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**Comments by**

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**On**

Jayati Ghosh's Presentation

Macroeconomic policy and inequality  
*Política macroeconómica y desigualdad*

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A main policy transformation of the world economy in the last two decades or so are the process market reforms in developing countries and former socialist economies accompanying the process of globalization. The record of stabilization, market liberalization and privatization on economic growth, social conditions and income and wealth distribution is a subject of debate and controversy. New empirical evidence, recent analytical work and greater time perspective starts to allow better judgment on the nature and effects of those policies. This note analyzes the effects of reform policies on growth first and then on social inequality, summarizing main results and drawing cross-country and cross-regional comparisons.

### Growth

- a) In most Latin America countries the reform policies of the 1990s were *not* followed by an acceleration of economic growth except in the case of Chile and to an extent Dominican Republic. In the last quarter century, the region has experienced a GDP per capita growth rates in the region. (see Solimano, 2006). Probably the best performer is Chile, a country that started its reforms in the mid 1970s. Only after a decade later growth became steadier after various crises and policy mistakes. In turn, the restoration of democracy in the 1990s and a more aggressive social policy, the economic model gained further social support and legitimacy. The Chilean story shows that free markets need to be combined with progressive social policies and democratic politics to consolidate.
- b) In former socialist countries of Russia and Eastern Europe, economic reforms were initially followed by big contractions in GDP and employment. The recovery of growth took near a decade to come in Russia although the sustainability of this recovery in Russia is still an open question given relatively reduced investment rates. GDP growth started earlier in Eastern and Central Europe.
- c) China that followed, since the late 1970s, politically controlled market oriented policies of openness to foreign investment and export orientation. However, unlike in Eastern Europe and Russia reforms in China did not entail shock therapy and massive privatization. In China very rapid growth has taken place for near three decades.
- d) India moved to more market oriented policies in the 1990s but the acceleration of growth has not been as fast as in China.
- e) Economic growth per capita in Africa still remains low and the most of the continent is mired in what observers call a low development trap.

The last 15-20 years of reform in the development world and post-socialist countries shows a large diversity of policy reforms paths: as we mentioned above the nature of the reforms in China were very different from those of Russia. In turn, the policies adopted in Latin America were different from those adopted in Africa and there are large variations in policies across countries of a same region. The variety in policies is matched also by a diversity of growth outcomes. It is difficult to map growth responses to specific policies within and across countries. More generally recent research is showing that growth rates in the same country have little serial correlation: current growth can be a bad predictor of future

growth. It is apparent that volatility in growth rates is a large part of the global growth story of the last two to three decades in the international economy.

In this vein, country-specific “growth diagnosis” of factors that ignite, maintain or stop growth is eschewing broad generalization of the type that dominated “policy-oriented”, growth economics in the 1990s. Those studies were often based in the use of cross-country growth regressions for a large sample of very heterogeneous countries with policy variables as explanatory factors of per capita growth rates. This suggests the importance of idiosyncratic, country specific factors such as external shocks, internal policies and politics, the responses of savings, investment and productivity to policies in accounting for observed growth paths.

#### Inequality and Social Impact of Reform.

Another main policy concern is the effect of macro and reform policies on social indicators and inequality of income and wealth. We can identify several channels through which macro stabilization and market-based reforms affect social conditions and inequality:

- a) In the initial phase of reforms several countries had to undertake macro stabilization. This is often oriented to reduce inflation, correct currency overvaluation and fiscal and current account imbalances with different effects on output, employment, real wages and income distribution. Shock therapy can lead to output contraction and probably over-achievement of current account targets, a feature often present in the actual implementation of IMF programs. Output contraction is often accompanied by cuts in real wages and employment with adverse effects on workers’ welfare and on poor families. However, if stabilization succeeds in bringing down inflation and leads to a recovery of output on a more permanent basis, this should help to boost real wages and employment. The short run impact of policies may differ from their medium term effects.
- b) Economic reforms often have sought to reduce the size of the public sector. In many instances this lead to firing of public sector employees and/or the compression of their real wages. The expectation in the design of reform was that people would reallocate to the private sector that was being boosted by market liberalization. In Chile in the mid 1970s more than 100.000 public employees were separated in one year under the military regime and unemployment climbed to near 20 percent. In several countries as a result of public sector retrenchment open unemployment increased. That was the case in the 1990s in Argentina in the Latin American context, in Poland, Russia and other post-socialist countries in the 1990s as a consequence of economic restructuring and reform. The empirical evidence shows that the growth of the private sector takes long to occur and consolidate; in addition, their capacity to create employment is often not enough to absorb the people laid out of the public sector and new entrants to the labor force and economies start to operate with a sort of structural unemployment and informal employment.
- c) Reforms often came along with privatization. This policy has potentially significant effects on wealth distribution, a main determinant of income distribution. The point is weather the first round of asset redistribution following privatization concentrates or leads to a makes more egalitarian asset

distribution in society. However, over time asset distribution can concentrate leading to the formation of large economic conglomerates with strong economic and political power in society with consequences for democracy.

- d) Recent studies are showing that the economic reforms in Russia, China, and former Socialist countries have been accompanied by an increase in the Gini coefficients for per capita income, showing a rise of income inequality after economic reform policies were undertaken, although with variations across countries (see Mitra and Yemtsov, 2006). These authors show that for Russia the Gini coefficient went up from 0.259 to 0.404, say an increase of around 15 points when comparing 1987-90 with 2003. This is a very large increase for a traditionally stable Gini coefficient. For China, the Gini of per capita income increased from 0.289 (in 1987-90) to 0.395 in 2001, another very large increase in inequality. More moderate changes in the Gini are observed in Czech Republic -- from 0.197 (1987-90) to 0.234 in 2003 and in Hungary from 0.214 (1987-90) to 0.268 in 2003. In Poland, in contrast, the Gini rose from 0.255 (1987-90) to 0.356 in 2003. Thus, the largest increases are in Russia and China rather than in Central Eastern Europe.
- e) India also seems to show increases in inequality in the 1990s following reform policies toward the market (see Goshi, 2006) India.
- f) In Latin America, Chile, Argentina and other countries saw either an increase or the maintenance of the value of the Gini coefficients in the 1990s and early 2000s, coinciding with a period of market liberalization. However, in the Latin American case the economies started from much higher Ginis (in the range 0.45 to 0.55/0.60, say higher levels of income inequality) than in socialist countries at the start of their reform processes as these countries at the end of the socialist period had Ginis in the range of 0.18-0.26.

Summing –up, the effects of economic reforms in developing countries and former socialist economies undertaken in the last quarter century or so have been accompanied by a wide variety of growth outcomes. Growth success stories are relatively few: China, Chile and some other countries. In contrast, stories of bumpy growth, stagnation and growth crises have been, unfortunately, more common. In turn, reforms have been accompanied by significant increases in per capita income inequality in Russia and China, but less steep increases in inequality in post-socialist countries of Eastern and Central Europe. In Latin America, a region of historically high inequality income distribution has worsened or remained relatively unchanged (i.e. Chile) during and after reform. These are clearly important issues for future research and reflection in the search for socially more progressive economic reform

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