# New Markets, New Opportunities?

## Mobility Issues in the Emerging Market

By Nancy Birdsall and Carol Graham

The dramatic entry of the emerging market countries into the global economy has brought issues of inequality and opportunity front and center worldwide. Indeed, as the recent international financial crisis has highlighted, even in the most successful fast-growing economies in Latin America, Eastern Europe, and Asia, global markets can bring, along with better opportunities, increased inequality and insecurity for individual citizens.

We focus here on Latin America, but similar questions are being raised wherever market reforms spurred by global integration have heightened concern about inequality. Because most countries in Latin America (and many elsewhere) are in the midst of quiet but profound political transitions to more democratic and more decentralized political systems, the inequality issue has political implications as well.

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### Explaining a Puzzle

In Latin America the market reforms of the 1990s have been accompanied by persistent, even heightened inequality. Increasingly dynamic and competitive markets have conferred most of their rewards on those with the wherewithal (property, connections, and, increasingly in the information age, education and skills) to exploit the new rules. Insecurity is also on the rise. Even people with good jobs and rising income work in more volatile and flexible labor markets, with globalized markets requiring constant adjustments in the nature and location of production and thus of jobs.

Chile stands out in Latin America as a leader in implementing market reforms, sustaining growth, and reducing poverty, while making a successful transition to democracy. Yet even in Chile, more than 60 percent of respondents in a recent poll favored increasing equality over increasing productivity, and more than 90 percent favored increased government spending on health, education, and pensions. Still, despite apparent concerns about inequality, most voters in Chile, as elsewhere in the region, have consistently endorsed market policies over the past decade. How is one to account for Latin American voters' continued support for reforms despite persistent or increasing inequality?

One explanation is that the collective memory of the high inflation and macroeconomic volatility of the 1980s forged a public consensus in favor of market discipline. That explanation has a limited life, however, as most countries of the region

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have now managed relatively low inflation for years. Voters may instead be prompted by a more enduring disdain for a state that is too big, too ambitious, and potentially too corrupt—and they may be endorsing a profound change in its role. Voting trends may thus reflect a view with potentially more lasting implications, namely that a more efficient state and greater reliance on more open and dynamic markets can bring not only inequality and insecurity, but also greatly increased and more broadly shared opportunities.

## Good and Bad Inequality

Inequality, depending on its nature, can be primarily constructive or destructive. A view popular in the United States is that inequality spurs economic growth by rewarding productivity and innovation and by supporting new opportunities. But inequality may also be destructive if it reflects entrenched differences in the capacity of individuals and households to exploit markets or in their access to education, employment, or property rights. Such inequality can discourage the poor from investing in their future.

Latin America's history of high inequality reflects, at least in part, a history of unequal opportunity. Until recently, labor laws made it virtually impossible to fire workers once they were contracted, thus discouraging hiring. Pockets of workers were privileged and overprotected, while the majority were driven into the informal economy. Inadequate regulatory and judicial systems often allocated services in response to bribes and other forms of influence peddling by wealthy individuals or firms. The poor, unable to negotiate the system to legally register their homes or small businesses, were left without titles and without the collateral to borrow and invest. Shallow financial sectors, often operating at negative rates of real interest, rationed credit, which inevitably went to large public enterprises or to influential firms, leaving small and medium-sized businesses unable to borrow to increase their size and efficiency.

By eliminating distortions that blocked the productive potential of the poor, market reforms should, at least in theory, open up new opportunities. Voters in Chile and throughout Latin America may thus be endorsing a deep shift, from closed to open societies, and to increased opportunity for all income groups.

## Trends in Opportunity

What voters perceive and endorse, however, is not easily assessed and quantified by social scientists. Changes in the distribution of income take years, even decades, to unfold. Underlying changes in the distribution of opportunity are harder still to observe. Income in Chile remains as inequitably distributed today as it was in the 1960s, despite all the reforms and major reductions in absolute poverty in the past 10 years. In most other countries in the region, measures of income inequality also remain largely unchanged. Yet these data tell us little about what happened to opportunity and mobility in the aftermath of market reforms. Nor do they tell us how or whether those reforms will affect future distribution patterns. Significant increases in mobility among younger low-income cohorts as a result of market reforms, for example, might make distribution more equitable in the future, but those improvements could be captured only by measuring distribution patterns in 10 or 20 years.

Charting trends in mobility and opportunity in the emerging market countries is particularly difficult because, unlike the industrialized countries, developing countries rarely collect long-term data relating to individual welfare changes. Detecting these trends requires modifying existing data sets to create proxy long-term (panel) data, as well as generating new long-term data. We do, however, have some indicators of recent trends in mobility and opportunity in emerging market countries, as well as some new evidence of how individuals *perceive* they have fared under market reforms and how those subjective perceptions relate to objective trends.

According to a recent analysis of Latin American household data by Jere Behrman, Nancy Birdsall, and Miguel Szekely, strengthened financial markets and increased public spending on basic education enhance intergenerational mobility, reducing the role of family background in determining individuals' mobility paths. Though the immediate effects of market reforms and education policy are not evident in any improvement in the distribution of income, it is likely that they will enhance mobility rates—and may make distribution more equitable—over the long term.

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In the shorter term, market reforms have favored some groups over others. Younger, better-educated, and skilled workers—those in short supply because of the region's poor record in educating its labor force—have fared the best. David Hojman, for example, has found that while income in Chile has increased across the board, rewards to managerial (skilled) personnel have outpaced those to workers as much as five to one.

## Sustainable Reform

Understanding how these trends in mobility and opportunity translate into voter behavior requires taking into account people's *perceptions* of their past mobility trends, as well as their assessments of their future prospects of upward mobility.

Carol Graham has analyzed regionwide public opinion surveys in Latin America in 1997 and 1998, in which respondents were asked to compare their living standards with those of their parents, as well as to assess their own prospects of upward mobility. Younger cohorts (ages 18–29) were the most optimistic, both about their standing relative to their parents and about their future mobility. More educated groups also tended to be more optimistic in most countries, though in some, such as Brazil and Bolivia, the least educated groups were the most optimistic.

In another study, Richard Webb compared actual economic progress of selected households in Peru between 1985 and 1997 with respondents' own assessments of their progress and prospects. Actual mobility over those years was quite high, as Peru moved from extreme economic crisis during the mid-1980s, to severe stabilization measures, and then finally to a growth surge. Most households in the study enjoyed significant improvements in their per capita income: 61 percent had increases of 30 percent or more. Responses to subjective questions regarding current and past economic status, however, were sharply and negatively skewed, with the highest performers having the most negative self assessments.

There are a variety of explanations for this anomaly, including higher expectations among more educated, urban groups, reluctance to make definitive statements among rural respondents, and difficulties in accurately assessing earnings and income trends, particularly by self-employed individuals. Another plausible explanation is that the increased uncertainty accompanying the turn to the market encourages negative assessments of progress and that those who have found new opportunities feel little guarantee of their stability. Regardless of the explanation, the results highlight a worrisome finding from a political economy perspective: some of the clearest winners in the market process do not perceive that they have experienced upward mobility.

The counter-intuitive nature of Webb's findings for Peru is complemented by regionwide results, in which some of the brightest assessments of prospects for upward mobility were in some of the worst-off countries with poor growth trajectories and high inequality. People, it seems, assess their prospects of upward mobility more positively when the margin for absolute advancement is greater. In a similar vein, Richard Easterlin's research on industrialized countries finds that as absolute income levels go up, relative income differences matter more to people's assessments of their well-being.

## The Way Ahead

In a global system that seems unfair and unstable, Latin American democracy and open markets have been strengthened, belying concerns about isolationist backlash and resort to authoritarian populism. How sustainable is this trend? Our findings thus far are ambiguous. Although deeper markets and better schools encourage mobility and opportunity in the emerging market countries, the new markets are rewarding some groups much more than others. These relative income differences may matter as much as, if not more than, absolute ones (at least above a certain level of income) as people assess their economic well-being and progress, which may explain why even some of the winners in the market process are so negative about their progress. That in turn may have important if as yet unrealized effects on the political sustainability of market policies.

The challenge for policymakers is to continue to deepen and support markets while pursuing policies that can increase opportunity for lower-income groups. Education is one area where both objectives can be achieved. Purely redistributive policies that attempt to equalize outcomes as well as opportunities have a more checkered record. Yet the importance that even highly mobile individuals attach to relative income differences in the new market economies suggests that inequality is an issue that is not going to go away, even in the context of fast-paced growth, and that addressing it in novel and creative ways may ultimately be critical to the sustainability of the worldwide turn to the market. ■