household				Distribution of Expenditures per Household			
	Ranked According to Household Expenditure		Ranked According to per Capita Expenditure		Ranked According to Household Income		Ranked According to per Capita Income		Ranked According to Household Income		Ranked According to per Capita Income	
Quintile	Without IR	With IR	Without IR	With IR	Without IR	With IR	Without IR	With IR	Without IR	With IR	Without IR	With IR
Household Budget Survey												
1987–88												
1	4.3	4.9	5.9	6.4	3.1	3.8	4.0	4.8	6.5	6.3	7.7	7.6
2	8.2	8.6	9.6	10.2	6.4	7.0	7.9	8.6	9.0	9.3	10.7	10.8
3	12.6	12.8	13.5	13.6	10.6	11.1	11.2	11.8	13.2	13.2	13.5	13.9
4	20.2	20.1	19.9	19.8	18.4	18.6	18.3	18.6	20.3	20.0	19.8	19.4
5	54.8	53.6	51.2	50.0	61.6	59.5	58.6	56.2	51.0	51.1	48.4	48.4
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Q5/Q1	12.7	10.9	8.7	7.8	19.9	15.7	14.7	11.7	7.9	8.1	6.3	6.4
Gini (1)	0.45	0.44	0.40	0.39	0.52	0.49	0.48	0.45	0.40	0.40	0.36	0.36

Household Budget Survey												
1996–97												
1	3.9	5.1	5.4	6.7	3.8	4.8	5.2	6.3	6.4	6.7	8.3	8.8
2	7.9	8.9	9.1	10.4	7.7	8.5	8.8	10.0	10.2	10.6	11.6	12.3
3	12.4	13.1	13.4	14.2	11.9	12.5	12.7	13.6	13.6	14.0	14.1	14.7
4	20.1	20.2	20.9	20.4	19.5	19.7	19.7	19.5	20.4	20.4	20.2	19.9
5	55.6	52.8	51.2	48.4	57.1	54.5	53.6	50.6	49.5	48.2	45.9	44.3
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Q5/Q1	14.3	10.4	9.5	7.2	15.0	11.4	10.3	8.0	7.7	7.2	5.5	5.0
Gini (2)	0.46	0.43	0.41	0.37	0.47	0.44	0.43	0.39	0.39	0.37	0.34	0.31
Ratio of Gini (2)/(1)	1.02	0.98	1.03	0.97	0.92	0.90	0.90	0.87	0.96	0.92	0.93	0.87

Source: ECLAC, based on special tabulations of the fourth and fifth Household Budget Surveys. Taken from Feres 2001.

[a]IR = imputed rent for homeowners.

adjusted, ranked both by household and by per capita income, show an improvement in the poorest 40 percent of households (in most cases in quintile 1) and a worsening in the richest 20 percent of households. That year, the Gini index had improved in all cases with respect to 1987 (see Feres 2001). In 1998, when the recessive adjustment began—it was already evident in November, the month when the survey was applied—a worsening in some indicators can be identified with respect to the 1996 survey. Nonetheless, these changes have low statistical significance. In summary, generally the 1990s perform better in terms of equity than did the 1987 sample.

The trend reversal in income distribution is also seen in the University of Chile employment survey for Santiago, with a worsening in 1994 and 1996–97 after improvements in the early 1990s. The deterioration in 1994 is partly accounted for by the fact that there was a minor contractive adjustment in this year (see Cowan and De Gregorio 1996), but 1996–97 were years of overexpansion (with the external deficit more than doubling that of the first half of the 1990s). We can interpret this overexpansion as an unsustainable surge in spending, with macroprices out of line, driven by an unsustainable volume of capital inflows. A great deal of such capital naturally goes to high-income sectors, including "wage earners" in these brackets; "trickle down" is never progressive. It is interesting to note that the (spectacularly large) spending boom in 1980–81 was also associated with a regressive impact on income (see Larrañaga 2001, figs. 1 and 2).

Thus, improvements in distribution took place mainly in the early years, when the *reforms of the reforms* were carried out; these injected a dose of equity into the regressive neoliberal inheritance. In the second five-year period, wage improvements moderated (with annual rises averaging 3.1 percent in 1996–98 as opposed to 4.9 percent in 1991–95), and the unemployment figures were already showing some deterioration in 1998.[14]

The main variable accounting for the lack of sustained progress would appear to be the labor market, with rises in the level of employment and social expenditure being offset by increasing wage inequality, which was mainly associated with differences in education (Beyer 1997; Bravo and Marinovic 1998; Larrañaga 2001).

14. Against this, there were substantial improvements in pensions and the minimum wage in 1998–2000, reflecting a growing awareness of the distribution problem but also coinciding with recessive years. Nonetheless, pensions and the minimum wage experienced strong improvements in 1998–2000, which reflected the public concern over social issues, on the one hand, and the frustrated expectation that investment and GDP would keep growing at around 7 percent per annum on the other. In the three-year period, actual GDP growth averaged 2.7 percent per annum, while fixed investment fell 14 percent between 1998 and 2000 (approximately 5 points of GDP). This deviation from the productive trend of the 1990s caused persistent regressive damage in the labor market.

The Concertación governments have pursued long-term policies of "investment in people," including a major reform of education. Nonetheless, the effects of the *reforms of the reforms* in the 1990s have been short of the target for three reasons. On the one hand, the main bills put forward by the two democratic governments faced opposition in the Senate, which meant that they had to be negotiated, and the reforms ultimately achieved were downsized (see Cortázar and Vial 1998; Ffrench-Davis 2000, chap. 7). Second, the institutional structure — the installed capacity of the state for spearheading actions against poverty and inequality — had been run down, as in the case of public health and education. Third, the policy was sometimes contradictory, being swept along at times by neoliberal fashion, an example being the setback in macroeconomic policy in 1996–97. Macroeconomic sustainability deteriorated since 1996 (see chap. 10). Chile became more vulnerable again, and it is in this condition that the country had to cope with the Asian crisis, with its patently regressive effects on employment and poverty, in 1999–2001.

Finally, the effects of investments in people take time to make themselves felt. Consequently, it is interesting to observe what happens to distribution when the free services provided by the state, whose benefits emerge in the long term, are added to people's monetary incomes.

As can be seen in table 9.1, there has been a substantial rise in per capita public spending delivered in the form of services such as education and health care, aimed essentially at the poorest quintiles. When corrected for these nonmonetary items, income distribution improves considerably, bringing down the difference between the richest and poorest quintile from 15.5 to 8.5 times for the CASEN survey of 1998. As social spending rose in the 1990s and was better targeted, its contribution to reducing inequality increased. This can be concluded from data produced by Bravo and Contreras (1999, table 7); these authors show that in 1990 the public sector provision of monetary income plus goods and services to the first quintile represented an addition of 49 percent to net per capita income, a figure that rose to 59 percent in 1994 and 75 percent in 1996. These large figures reflect the importance of free health care and the provision of education. A key variable is whether higher social spending actually leads to an increase in the volume and/or quality of services or whether the same services are merely provided at greater cost.[15] To ensure that spending produces results, effective pressure needs

15. It needs to be borne in mind that a substantial proportion of the increase in social spending in the 1990s was used to raise the wages of teachers and National Health System personnel. It is clear that in 1990 their salaries were notably out of line with the market and below the minimum required for efficient functioning. Unfortunately, while the quality of services fell as a result of the decline in pay and in the social status of these public services in the 1980s, improved incomes are not immediately followed by a recovery in quality.

to be applied to ensure high standards of productivity and better service to beneficiaries.

It will be recalled that at the beginning of this chapter and in chapter 1 I noted the dissatisfaction that was felt regarding the macrosocial imbalances prevailing around 1970. Although income distribution improved in the 1990s, the available data indicates that the situation is even worse now than it was then. This is a cause for greater dissatisfaction, and it means that more vigorous and effective efforts need to be made.

Factors Underlying Poverty and Income Concentration

The Role of the Neoliberal Reforms

The economic reforms applied in Chile in the 1970s and 1980s have had significant repercussions in the social field. Changing structural conditions, which meant a shift from an economy in which the state had a sizable presence to one driven by the free market forces, led to many changes in the distribution of well-being among the population. On the one hand, there were large, direct, negative effects on various social indicators owing to the move away from a model that treated income distribution and the struggle against poverty as top priority objectives to one that focused on the neutrality of policies. On the other hand, the extreme implementation of neoliberal principles and failure to take account of the heterogeneity of agents, combined with significant market failures and segmentation, translated into costly adjustment processes and severe recessions and generated a background of low productive investment and high unemployment (see chap. 1 and Ffrench-Davis 2000, chap. 1). Thus, indirectly these policies had a negative impact on an unprotected population. For this reason, the worsening of income distribution and the high levels of poverty that prevailed during the Pinochet government should come as no surprise.

As far as the reforms are concerned, one of the greatest changes was in the fiscal sphere. Reforms to the tax system, in 1975, included the abolition of wealth and capital gains taxes and a substantial reduction in the burden on profits. On the other hand, a value added tax was adopted and exemptions that existed for basic consumer goods were abolished.[16] The objective of these changes was to reduce the tax burden and concentrate it

16. There can be no doubt that the replacement of progressive taxes with VAT without exemptions was regressive in itself, and this was compounded by drops in social spending. This should not lead us to overlook the efficiency and high yield of VAT or the fact that a rate rise that has the purpose of increasing social spending is clearly progressive.

on taxes that were "neutral and efficient," the criterion of progressiveness being relegated to the background.

Public spending, as a percentage of GDP, was reduced by more than a quarter, in comparison with the late 1960s, after having spiraled out of control in 1972–73. There was a dramatic fall in public sector investment, which declined by more than half between 1970 and 1979 as a share of GDP. Public support for private productive activities, in the form of subsidies and infrastructure, also fell. Social spending increased as a share of all public spending, although, as has been noted, it fell in per capita terms. In 1981, it was lower than it had been in 1970, with a drop of 8 percent for education, 25 percent for health, and 30 percent for housing, all measured in real terms (Ffrench-Davis and Raczynski 1990). The decline continued until 1990.

The privatization of many of the means of production owned by the state took place in the mid-1970s. The process was conducted against the background of a domestic recession and extremely high interest rates. For this reason, only a few private groups were in a position to buy the privatized enterprises, mainly those that had greater access to external credit. Therefore, the concentration of wealth and power was strengthened still further (see chaps. 2 and 5; Dahse 1979; and Dahse 1982).

Chapter 5 analyzed the way in which the reforms in the financial market, far from enhancing productive investment, were characterized by extremely high real interest rates and a great deal of financial activity but contributed little to the generation of new productive capacity and were associated with crowded out domestic savings. Increasing financial inflows led the economy through a path of unsustainable expenditure, which ended in the deep crisis of 1982. The state had to intervene in the financial system to avoid a worse collapse; the high cost of subsidies to the financial system and borrowers contributed to a markedly regressive redistribution of wealth, which involved reductions in social spending and public sector investment in the 1980s and the long-lasting recession in the years following the crisis. Recall that only during 1988 was the 1981 level of GDP per capita restored.

Labor legislation also underwent major changes that had a negative impact on workers: the coverage of the minimum wage was reduced, the dismissal of workers was made easier, and the labor tribunals were abolished (they were restored in 1986). The unions were suspended in September 1973; later, in 1979, they were authorized again but with limited powers that excluded collective negotiation with unions of other companies, restricted the rights of union leaders, and fomented the segmentation of these groups (Campero and Valenzuela 1981; Cortázar 1983). In combination with political repression and economic depression,

the legislation was effective in reducing the power of social organizations and their ability to defend their rights. These institutional factors emerge as a significant cause of the drift toward informal working and, for long periods, the deterioration in income distribution, which characterized the years of the dictatorship (Bravo and Marinović 1998).

In the early 1980s, deep reforms in the architecture of social security were introduced, affecting the health and pension systems. There were two structural reforms of great significance, which had a major impact on the fiscal budget, and distributive effects at the time the reforms were implemented. The structural changes to health care culminated in the creation of a dual system, with a public component acting through a National Common Fund (the Fondo Nacional de Salud or FONASA) and a private component consisting of a network of health care institutions (ISAPRES), which compete among themselves, acting as insurance companies.

To a large extent, health care was being financed by a payroll tax. The reform initially meant that 11 percent of the beneficiaries moved to the new ISAPRES system with 48 percent of the yield from health contributions (Titelman 2001). Regardless of the quality of the reform, this effect evidently constituted a regressive form of "targeting," and it helped to deepen the crisis in the public health system. Most people in the four poorest quintiles are covered by the public health system, and only in the richest quintile do ISAPRES cover a higher proportion of people than FONASA.[17]

Similarly, private pension fund management companies (the Administradoras de Fondos Previsionales [AFPs]) began to operate in 1981, in what marked the transition from a pay as you go system (which remained in existence for a decreasing number of people) to an individual capitalization one. This has a number of consequences for distribution. On the one hand, with fewer people retiring early (only white-collar workers had the option) and with higher pensions conditional on larger contributions beforehand, there were clearly progressive effects. On the other hand, the reform led to a decline in public revenue as payments were transferred to the AFPs in 1981. As the public sector was left with responsibility for covering the financing of existing pensions and the pensions of those due to retire in the coming years, the public social

17. Another important point, with regard to distribution, is the risk discrimination applied in the private system in the way that the insurance premium is linked to the health risk of the person concerned. This discriminates greatly against the elderly, the young, women, and in general those who are most in need of health services. It is noteworthy, for example, that if we limit the analysis to those aged sixty-five or over we find that even in the fifth quintile most people, some 56 percent, are treated in the public sector (Titelman 2001).

security deficit rose from 2 percent of GDP in 1980 to 7 percent in 1983–86. In a time of recession, this increased the strain on the fiscal accounts and was one of the factors behind social spending constraints and the unraveling of investment in human capital. As can be seen in table 9.1, the cuts in social spending on education and health between 1980 (before the reforms were implemented) and 1987 were spectacular. The reform did not succeed in including lower income informal or self-employed workers. Whereas 60 percent of the labor force was actively contributing to the social security system in 1974 (some 79 percent were affiliated), in 1988 the figure was just 55 percent; between these two years, the rate had fallen spectacularly, to a point as low as 40 percent in 1982 (Arellano 1989). Another important distributive implication is the concentration of power in the hands of AFP owners, who use the funds of workers to buy shares and thus have a strong say in appointing the boards of companies.

Finally, the trade reforms introduced since the mid-1970s have proved to be a key factor in explaining factorial income behavior. On the one hand, they had a great impact on the production structure of the country (see chap. 3), which led to a significant relative decline (and often an absolute one) in employment in some sectors (this was particularly steep in manufacturing) accompanied by a weaker dynamism in expanding sectors (Valdés 1992). This negative balance was strengthened by the exchange rate appreciation of 1979–82 and by the procyclical bias of macroeconomic policies.

Since the economy was opened up, there has been a marked increase in the rate of return to higher education, with the wage income distribution worsening, as has been noted. The forces behind this change in relative prices are rooted in the relative decline in the demand for unskilled labor accelerated by abrupt import liberalization and low investment, acting in tandem with greater human capital requirements in the economy since the reforms. But this tendency toward a growing wage gap would appear to be partly the result of an exogenous increase in demand for qualified workers (resulting from the direction of technological change and transmitted by growing trade links with the rest of the world, where wage inequality is also on the rise), vis-à-vis a rather inflexible composition of supply in terms of human capital.[18] At the same time, the productive structure in the 1980s was dominated by a natural-resource-intensive export sector using little unskilled labor,

18. Labor training can contribute significantly to making the labor supply more flexible. There was some progress in this field in the 1990s. The percentage of the labor force trained under the tax-exempt National Training and Employment Service (SENCE) scheme increased from 4 percent in 1990 to nearly 8 percent in 1998. Nonetheless, only 20 percent of companies made full use of this benefit and the distribution of their spending was highly regressive (Benavente and Crespi 1998).

which kept demand for this group low and accentuated the inequality of wage distribution.[19]

The concentration of human capital investment opportunities, with only a minority of the labor force attaining more than 12 years of schooling (which is the threshold that denotes a break in the yield curve to school years), depicts an inadequate training effort and a regressive system of higher education. This became even more regressive when public funding for the universities was cut back in the 1980s and public institutions yielded in importance to private ones, which has acted as a mechanism that perpetuates historical inequities across generations.

Crucial Factors

The regressive trends of the 1980s were not exclusive to Chile. In general, income distribution worsened, real wages fell, and the level and quality of employment declined throughout Latin America. Something similar happened in the United States and Great Britain in that decade, with the ratio between the richest and poorest quintiles rising. In the United States, the family incomes of the poor fell, while those of the richest 10 percent improved substantially in the 1980s (Krugman 1990).

Poverty and income distribution are determined essentially by the production process itself,[20] whence the great importance of ensuring that the transformation of production is accompanied by equity. For this, growth is essential. It is clear that the choice is not between growth and equity. It is not simply a matter of choosing growth, since to achieve this, and make it sustainable, is no easy matter: Chile has only managed it in exceptional periods, one of which was 1990–97. Consequently, the most crucial thing is to identify the determinants of growth, and at the stage of development that Chile is now going through there are crucial complementarities between the sources of growth and equity, between macroeconomic and macrosocial balances.

The creation of productive employment is the main channel through which economic and social progress is transmitted. This depends on supply and demand, and both are affected by public policies.

For there to be demand, productive investment must be high, much

19. Like other countries in Latin America, Chile has comparative advantages in the production of natural-resource-intensive goods. The use of non-labor-intensive methods to produce them was to entail a worsening of income distribution, in contrast to what would happen in other developing countries that concentrate on the production of labor-intensive goods, such as the Asian ones (Fischer 1999).

20. Inequality is also the result of a demographic factor. Higher fertility rates that continue to be a feature of low-income sectors and the relatively low market participation of women from the lower strata reinforce the regressive trend of income distribution.

higher than it was during the neoliberal regime. Larger capital formation makes it possible to have higher growth with greater job creation and better wages. The fact that average wages were still lower in 1989 than in 1970 is principally due to the low investment ratio recorded in the 1970s and 1980s. Similarly, the high rate of investment between 1992 and 1998 helps to explain the sustained although still insufficient improvement in wages that occurred under the two democratic governments.

But physical investment is not enough. There is also a need to increase human capital, to invest in people, given the dynamics of innovation and technological progress (an issue discussed later). Investment in people, one of the two components of social spending, is a factor of production. An even more important feature, though, is that investment in people – particularly in education and health care – prepares them to participate more effectively in the market and is instrumental in bringing the perpetuation of poverty, whereby the children of the poor are condemned to be poor themselves, to a halt. Better nutrition and more education of higher quality are key inputs for a more flexible labor supply, which permits a more effective adjustment to the demand requirements, within a globalization environment. The other component is continuous redistributive spending, aimed at compensating the losers with modernization, those who cannot earn a better living in the market or those who have ended their working lives and have insufficient pensions or none at all.

Stability, Investment, and Distribution

Comprehensive stability is essential to equity and economic growth. If we look at what happened to wages and employment during recessive periods in the last quarter of the century, we can see that in all of them the fall in labor income was disproportionately high and informal working increased. Given the regressive effect that adjustment processes normally have on lower income sectors and wage earners, it is clear that efforts need to be made to remove the factors that cause instability and uncertainty (Rodrik 2001).

The definition of stability is crucial. CPI stability is essential, but it is only one ingredient of comprehensive stability, of which the stability of the *real* economy is the most significant. That implies using productive capacity (potential GDP) with *right* macroeconomic prices (see Ffrench-Davis 2000, chaps. 1 and 6).

This conclusion is even more compelling when we observe the performance of investment, since instability is also a disincentive to invest. When firms are producing below capacity and land is underused, it is obvious that there are fewer market incentives to invest in the creation

of new productive capacity (Ffrench-Davis and Reisen 1998; Agosin 1998). Empirical evidence shows that one of the most common tendencies during recessive adjustment is a sharp drop in investment: if aggregate demand is adjusting downward, some installed capacity will be underused, and the potential investor will therefore wonder what point there is in continuing to create additional productive capacity. Since capital formation is not a priority for short-termish thinking, public investment is generally cut as well, and this discourages private investment still further.[21]

The result is a negative effect on the link between the present and the future, a link that is strengthened with investment and productivity increases.

There are two ways of looking at productivity. One considers how much the output of a given set of resources increases or decreases as its utilization rate changes. When in the course of an economic cycle output falls sharply by 14 percent, as happened in Chile in 1982, what is really falling is the rate of resource utilization. Against a background of instability, this way of measuring productivity indicates that the same labor and capital that existed before are now producing 14 percent less than they were. But this kind of productivity is restored by bringing what already exists back into use once the recessionary stage of the cycle has given way to the expansionary one, even when the volume of resources and potential productivity remain unchanged. The other view of productivity is concerned with efforts to innovate, with new combinations of productive resources and improvements in their quality. This second type of productivity is one of the determinants of long-term growth. Frequently, research mixes up these two components (see essays by several authors in Morandé and Vergara 1997).

Economies with large fluctuations tend to discourage technological innovation, as instability leads both to large losses and great opportunities for easy profit. In such periods, the profits of some are generally made at the expense of others (in a negative sum game). If a business periodically has the opportunity to earn 10 or 20 percent on invested capital in a short-term operation, it is obvious that it will be less concerned with improving productivity at a rate of 2 or 3 percent a year by means of complex technological innovations. During upswings in the economic cycle, there are great opportunities to generate disproportionate profits as a result of sudden changes in the relative prices of both

21. Another consequence has been underinvestment by domestic SMEs. Correcting this imbalance takes time, and progress has been slowed by downward adjustment processes, as increases in interest rates above "normal" levels and domestic demand restriction affect such companies more severely than large ones, which are more diversified and can obtain financing through other channels.

products and assets, without the need for a managerial effort for long-term innovation. What happens, therefore, is that cyclical instability processes tend to result in neglect of medium and long-term productivity: what is the point of worrying about improving the quality of what you produce and the way it is produced, and the design of products and new production lines, when other opportunities are available?

Instability clearly creates an environment that is prone to speculative investment rather than technological innovation and productive investment.

Environments of great instability, like those seen in Chile during the 1970s and 1980s, tend to be accompanied by two other phenomena whose effects on society as a whole are negative. On the one hand, as we have seen across virtually all of Latin America, there are cuts in social spending during cyclical downturns. Public sector social spending on education, health, and housing has tended to "overadjust," falling proportionately more than GDP, even though needs increase during periods of recessive adjustment (ECLAC 2000).

Second, in these situations of instability losses tend to emerge in productive or financial sectors, with an inclination to sustain them by public sector subsidies. One case at hand is that of the Chilean banking system after the 1983 crisis, as discussed earlier, with a total final cost equivalent to 35 percent of a year's GDP (Sanhueza 1999). Thus, over the course of a few years, the equivalent of a third of national output (or public expenditure on education during a full decade) was transferred from some sectors to others in order to cope with this banking crisis. The magnitude of the problems in the banking sector accounts for the need to act, but it in no way justifies the specific policies imposed. Similarly, there can be no doubt that transfers as large as these could have been designed to have a very different distributive impact. Most of the large transfers of wealth that took place in the 1970s and 1980s were only possible in the framework of great instability, reinforced by the arbitrary and ideology-driven approach of the authoritarian regime in power.

Technological Innovation

The last two decades have been a time of great technological innovation in the world, particularly in areas such as communications, information technology, and electronics. These innovations unquestionably have served to improve productivity. What has happened to world growth over recent years? Paradoxically, the world is growing more slowly. The average expansion rate has sunk from 4 percent a year in 1965–80 to 3 percent in 1980–2000; the good performance of 2000 (over 4 percent) was rather exceptional and not the new trend rate.

This in no way means that technological progress has not been helpful to growth. Rather, it shows that some requirements of quality and proportion must be met. For one, technological innovation cannot be significantly introduced on a large scale in isolation. Much of it is embodied in machinery and equipment and the capabilities of people. This means that much higher productive, physical, and human investment will be needed in order to incorporate technological development and thus improve national total factor productivity.

Meanwhile, a high rate of technical progress requires flexible and increasingly highly qualified labor if excessive "technological unemployment"—where the dynamics of innovation displace workers who are unable to adapt to the requirements of the new technologies—is to be avoided. In order to countervail the expanding gap between low and high wages, an increase in physical investment and investment in people is essential. High investment can compensate for labor-saving techniques and easier restructuring. Other crucial aspects are improving the skills of labor and providing better training for workers during the course of their working lives, whence the importance of reforming education and redoubling labor training efforts.

Recently, however, the trend in the world at large has been a reduction in investment and savings ratios (Schmidt-Hebbel and Servén 1999). This is closely related to the declining effectiveness of macroeconomic policies and the nature of innovation in capital markets, which have brought about a dizzying increase in the speed at which speculative capital can move from one country to another; this has led to great instability in exchange rates, interest rates, and economic activity.

Thus, a downward trend can be seen in world productive investment, together with a spectacular increase in international capital flows. This contradiction is explained by the fact that most of these funds are not tied to productive investment, but are of a speculative nature. These movements are guided by expectations about differentials in interest rates, exchange rates and stock market prices in different countries. There are too many agents dedicated to the capture of capital gains rather than generating productivity gains. This financierism appears to be one of the reasons for the weakening of productive investment and economic growth.

Concluding Remarks

The regressive trends in Chile in the years prior to 1990 were generally reversed by the active policies of the two democratic governments. Although considerable progress was made in reducing poverty and indi-

gence during the decade, after an initial improvement income distribution fell back into stagnation, which raises major challenges for the authorities.

The 1990 tax reform made it possible to finance increased social spending and initiate the long process of restoring and raising the quality of education and health care. The labor reform helped unions to gather strength and workers to better defend themselves. Nonetheless, it should be borne in mind that neither reform went as far than the democratic government intended, although progress was achieved in the desired direction.

Improvements in the minimum wage and family allowances in the 1990s directly benefited Chileans in the poorest quintile. The same result was achieved by means of innovative targeted programs such as primary schools in poor areas and labor training for youngsters (Raczynski 1996).

There is overwhelming evidence that macroeconomic balances are of crucial importance for the success of any development strategy. The price that has to be paid when balances are lost is very high. Not only do countries forfeit any initial improvement in growth or equity that might have been achieved, but experience shows that there are also very high political costs for governments that succumb to populist temptations, whether on the Left or the Right. The methods used to achieve macroeconomic equilibria can be very diverse (Ramos 1993; Ffrench-Davis 2000, chap. 6): they may be more focused or dispersed, more cyclical or stable. They depend, among other things, on the relative weight given to variables such as the composition of public spending and revenue, the structure of financial institutions and capital flows, exchange rate policy, and public sector initiatives that contribute to the skills and organization of lower income sectors. These features make the difference between a government for the minority and one that serves the majority.

A significant change has taken place in macroeconomic policy since 1990. As a result, major imbalances like those recorded in 1975 and 1982–83 were avoided. For example, Chile could have persisted with the neoliberal approach by adopting a passive policy toward inflows of speculative capital, as Argentina and Mexico did. In that case, it would have suffered an acute recession and a marked deterioration in income distribution once again in 1995, which is what happened in those two countries.[22] However, Chile implemented fairly efficient regulations on short-term financial flows, thanks to which the "Tequila effect" reached the country in diluted form.

22. In Mexico, for example, real wages were on average 15 percent lower in 2000 than in 1994.

As is discussed in chapter 10, after 1995 the peso was allowed to appreciate excessively and the current account deficit was allowed to expand in 1996–97. What lay behind this policy reversal? Chile showed itself to be immune to the 1995 crisis in Mexico and Argentina, which enhanced perceptions of the country's strength. What was not understood is that this was primarily due to the deep change that had taken place in macroeconomic management in the first half of the 1990s; a key instrument was clearly the unremunerated reserve requirement, which discouraged inflows of short-term liquid and speculative capital. In the international financial media, meanwhile, wide support was given to the dangerously mistaken idea that financial crises were a matter of the past.

Finally, inflation reduction targets were given priority over the other objectives of Chilean economic policy; a 16 percent appreciation in the real exchange rate between 1995 and October 1997, resulting from a dangerous move toward a quasi-free-floating exchange rate policy in that period, was largely instrumental in reducing inflation from 8.2 percent in 1995 to 2.6 percent in 1997 (and to 1.9 percent in the wholesale price index [WPI], which has a large tradables component). This was not so much the result of a deliberate policy as of a more passive approach toward the capital surge into Chile over those two years and its impact on the exchange rate (see chap. 10). These imbalances in 1996–97 made Chile more vulnerable to the Asian crisis of 1998. Once again, as adjustment took place across the economy, and despite government efforts to increase social spending the least affluent sectors suffered most. The result in 1999–2001 was an increase in unemployment, stagnation in the reduction of poverty, and a worsening of income distribution. Recent data on the distribution of household per capita income in Santiago shows a worsening in 1999–2001 (Gini 55.3) in comparison to 1991–98 (Gini 52.5) but still somewhat less uneven than in 1987–90 (Gini 57.0) (Larrañaga 2001).

Securing structural improvements in distribution is a long-term task. It has been addressed willingly since the return to democracy but with some inconsistencies. Among other macro- and mesoeconomic aspects, the approach that needs to be taken includes:

1. Improving active macroeconomic management to make the economy less vulnerable to external shocks, the effects of which are always regressive; reactivating and improving regulation of flows in the face of the next capital surge; rebuilding an active exchange rate policy in order to provide greater predictability for the export sector; avoiding the two extremes of a fixed or totally free-floating exchange rate; and establishing a systematically anticyclical fiscal policy.

2. Continuing to reduce legal tax elusion and illegal evasion, which are detrimental to fiscal equity.
3. Implementing a systematic educational reform and improving and standardizing educational quality, and upgrading programs and teaching staff, with the financing these require.
4. Making a real push toward an increase in the quantity, functionality, and efficiency of labor training, in order to enhance the flexibility and adaptability of the labor supply.
5. Providing SMEs with significantly greater access to long-term domestic financing, modern technology, entrepreneurial and labor training, and more stable domestic markets and to enhance the ability to search for foreign markets.
6. Strengthening the dynamism of nontraditional exports with greater value added. The essential ingredients for renewed momentum of exports, more closely associated with domestic productive development, are as follows: consolidating Latin American integration processes, promoting an active exchange rate policy, an ambitious national program for labor training, and the productive development of SMEs.