GLOBALIZATION AND EQUITY: A LATIN AMERICAN PERSPECTIVE^{*}

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Much of the economic debate in Latin America at the turn of the century has revolved around the effects of globalization and structural reform on economic growth and equity. While there is agreement that deeper integration into the world economy raises the potential for economic growth, the recent experience of Latin America suggests that such potential may not materialize. The effects of globalization on equity are subject to more debate, but the Latin American record is also far from encouraging. During the last decade poverty and equity have actually worsened in many countries of the region, breeding discontent as to the effects of globalization and economic reform on poverty and income distribution. Although the causal links between globalization and economic growth and equity are far from straightforward, the Latin American record suggests that domestic institutions and policies are critical to be able to reap the benefits of deeper integration into the world economy.

This paper reviews the recent literature on globalization and equity in Latin America. An evaluation of the distributive effects of globalization has more than academic interest. In effect, the design and implementation of policies to prevent or compensate the negative effects that globalization and liberalization may have

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on equity would not only improve economic performance, but also increase the political support required to make outward-oriented reforms sustainable. The paper is organized in five sections. Section 1 introduces a distinction between globalization as a market and a policy phenomenon. Section 2 provides an overview of the evolution of inequality in Latin America in the last decades. Section 3 discusses the conventional transmission channels through which globalization can affect equity and income distribution, and presents some of the evidence about Latin America. Section 4 focuses on the macroeconomic dimensions of the link between globalization, growth and equity. In Section 5, at last, we present some conclusions from the preceding discussion.

1. Globalization: markets and politics

The concept of globalization usually enters public policy debates with a dual –but not always visible- face. One face is "positive": it makes reference to structural trends in technology and their effects on economic distance. The other face is "normative": it takes the shape of policy recommendations. The "positive" and "normative" faces of globalization appear frequently mixed in public policy debates. Distinguishing among them is not always easy (Bouzas and Ffrench-Davis, 1998).

As a market phenomenon (its "positive" face), globalization is driven by the falling cost of moving goods, services, money, people and information. The reduction in economic distance made possible by technical progress enables the exploitation of arbitrage opportunities in goods, services and factor markets, reducing (but not eliminating) the importance of geography and the effectiveness of policy and institutional barriers. As a market phenomenon, globalization has increased the ability of firms to fragment the production process across different

geographical locations, thus contributing to the steady growth of international trade (especially in manufactures and services) and foreign direct investment.

Although globalization is a major feature of the contemporary international economy, there is widespread disagreement over its extent and depth. According to one view, globalization triggers pressures towards convergence in performance and institutions (the familiar "race to the bottom"). An alternative perspective, however, emphasizes the uneven and incomplete nature of globalization. While it is accepted that mobility is very high in certain markets (such as in financial markets), integration is far from complete. In goods or labor markets the degree of integration is even shallower. Similarly, idiosyncratic features still dominate in areas such as infrastructure, basic societal principles or institutions (Garret, 1999).

But globalization is not simply a market phenomenon. Public policies (such as the removal of administrative barriers and the harmonization of national policies and institutions) also play an important role in fostering international integration. Policy decisions may deepen market integration, speed up the pace towards globalization and promote convergence between national practices and institutions. This process, however, takes place in the context of an international system shaped by power asymmetries. In this environment, some agents (public and private) are more successful than others in promoting their preferences and values, which may then appear as universal (Lawrence, Bressand and Ito, 1996). Thus, policy-making in developing countries must deal not only with the challenges posed by globalization as a market phenomenon, but also with the pressures arising from a policy agenda that asymmetrically reflects preferences and vested interests.

2. Inequality in Latin America: an overview

Income distribution in Latin America is the most unequal in the world. This is not a new phenomenon: at least since the sixties Latin America displays the highest Gini coefficient in the world, followed closely by sub-Saharan Africa (Table 1). In contrast to other regions, and despite the high levels of inequality recorded at the beginning of the period, during the last two decades Latin America also failed to improve equity indicators.

REGION	1960s	1970s	1980s	1990s
Eastern Europe	0,251	0,246	0,250	0,289
South Asia	0,362	0,339	0,350	0,319
OECD and high income	0,350	0,348	0,332	0,337
countries				
Middle East and North Africa	0,414	0,419	0,405	0,380
East Asia and Pacific	0,374	0,399	0,387	0,381
Sub-Saharan Africa	0,499	0,482	0,435	0,469
Latin America	0,532	0,491	0,497	0,493

Table 1. Median Gini Coefficients By Region And Decade

Source: Deininger and Squire (1996).

Most studies on Latin America confirm either that inequality has remained relatively stable in the last twenty years (Deininger and Squire, 1996) or that it has increased slightly (Morley, 2001a; Londoño and Székely, 1997). Considering that most Latin American countries experienced an economic recovery during the early nineties following a decade of deep recession and structural adjustment, it cannot but surprise that inequality remained practically unchanged.¹ This result may be

¹ The frustration regarding the reduction of inequality extends into poverty reduction. According to CEPAL (2003), in 2002, there were 220 million Latin Americans living in poverty, accounting for 43% of the population.

accounted for by the fact that while economic recessions worsen income distribution, economic recoveries may not improve it to an equivalent extent. Moreover, slow economic growth may be compatible with a worsening income distribution.

During the last two decades Latin America as a region did not experience a substantial change in income distribution, but individual countries did.² The resilience of income inequality in Latin America showed itself in parallel with a significant increase of the Gini coefficient in Argentina and Venezuela, and an increase in Brazil and Mexico in the eighties and stabilization thereafter (Morley, 2001a). Uruguay, by contrast, showed a significant fall in inequality, followed by Peru, where equality improved during the last decade. Taking a longer-term horizon, in Chile there was a sharp worsening of income distribution in the 1970s and a further worsening in the 1980s; an improvement took place in 1990-97, with a moderate step-back after the contagion of the Asian crisis. All in all, income distribution is today somewhat better than in the 1980s, but significantly more regressive than in the 1960s (Ffrench-Davis, 2002, ch. 9).

The cross-country disparities of the Gini coefficients imply significant differences in the share of each income group in national income. Recent data indicate that by the end of the nineties in four Latin American countries (Brazil, Bolivia, Colombia and Honduras), the percentage of total income that accrued to the richest decile more than trebled the percentage of the poorest 40 per cent³ (CEPAL, 2002b). In the case of Brazil that ratio was 4.6 times. At the other extreme, Uruguay and Costa Rica displayed ratios of 1.25 and 1.9, respectively.

 $^{^2}$ Despite different national performances, by the late nineties virtually all the large economies of the region displayed values for the Gini coefficient that were higher or close to 50%, among the highest in the world. Only in Uruguay and Costa Rica inequality was comparable to that of developed countries.

³ The first decile is critical to characterize income distribution inequality in Latin America. If the first decile is excluded, the Gini coefficient for most Latin American countries is not substantially different from that of the US (Birdsall, 2002).

		Share in total income of			
				20%	
				closest	
		Poore		to the	Riche
		st	Next	richest	st
Country	Year	40%	30%	decile	10%
	1990	14.9	23.6	26.7	34.8
Argentina	1997	14.9	22.3	27.1	35.8
	1999	15.4	21.6	26.1	37.0
	1989	12.1	22.0	27.9	38.2
Bolivia	1997	9.4	22.0	27.9	40.7
	1999	9.2	24.0	29.6	37.2
	1990	9.5	18.6	28.0	43.9
Brazil	1996	9.9	17.7	26.5	46.0
	1999	10.1	17.3	25.5	47.1
	1990	13.2	20.8	25.4	40.7
Chile	1996	13.1	20.5	26.2	40.2
	2000	13.8	20.8	25.1	40.3
Colombia	1994	10.0	21.3	26.9	41.8
	1997	12.5	21.7	25.7	40.1
	1999	12.3	21.6	26.0	40.1
Costa	1990	16.7	27.4	30.2	25.6

Table 2. Latin America: Household Income distribution, 1990-2000

Rica	1997	16.5	26.8	29.4	27.3
	1999	15.3	25.7	29.7	29.4
	1990	17.1	25.4	27.0	30.5
Ecuador	1997	17.0	24.7	26.4	31.9
	1999	14.1	22.8	26.5	36.6
	1990	10.1	19.7	27.0	43.1
Honduras	1997	12.6	22.5	27.3	37.7
	1999	11.8	22.9	28.9	36.5
	1989	15.8	22.5	25.1	36.6
México	1994	15.3	22.9	26.1	35.6
	2000	14.6	22.5	26.5	36.4
	1991	12.5	22.9	28.8	35.9
Panama	1997	12.4	21.5	27.5	38.6
	1999	12.9	22.4	27.7	37.1
	1990	18.6	25.7	26.9	28.9
Paraguay	1996	16.7	24.6	25.3	33.4
	1999	13.1	23.0	27.8	36.2
	1990	20.1	24.6	24.1	31.2
Uruguay	1997	22.0	26.1	26.1	25.8
	1999	21.6	25.5	25.9	27.0
Venezuel	1990	16.7	25.7	28.9	28.7
	1997	14.7	24.0	28.6	32.8
u	1999	14.6	25.1	29.0	31.4

Source: CEPAL

(2002b).

Wage inequality is a major determinant of income inequality in Latin America. In other words, high inequality is not just a consequence of the wedge that exists between labor and property income, but of income differences among workers as well. Wage differentials, in turn, are to a large extent the result of an unequal distribution in the quantity and the quality of education⁴ (Morley 2001a; Behrman, Birdsall and Székely, 2001), a feature particularly marked in the case of Latin America. According to the IADB (Inter-American Development Bank, 1998), the second richest decile of the Latin American population has on average three years less of education than the richest one. For the lowest thirty percent this difference rises up to nearly seven years.

Despite the policy relevance of the subject, there is scarce information on wage differentials according to qualification across Latin America. Some studies have attempted to harmonize the information collected by household surveys (e.g. Inter-American Development Bank, 1998). Morley (2001a) compared the average wage of white-collar workers (typically more educated) with those of blue-collar workers (typically less educated). As shown in Figure 1, the ratio between these two groups' incomes is higher in Latin America than in other regions of the world. Moreover, the data shows that while this ratio contracted in the rest of the world after 1982, it failed to fall in Latin America (where it experienced a significant increase after 1988).

⁴ Apart from education, the literature typically takes into account factors such as gender, labor market fragmentation between formal and informal employment, and rural and urban employment.



An alternative procedure to estimate wage differentials according to education is to run regressions using education, gender, work experience and other relevant factors as independent variables, and then apply the estimated coefficients to calculate rates of return per level of education. Available evidence suggests that in Latin America the rate of return of post-secondary education is very high (as compared to Asia and other industrial regions) (Inter-American Development Bank, 1998) and that it increased the last decade. Behrman, Birdsall and Székely (2001), for example, estimated that the return of an additional year of study increased during the nineties by nearly 7 per cent. When disaggregated by level of education, their estimates show that this rise was almost entirely due to a significant increase in the marginal return of higher education. This means that the relative returns of primary and secondary education fell as compared to those of higher education. Computing hourly wages for each educational category⁵, Figure 2 shows that the wedge between workers with post-secondary education and the rest increased notably during the nineties. The wedge between high and primary education increased notably during the early nineties, but fell by nearly 13 per cent between 1994 and 1998.



It is not easy to account for the high and persistent income disparity by level of education that prevails in Latin America. These differences cannot be accounted for by the relative scarcity of university graduates, since in comparison to the typical Asian economy the share of university graduates is higher in Latin

⁵ The data refers to 30-55 years old adult male workers employed in urban regions.

America⁶ (Morley, 2001a). Moreover, since the seventies the share of university graduates in the labor force has increased significantly in Latin America. One possible hypothesis is that the effects of globalization on the demand for qualifications in Latin America have helped to maintain large wage differentials.

In summary, the causal links between globalization and equity are far from straightforward. Higher mobility of goods, factors of production and technology will affect relative prices and factor returns, thus influencing equity, but the direction of the effect is policy-dependent. In the next two sections we explore the "micro" and "macro" dimensions of the links between globalization and equity.

3. Globalization and equity: transmission channels

As a market phenomenon globalization manifests itself in the increasing mobility of goods, services, technology and factors of production. In the last two decades international trade and FDI have increased much faster than real output (see Table 3). In effect, since 1983 annual output growth averaged 2.8 per cent (a slower pace than in previous decades), while merchandise trade rose by 5.7 per cent per year and FDI by a remarkable 16.2 per cent. The higher international mobility of output and factors of production (particularly capital) has affected the return of different factors of production. In this section we briefly review the major transmission channels as treated in the literature.

⁶ This is not the case with secondary education. No Latin American country has a higher rate of secondary school graduates than Korea, Malaysia or Taiwan. According to Morley (2001b), the contrasting educational strategies pursued by the countries of the two regions since the 1970s –the extension of secondary education in Asia and the increase in the coverage of higher education in Latin America (even at the expense of a high rate of drop-outs in secondary and tertiary education) help to account for the different performance of inequality. Educational strategies affect the distribution of one of the scarce factors in most developing countries (ie, human capital). Although educational strategies can help to account for the distribution of the costs and benefits of deeper integration into the world economy, an examination of this interesting connection goes beyond the scope of this paper, more focused on the impact of globalization and economic reform policies on equity.

	(mulces, 1983–100, and percentages)				
		World trade(a)			Percentage
					of M&A in
	World		Manufacturin	Real World FDI	World FDI
	GDP	Total	g	(b)	(c)
		100.			
1983	100.0	0	100.0	100.0	n.a.
		110.			
985	108.3	8	116.1	116.6	n.a.
		147			
1990	128.3	147. A	160.9	337 /	74.4
1770	120.5	+	100.7	557.4	/+.+
		195.			
1995	138.4	8	218.5	558.4	56.4
		270.			
2001	163.4	3	310.6	1487.3	80.8
	Annual average growth (%)Average				
1983-2001	2.8	5.7	6.5	16.2	62.5 (d)

Table 3. Globalization: stylized facts, 1983-2001(Indices 1983=100 and percentages)

Source: Trade and world GDP, from WTO; FDI figures from UNCTAD.

a. Merchandise export

volume.

b. Based on inflows, deflated by unit price of world imports,

published by the IMF.

c. M&A are mergers and

acquisitions.

d. 1987-2001.

n.a.: not

available.

3.1. Mobility of goods.

According to neo-classical trade theory, summarized in the Heckscher-Ohlin and Stolper-Samuelson theorems, international trade can act as a substitute for factor mobility in order to bring equality in factor payments across countries. With two factors of production (unskilled labor and capital or skilled labor), trade liberalization in developing countries (where unskilled labor is typically taken to be the abundant factor) will raise the demand for that factor, as well as its price. Since the poor are owners of unskilled labor, trade liberalization will raise their welfare in absolute as well as in relative terms.

The opposite will take place in developed countries, which are intensive in skilled labor or capital. In developed countries the owners of capital or skilled labor will see their price rise, while the income of unskilled labor will contract. In the absence of trade barriers, factor prices will tend to converge in both regions. According to this simplified account, given two factors of production, globalization (understood as trade liberalization) will reduce income differentials in developing countries and widen them in the developed world. The implications are clear: trade liberalization in developing countries will bring not only higher efficiency, but also more equality.

This story, however, rests on a number of assumptions that do not fully apply to Latin America. First, the model assumes only two factors of production and developing countries are taken to be a homogeneous group in which unskilled labor is unambiguously abundant. However, Leamer (1984) data suggest that the most abundant factor in Latin America is not unskilled labor but (depending on the country) some natural resource such as arable land, minerals or oil. Data collected in a classic study on the factor content of foreign trade (Bowen, Leamer and Sveikauskas, 1987) shows a similar picture. Moreover, trade liberalization in Latin America was implemented *pari-passu* to the integration into the world economy of other large countries such as China, where unskilled labor is unambiguously abundant.

The second critical assumption is the absence of factor intensity reversal. However, factor intensity reversals were detected long ago when comparing rice production in Asia and the United States (Arrow et al, 1962). If this is the case, even if unskilled labor is the abundant factor, it will be impossible to predict that trade liberalization will produce a higher demand for unskilled labor.⁷

At last, the statement that trade liberalization will reduce income differentials in unskilled labor abundant countries require technical change to be neutral. *If technical change is biased against unskilled labor* and, in addition, technological development takes place mainly in the developed world (where unskilled labor is scarce), the importation of technology embodied in capital goods may have effects other than those expected (see below).

In sum, the assumptions of classic trade theory may be inappropriate to make a prognosis about the effects of trade liberalization on factor earnings and equity in many Latin American economies. If this is so, trade liberalization may not lead to an improvement in income distribution, but to the reverse. This may demand the implementation of mechanisms to cope with the undesired effects of trade liberalization on equity.

Indeed, according to Morley (2000) the prediction that trade reform would reduce wage differentials and lead to a more equitable distribution of income in Latin America did not materialize.⁸ One reason for this result may be precisely that

⁷ There is evidence, for example, that while agriculture (more specifically corn production) is labor intensive in Mexico, it is capital intensive in the United States. Moreover, in a two-good, two-factor model, if the autarky relative price of corn, say in Mexico, is higher than the free trade price, trade liberalization will lead to a lower demand of unskilled labor at initial factor prices. This may help to account for the fact that Mexico has been so cautious regarding the liberalization of agriculture.

⁸ This standard prediction was based on the assumption that Latin America had comparative advantages in unskilled labor-intensive products and/or the neutrality of technical progress. Indeed, the record of Southeast Asian countries

the region's comparative advantages do not lay in unskilled labor-intensive activities and/or that trade liberalization has favored the importation of capitalintensive or skills-intensive technologies (generally embodied in imported capital goods). Rama (2001a) also claims that one channel through which trade liberalization may have contributed to a growing skills premium in Latin America is the "China effect". Compared to this region, many Southeast Asian and Asian economies have large pools of cheap unskilled labor. The massive importation into Latin America of products from that part of the world induced by trade liberalization and Asian (particularly China's) fast integration into the world economy may have lowered considerably the demand for unskilled labor in Latin America.

But Morley's findings on the effects of trade reform on wage differentials are not consensual. Behrman, Birsdall and Székely (2001) collected data on wage differentials for eighteen Latin American countries over the last two decades⁹. Based on this information they performed panel cross section regressions using structural reform indexes as explanatory variables (this paper and Morley (2000) use the structural reform indexes developed in Inter-American Development Bank (1997)).¹⁰ In contrast to Morley (2000), these authors found no reliable relationship between trade liberalization and wage differentials¹¹. Rather, their regressions suggest that trade reform slightly reduced incomes inequality, albeit

during the 1960s and 1970s gave support to the view that deeper integration into the world economy would reduce wage differentials between skilled and unskilled labor in the developing world as a whole (Wood, 1997).

⁹ The sample used by the authors includes urban male workers, aged 30-55. This groups accounts for approximately a fifth of the total employed population.

¹⁰ The proposed trade reform index is based on a simple average of average tariff rates and average dispersion. One shortcoming of this indicator is that it does not take into account the incidence of non-tariff measures. However, in contrast to other usual indicators (such as the export plus import to GDP ratio) it refers exclusively to policies and it is not contaminated by the agents' response to those policies.

¹¹ This work focuses on wage differentials, not in income distribution or per-capita income. As Morley (2001b) points out, these three variables may not move in the same direction due to structural changes in the supply of labor, the effect of transfer payments or unemployment.

with a lag¹². However, they stop short of attributing their results to trade liberalization per se, as the latter may open the door to multiple forces with counterbalancing effects¹³. Using national data, Acosta and Rojas (2002) found that trade liberalization accounted for only a minor fraction of the increase in Mexico's skills premium (decreasing through time), and even a smaller share in the case of Argentina¹⁴. In the case of Argentina, the increase in the skills premium induced by trade reform may have been a result of the factor content of imports (intensive in unskilled labor), the relative abundance of skilled labor as compared to its regional trade partners (who gained preferential market access through Mercosur) and/or a contraction in the share of manufacturing in total output experienced during the nineties (traditionally, important low tech manufacturing - such as textiles, food and tobacco- employed a relatively high share of unskilled labor).¹⁵

Apart from the effects on the skills premium, trade liberalization has had significant effects on employment. The dismantling of the protectionist policies that prevailed during most of the import substitution period produced a significant loss of jobs in Latin America. Although the reforms also created new jobs, an asynchrony between the process of job destruction and job creation may have existed. In effect, while old jobs were destroyed typically very fast, the new jobs

¹² Galiani and Sanguinetti (2002) studied the relationship between wage differentials and trade opening in urban Buenos Aires during the 1992-1999 period. Their results suggest that the wedge between workers with complete superior education and the rest widened most markedly in those sectors in which import penetration was higher.

¹³ When interpreting these results one should recall that their authors use different dependent variables. Morley (2000), for example, uses the Gini coefficient. Behrman , Birdsall and Székely (2001), in turn, use wage differentials for different groups of individuals, controlling for age and educational level. Although these variables are closely linked to inequality, they do not measure the same concept. These methodological differences suggest that the results must be interpreted with care. In particular, differences in the estimated sign for some specific reform variables should not be automatically interpreted as contradictory.

¹⁴ To assess the effect of trade liberalization on the education premium, Acosta and Rojas (2002) regress workers` wages (in log form) against, among other factors, age and educational levels (personal characteristics), as well as the interaction between the skills level and the relative importance of exports and imports for each sector.

¹⁵ Beckzuk and Gasparini (2000) argue that in the case of Argentina "the fall of industry during the whole period (1980-1998) seems to be the main determinant of the collapse of the demand for individuals with high school degree or less".

took longer to be created. An illustrative case may be that of Mexico, the Latin American country that went probably the farthest in the process of globalization. According to Rama (2001a), a 20 per cent cut in Mexico's average tariffs reduced wages by an estimated 5%, which experienced a slow recovery thereafter. Industrial restructuring also shifted workers previously employed in noncompetitive industries towards the low productivity rural sector or the informal labor market. Although industrial restructuring led to new job creation in exportoriented activities (such as the *maquiladora* industry), these may be lower quality jobs as compared to pre-existing ones, both in terms of wage levels and stability of employment. If job insecurity matters, the new jobs may result in a welfare loss (Ferranti et al, 2000). Of course, the alternative to these new jobs may be sheer unemployment, the informal labor market and poverty.¹⁶ On aggregate, this outcome may have been aggravated by the macroeconomic context and the specific content of the reforms implemented, which may have encouraged faster net import de-substitution as opposed to a net increase in exports (Ffrench-Davis, 2000, chs. 1-3).

3.2 Factor mobility

If factors of production can move freely, they will leave locations where they are low paid towards those in which they are high paid. Consequently, the outflow of unskilled labor from unskilled labor-abundant countries will raise its price in the latter and lower it in skilled labor or capital-abundant countries. Skilled labor or capital will flow in the opposite direction, raising skilled labor or capital incomes

¹⁶ In the case of Mexico the sizable impact of the "tequila" crisis shows in the fact that average wages fell by 15% in 2000/94.

in developed countries and lowering them in the developing world.¹⁷ As a result, income inequality will rise in developed countries and fall in developing countries (Culpeper, 2002).

However, one of the major features of the current phase of globalization is the asymmetry between the high mobility of capital and the widespread restrictions that constrain labor mobility. Indeed, it is somewhat paradoxical that the widespread political consensus about the benefits of the free movement of goods, services and capital does not extend into the free movement of persons (Solimano 2001a; Martínez, 2000). As Rodrik (1997) points out, this gives rise to asymmetries in income distribution that hurt the less mobile factors (especially unskilled labor). The lower mobility of unskilled labor also contributes to an excess supply of unskilled-labor intensive products (in the production of which developing countries have comparative advantages), lowering their price in the international marketplace (CEPAL, 2002a). Most importantly, restrictions on the mobility of unskilled labor lowers world output, since they inhibit labor from moving from low to high productivity regions.

In contrast to unskilled labor, the mobility of skilled labor is much higher. The "brain drain" towards developed countries may create an additional burden on developing countries. This burden tends to increase after big macroeconomic crisis, as human capital flies in search of more stable environments. This trend may worsen the long-term growth potential of developing countries, particularly the poorer ones (Solimano, 2001b).

The high mobility of physical capital also changes the relative productivity of skilled and unskilled labor, altering the wage structure. In particular, the fact that capital and skilled labor are often complementary and that incorporated technical change has a pro-skilled labor bias means that there may be a positive

¹⁷ This prediction neglects the impact of agglomeration effects.

correlation between mobility and incorporation of productive capital and the skills premium (Acosta and Gasparini, 2002)

The naïve view that factor mobility will reduce income inequality in developing countries must also be qualified by other real world facts. In effect, in many Latin American countries trade and capital account liberalization coincided with periods of euphoria in international capital markets. As a result, trade liberalization was accompanied by a significant real appreciation of the domestic currency (CEPAL, 1998; Ffrench-Davis, 2000). A real appreciation of the currency will reduce the incentives of trade liberalization to shift resources from non-exportables to exportables producing sectors, moderating the effects of freer trade on factor prices, reducing the rate of utilization of factors, and discouraging net employment in the production of tradables. Yet, the most negative effects of higher capital mobility may not be a result of their level, but of their volatility –an issue addressed in more detail in the next section.

As opposed to his findings on trade reform, Morley (2000) found that capital account liberalization had progressive effects on the distribution of income. His results suggest that when barriers to capital inflows are dismantled, new capital inflows reduce profits and raise labor demand.¹⁸ By contrast, according to Berhman, Bridsall y Székely (2001) capital account liberalization had regressive effects on income distribution, although they contracted sharply through time. This result is consistent with the findings of Rama (2001a), for whom the effects of capital inflows on the skills premium (and particularly FDI) was positive and stronger than that of trade liberalization¹⁹. These findings are consistent with the previous work of Feenstra and Gordon (1997) based on microeconomic data for

¹⁸ An alternative interpretation may be that capital account liberalization was implemented during a period of abundant international liquidity and after Latin America suffered many years of a binding external constraint. Consequently, inflows appear associated to the economic recovery that effectively took place in 1990-97.

¹⁹ This result is verified not only in Latin America, but also in other developing regions.

the Mexican *maquiladora* industry. Acosta and Gasparini (2002) offer evidence supporting the hypothesis that capital and skilled labor are complements in the case of Argentina. Using disaggregated data, they show that the skills premium for workers with higher education increased in those sectors where the incorporation of physical capital was more intense.²⁰

Moreover, a more detailed assessment of the impact of capital flows in income distribution would need to distinguish between flows of green-field FDI, mergers and acquisitions, and financial flows. These effects would also be very dependent on the macroeconomic environment in which these flows would take place. Titelman and Uthoff (1998) show that capital *surges* have tended to crowd-out domestic savings and to weaken macroeconomic sustainability. On the contrary, flows that are both more stable and more directly linked to capital formation can crowd-in domestic savings and enhance capital formation and macroeconomic sustainability. Since economic cycles have asymmetric effects on employment and earnings, capital surges may end up worsening equity. The composition of capital inflows can also be traced to the kind of domestic policies implemented, particularly concerning capital account liberalization vis-a-vis prudential macroeconomic regulation of capital flows (Ffrench-Davis, 2002, chs. 9 and 10).

3.3 Movements of technology

The effects of technical change on income distribution depend on the way in which new technologies affect the use of productive factors. Unskilled labor-intensive

²⁰ Acosta and Gasparini (2002) estimate a series of models in which workers' hourly wages (in log form) depend, among other factors, on variables capturing the relationship between their educational level and the incorporation of machinery and equipment (as a share of value added) in their sectors of activity. They cover the 1992-1999 period and use information for 20 Argentine urban conglomerates.

technologies will increase the demand for unskilled labor and thus raise its income. Capital-intensive or skilled labor-intensive technologies will do the same with the demand for capital and skilled labor and raise their returns. Consequently, the effects of technical change on equality will depend on the bias of a specific technology. Most of the literature on technical change in the developed world agrees that during the last decades wages and the return to education have been consistent with skills-biased technical change. Technological innovations such as computers and telecommunications tend to raise the productivity of the best trained and most flexible workers. Consequently, in periods of rapid technical change – such as during the last two decades- the education premium should be expected to increase (Acemoglu, 2002).²¹

Trade and investment liberalization in Latin America fostered significant, albeit heterogeneous, technological modernization. Although the relative abundance of unskilled labor in Latin America (as compared to industrial countries) should favor the adoption in the region of unskilled labor-intensive technologies, the limited resources channeled to indigenous research and development means that technology is mostly imported and embodied in new capital goods. The concentration of technical progress in developed countries is one of the most important sources of international asymmetries (CEPAL, 2002a). In effect, quite apart from the inadequacy of technical progress to developing countries' factor endowments and its effects on equity, the limited development (technical progress being a major factor behind economic growth). Few activities closely related to technical change have located in Latin America (except for some

²¹ Since the education premium makes investment in human capital more attractive, the supply of this type of labor should increase over the longer term. Thus, in the long term the effects of technical change could even be progressive (Morley 2001b), by inducing socially desirable investments in education and fostering a rise in productivity and average wages.

regions of Northern Mexico, though limited by the fact that are mostly *maquila* activities), in contrast to Southeast Asia. Although the spread of new information technologies has broadened the sources of freely available information, stricter protection of intellectual property rights has slowed down the rate of technology transfer and led to higher payments of innovation rents. This is most likely to have had regressive international distributive effects.

Trade liberalization in Latin America sharply reduced the relative price of capital goods, stimulating imports and the incorporation of new technologies embodied in production equipment. This fact combined with sizable FDI inflows towards the region stimulated technological modernization.²² The assessment made of this process during the last decade is nearly unanimous: technical change has been biased towards skilled labor, a fact which partly accounts for the increase in the skills premium (Cornia, 1999).

The results of Berhman, Birdsall and Székely (2001) suggest that for those Latin American countries that engaged in trade and structural reform during the last two decades, it has been technical progress –rather than trade- which accounts mostly for the increase in the skills premium. However, it is hard to split these effects because much of the technical progress is transmitted through trade, as it is embodied in high-technology capital and intermediate goods. For Acosta and Rojas (2002) technical change is the main responsible for the increase in the skills premium in Argentina, a result which is consistent with the previous work by Bebczuk and Gasparini (2000)²³. Acosta and Rojas (2002) also report effects in the same direction in the case of Mexico. In summary, since trade liberalization has

²² The positive contribution of technical change was not reflected in vigorous GDP growth because capital formation remained depressed and domestic demand unstable.

²³ Beckzuk and Gasparini (2000) estimate that more than two-thirds of the increase in the skills premium is accounted for by technical change, while only 15% can be attributed to the effects of trade liberalization.

been a potent stimulus for technical upgrading, trade reform may have had significant indirect effects.

4. Globalization and equity: the macroeconomic dimension

The effects of globalization also have a macroeconomic dimension. This dimension affects deeply the way in which transmission channels operate and is tightly linked to policy choice. In this section we briefly address three topics, namely: a) the links between globalization, trade and growth; b) the issue of volatility and c) the question of discretion in national economic policy making.

4.1 Globalization, trade and growth

The links between globalization and equity must take into consideration the issue of economic growth. The conventional view holds that the rationale for globalization (and for policies that foster liberalization and structural reform) rests on its positive effects on economic efficiency and growth. Although this view is deeply rooted in academic and policy circles, there is enough evidence to challenge the strength of the relationship as well as the implied causal links (Rodrik, 1999 and Rodríguez and Rodrik, 2001). Moreover, even if a strong causal relationship between openness and growth were established, the issue of whether economic growth is neutral in terms of income distribution would remain open.²⁴ It is also important to take account of the often neglected issue of the effects of liberalization and globalization during the transitional phase. In effect, even accepting the existence of long-term beneficial effects in terms of efficiency and

²⁴ The neutrality of economic growth in terms of income distribution has given rise to a lengthy literature. See, for example, Aghion and Howitt (1998); Forbes (2000) and Bertola (2000).

growth, attention needs to be paid on how to deal with transition costs and how these will affect the final outcome. The optimists maintain that any negative effects may be counterbalanced by social policies and will be eventually more than compensated by faster economic growth. Skeptics, by contrast, emphasize that it may be difficult to effectively address transition costs in a context characterized by fragile and underdeveloped institutions. They also point out that these negative trends may give rise to negative "path dependent" outcomes.

During the thirteen year period since 1990s, the foreign trade of Latin American countries grew rather vigorously, both on the export and import side. In fact, the rate of growth of export volume averaged 7.4%, slightly faster than in the world as a whole. Yet this did not translate into faster economic growth. That the exports to GDP ratio accounted for scarcely one/fifth of GDP may help to account for the fact that relatively rapid export growth during 1990-2002 coexisted with a meager growth of GDP of 2.4% per year (see table 4).²⁵

Comparative research in Latin America has shown four intertwined policy features that can make a significant difference for the growth and equity outcome of globalization and liberalization. The first issue is whether trade liberalization is led by import liberalization or export promotion. Agosin and Ffrench-Davis (1993) show that depending on the nature of the trade reform process, the effects of liberalization on growth and employment can differ markedly. The second issue concerns the behavior of the capital account and the exchange rate during trade liberalization. A liberalization process undertaken simultaneously with complete capital account liberalization –particularly if this is done under abundant international liquidity- will lead to a real appreciation of tradables. This will have negative long-run effects on the sustainability of the liberalization drive and will

jeopardize outward-orientation. The third issue is the macroeconomic environment that prevails abroad and domestically during the process of trade liberalization. In effect, a vigorous external environment characterized by fast import growth in major trade partners will imply a faster and easier growth of exports. Similarly; a domestic macroeconomic environment characterized by an economy working along the production frontier (at full employment) will make easier the reallocation of factors from import substitution toward the rest of the economy. Finally, the effects of trade liberalization can be quite different depending on the extent and coherence of complementary policies geared to *complete* markets, particularly long-term capital, technology diffusion, management practices, and labor training (CEPAL, 1998; Ffrench-Davis, 2000, chaps. 2, 3, 6 and 10).

Latin America (19 countries): GDP growth, 1990-2002						
(annual percentages)						
	Total GDP	Exported GDP	Non-exported GDP			
1990-94	2,9%	6,4%	2,4%			
1995-97	3,3%	10,9%	2,0%			
1998-2002	1,2%	6,3%	0,1%			
1990-2002	2.4%	7.4%	1.5%			

Table 4

Source: Author's calculations based on official data, provided by ECLAC. Preliminary data for 2002.

4.2 The importation of volatility

Closer integration into the world economy offers new opportunities for developing countries, but also new challenges and risks. The Latin American countries have

²⁵ For an analysis of the effects of trade reforms on trade performance, see Bouzas and Keifman (2003).

been traditionally subject to large shocks stemming from terms of trade fluctuations. These shocks have been amplified by the heavy dependence of export earnings on a limited number of natural resource-intensive products. This long-standing feature has not changed in the nineties, except for countries such as Mexico and some Central American economies that have succeeded in diversifying exports towards manufactured products.²⁶ For most of the rest, however, commodities continue to account for the bulk of their export earnings.

Deeper integration into the world economy should facilitate risk diversification and ease adjustment to external shocks (for example, developing countries should be able to diversify terms of trade risks by hedging in international financial markets). In practice, however, domestic and foreign financial markets have proved not deep enough. They also usually operate with such short-term horizons that they cannot provide insurance to the domestic economies against the rather long cycles that prevail in markets of goods and finance. Moreover, capital flows have behaved pro-cyclically with respect to trade shocks, amplifying the international business cycle. Consequently, shifts in capital flows have compounded the traditional sources of imported volatility.

One of the tensions of globalization is associated with the fact that in a more inter-linked world economy any adverse global or regional shock propagates rapidly to other economies. "Contagion" can be transmitted through either a decline of import volumes and/or changes in commodity prices. But influences can be also channeled through asset markets. Portfolio shifts can affect the exchange rate, interest rates and economic activity levels. In a context of highly integrated financial markets global, regional and local shocks tend to be transmitted much more rapidly than in the past. This source of financial volatility was largely absent

²⁶ In 1999 manufactures accounted for 84 percent of total Mexican exports, as compared to just 27 percent one decade earlier. In the case of the Central American Common Market, the share of manufactures in total exports

in the world of the 1950s, 1960s and early 1970s, when multilateral lending, foreign aid and foreign direct investment dominated global capital movements (Solimano, 1999).

The volatility of capital flows and domestic policies is higher in Latin America than in the industrial world and the more stable developing regions, such as the East Asian miracle economies (Ferranti et al, 2000)²⁷. The Latin American experience during the 1990s shows that in periods of financial euphoria, domestic credit and liquidity expands too much. Similarly, during the "dry season" liquidity tends to contract too sharply. These powerful financial amplifiers lead to sharper expansions, but also to deeper busts. Volatile financial flows, coupled with unstable growth rates, have negatively affected the incentive to invest and damaged the long-run growth potential.

Figures 3 and 4 show the marked instability of net transfers between Latin America and the rest of the world during the last quarter of a century, and the huge fluctuations of economic activity levels in the region. It can be observed that the overall evolution of GDP in Latin America in the last decades has been systematically anticipated by changes in aggregate demand. By comparing Figures 3 and 4 one can observe that changes in aggregate demand have been closely associated with changes in net foreign transfers.

increased from 39 to 54 percent over the same period.

²⁷ In the years preceding their crises, East Asian nations became "latinoamericanized", in the sense of allowing increased external deficits, mounting outstanding debt and currency and maturity mismatches, thus entering vulnerability zones (Ffrench-Davis and Ocampo, 2001).





The economic impact of international disturbances is magnified by the region's thin domestic financial systems, the development of which lags very far behind those of the rest of the world. In spite of recent innovations towards the development of new international financial instruments (such as contingent credit lines, which were of little help in the case of Argentina), world financial markets still offer limited opportunities for risk diversification and insurance against global disturbances. In a context of shallow domestic financial markets, high volatility in international capital flows and a deficient international financial architecture have led to a growing (but still far from unanimous) consensus that full capital account convertibility may be far from an optimal policy.²⁸ The critics of unrestricted integration into world capital markets underline the desirability of counting on instruments for prudential regulation of international capital flows, whether direct (such as mandatory reserves, taxes on foreign capital or quantitative limits to FDI) or indirect (such as tax regulations). The regulatory regimes adopted by Chile (Agosin and Ffrench-Davis, 2001; Ffrench-Davis, 2002) and Colombia (Ocampo, 2003) in the nineties are good examples of the suggested practices.

The importation of volatility brought about by globalization may have negative effects on equity if the performance of income distribution throughout the business cycle is not symmetrical. In effect, if there are "hysteresis effects" the worsening of income distribution during economic downturns may not be fully compensated by an improvement in the upswings.

4.3 Loss of discretion in macroeconomic policy-making

One explanation for the evolution of inequality in the last two decades is that globalization has limited the power of governments to follow certain policies. It is

²⁸ See, among others, Ffrench-Davis (2000); Ocampo (2003); Palma (2002) and Solimano (1999).

beyond discussion that globalization, and especially the ability to move money rapidly from one place to the other, has limited policy discretion for governments and has taken certain policy issues virtually off the agenda. Examples of the latter include land reform or expropriations of any kind, except in exceptional circumstances and following pre-agreed procedures. The constraints posed by globalization have led to a shared consensus that the sustainability of "populist" policies is much more fragile in a more integrated world. Some authors and policy makers would go one step further and argue that governments are no longer able to implement the kind of redistributive and compensatory policies that may be desirable in order to reduce inequality. However, despite the growing influence of these views, the reduction in policy discretion has been uneven across countries and has varied according to circumstances. Based on an analysis of OECD economies, Garret (1999) showed that the loss of policy discretion has been far from homogeneous. He also sees no evidence of a "generalized race towards the bottom" as predicted by the proponents of globalization as an all-encompassing process. This does not invalidate the view, however, that developing countries are now more vulnerable both to volatile flows as well as to changes in expectations and market sentiment.

The loss of some policy discretion may not be necessarily a bad thing. According to Solimano (1999) and Rodrik (1999), the constraints on domestic policies posed by some international agreements (such as the WTO) may help developing countries by boosting the credibility and sustainability of their own domestic policies and by reducing the scope for rent-seeking practices. Examples of these are prudential regulation of financial markets, limits to budget deficits, efforts at tax harmonization and compliance with basic labor rights. However, whether these constraints will exert positive or negative influences on performance will ultimately depend on the nature of the constraints and the incentives associated to them. There is nothing intrinsically good or bad in reducing or increasing policy discretion. What matters is the way in which policy discretion is exercised or the kind of constraints that the outer world imposes on local authorities. As we already argued, the opening of the capital account may actually lead emerging economies to import external financial instability, with capital inflows worsening macroeconomic fundamentals, rather than to higher investment rates. Similarly, the contribution of international market disciplines to check the domestic sources of instability may not be very efficient, given the whims of opinion and expectations characteristic of financial markets. Financial markets may inaccurately perceive some domestic policies as inadequate and, even more importantly, they may actually induce key variables (such as the exchange rate) to deviate for relatively long periods of time from sustainable levels. In such circumstances, market sentiment may (and will) generate incentives for emerging economies to enter a "vulnerability zone" during the booms.

One of the new constraints on policy-making is that economic policy has partly lost its capacity to be used as a counter-cyclical instrument geared to maintain full employment. To the extent that the loss of discretion to use monetary, exchange rate and fiscal policies either to absorb external shocks –financial or realor to smooth the business cycle is real, a larger share of the adjustment burden would fall on real output and the labor market. Since nominal wages are not fully flexible, the adjustment process will eventually affect output and employment levels (CEPAL, 2002a; Ocampo, 2003; Rama, 2001). However, the extent of this loss of room for exerting policy discretion may have been exaggerated, as revealed by some Latin American countries in the last decade (eg: Chile). The idea that governments cannot use capital controls to restrict the inflow or outflow of all or certain types of capital, thus leaving the domestic economy vulnerable to the ebbs and flows of international capital markets, may hold some truth (particularly at times of crisis), but less than what is often believed. In effect, the Chilean experience with portfolio capital inflows controls illustrates the fact that there is scope to adopt compensatory policies in the context of a market-oriented policy framework (Ffrench-Davis, 2002; Williamson, 2000). Indeed, the loss of policy discretion may derive more from the fact that policy-makers lacking intellectual independence or credibility may want to please "market sentiment", rather than from some irreversible trend.

It is generally accepted that international financial markets are sensitive to the fiscal policy stance of a particular country, particularly at time of crisis. Such fiscal stance can also be used as an indicator of how 'responsible' the government is in managing the macroeconomy (Solimano, 1999). This may encourage governments to implement pro-cyclical fiscal policies, cutting government spending or raising taxes in economic downturns, thus amplifying an economic slowdown or a recession (with the ensuing loss in employment and real incomes).

One related issue, worrisome for democratic governance, is the growing duality in the constituencies that policy makers take into consideration. The increasing complexity and globalization of the world economy has widened the gap between policy-makers and financial agents, on one side, and those that bear the consequences (workers and firms) of their actions. At least in the case of some Latin American countries, an excessive concentration on financial markets' sentiment has had a major influence on the evolution of the countries' macroeconomy and productive systems.

The integration of capital markets has remarkable implications for the governance of domestic policies and on the constituencies of national governments. Most leaders in emerging countries are living a 'dual constituency syndrome' (Pietrobelli and Zamagni, 2000): on the one hand, they are elected by their countries' voters; on the other, they seek the support of those who "vote"

through the financial markets. Recent cycles in financial markets have revealed significant contradictions between the two, in what has become a negative sum game. A more positive outcome would require policies that actively foster consistency between the level and composition of financial flows and the sustainability of key macroeconomic indicators.

5 **Preliminary conclusions**

There is still a large pool of ignorance on the linkages between globalization and economic reform, on the one hand, and welfare and equity, on the other. The major message of this paper is that there are no obvious or univocal conclusions that can be offered as ready-to-use policy recipes. This suggests that it may be wiser to adopt a more balanced and careful approach than the one that prevailed in academic and policy circles for most of the last two decades. Our main conclusions would be the following:

- The effect of globalization and "structural reforms" on equity remains a hotly debatable issue. The empirical works reviewed frequently reach opposite conclusions. For example, while trade liberalization had regressive effects for Morley (2000), Berhman, Birdsall and Székely (2001) do not find a significant relationship between the two phenomena.
- There is no consensus on the factors that account for the increase in the skills premium in Latin America, a fact that has contradicted the predictions of conventional theory. Several hypothesis have been

offered, such as the "China effect" or the fact that unskilled labor was heavily protected prior to the reforms. More recently, however, a growing consensus has emerged on the potential role of biased technical change.

- One topic that needs more research is the role of domestic policies and institutions in transmitting the effects of globalization. Based on a large sample of developing countries, Rama (2001b) concluded that globalization can have negative or positive effects on income distribution, depending on variables such as the level of public sector spending or investment in education.
- There is also little knowledge on the effects of globalization on phenomena such as the incomes gap produced by differences in gender or the use of child labor, factors than can significantly affect large sections of the population. In this case, the causal links are more tenuous, since child labor and production for self-sufficiency are nor directly related to globalization (except for forms of sexual tourism)
- The distinction between the market and policy components of globalization does not always come out clear in the policy debate. This creates a grey area in which policy prescriptions are presented as optimal responses to market constraints, although they are in practice a result of preferences and/or vested interests. The search for simplified policy recipes, instead of a more transparent and more pluralistic policy debate, may have been a significant factor behind

the disappointing economic and equity performance of Latin America since the nineties.

- That globalization restricts the range of policy choice at the disposal of public sector officials is beyond dispute. However, not all countries are affected in the same way and with the same intensity. Consequently, rather than making general statements on the constraints on policy discretion posed by globalization, a more careful analysis of the factors that shape national differences can help to identify policies and institutions that may increase the resilience of developing countries to negative external shocks and enhance the room for indigenous policy choice.
- There is need to know more about how to cope with the problem of the "globalization of financial volatility" and macro sustainability. More research and understanding is required on the need and the direction of international financial institutional reform. More and better knowledge is also required on how to make sure that developing countries have enough room to make responsible but active counter-cyclical monetary, fiscal, exchange-rate, and capital account policies.
- At last, more research is needed on how to compensate or deal with the negative effects of pro-market reforms and globalization, whenever these negative effects (transitional or otherwise) are proved to exist.

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