

**First Draft**

**ECONOMIC REFORMS, INCOME DISTRIBUTION  
AND THE INCIDENCE OF POVERTY IN URUGUAY\***

**by**

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**I. INTRODUCTION**

Starting in 1968 --but more clearly after the 1973 coup d'état-- Uruguay experienced a gradual dismantling of the development model that had been in place for the last 40-50 years. A regression took place where the import-substitution industrialization (ISI) model was replaced by an export-oriented model favouring the production of traditional agricultural products first, and then the production of nontraditional products and particularly manufactured goods. The adoption of the new model implied the opening of the economy and the implementation of structural reforms. This reform process has been extremely gradual and after 25 years has not yet been completed. Notwithstanding, the reforms carried out to date have significantly altered the Uruguayan economy and society.

The purpose of this paper is to analyze the trends in the distribution of income and the incidence of poverty in Uruguay, most particularly during the period of liberalization of the economy. The evidence shows that though the distribution of income worsened during the first years of military government, the process of income concentration started in 1960s as a consequence of the deliberate siding of the State with the capitalist class in opposition to the working class and popular sectors in general. The evidence also shows that, relative to that prevailing in most other Latin American countries, the incidence of poverty is not very significant in Uruguay. The structure of the paper is as follows. The next section briefly examines income distribution and poverty trends during the period of exhaustion of the ISI model. Section III focuses on the period following the heterodox stabilization attempt of 1968 which brought about the break down of democratic rule in Uruguay and prepared the stage for the new economic model adopted by the military regime in 1974. The next two sections examine the changes in the distribution of income and in the incidence of poverty in Uruguay during the period of liberalization of the economy and adoption of structural adjustment programmes by the military government, and during the new democratic period which started in 1985. Finally, a brief summary and conclusions are presented in section VI.

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## II. THE STAGNATION OF THE ECONOMY (1956-1968)

The rapid expansion of GDP that characterized the period 1945-55 came to a sudden end in the second half of the 1950s: GDP *decreased* at an annual average rate of 0.1% between 1956 and 1960, and then expanded slightly at 0.9% per annum during the next five years. All sectors of the economy stagnated after 1955, and most particularly the industrial sector which encountered insurmountable internal and external constraints due to the size of the domestic market and its growing dependence on imported inputs. Notwithstanding the ISI model showing clear signs of exhaustion, the economic policy of the government continued along traditional lines until the end of the decade. The industrial sector, however, was unable to regain its dynamism. On the one hand, excessive protectionism had caused the sector to grow inefficient, completely dependent on the domestic market, and thus unable to compete in the international market. On the other, the inability to continue using distributive policies to increase domestic demand sealed any possibility of expansion of the manufacturing sector. The situation of the industrial sector, coupled with the long standing stagnation of the agricultural sector, made impossible the continuous growth of the Uruguayan economy and by 1958 Uruguayan GDP showed for the first time since 1942 a negative rate of growth.

The Colorado party --which had been in power since the third quarter of the nineteenth century and has historically represented the interests of the industrial sector and the urban population-- lost the 1958 election to the Blanco party --the political voice of the agricultural sector and rural interests in general. The new Blanco government took office in 1959 and soon after introduced important reforms directed towards the dismantling of the protectionist apparatus. This first liberalization attempt was based on the perception that economic growth could only be restored by facilitating the expansion of the sector enjoying international comparative advantages: the agricultural sector. The defence of free-market policies, however, was gradually abandoned over time.

By mid-1960s it became already evident that this first timid attempt to restore dynamism in the economy through trade liberalization and price deregulation had not succeeded. It must be noted, however, that the experience of the early 1960s only represented a first step towards the liberalization of an economy which remained afterwards still quite protected. Nonetheless, for many it became clear that the agricultural sector --and particularly the cattle raising sector-- could not become once again the engine of growth of the Uruguayan economy and that the sector's stagnation was structural in nature. Given the failure of the new model, the government encountered the dilemma of having to choose between two alternative paths to restore the healthy state of the economy: to keep an outward oriented development strategy but based now on the expansion of manufactured exports, or to reverse to the inward oriented model of the past. The first alternative was timidly pursued with the incorporation of Uruguay to LAFTA in 1961 and the introduction of subsidies and other exports incentives for manufactured goods in 1964. These measures, however, did not have significant effects and external sector disequilibria continued throughout the period. The second alternative was pursued without much success either throughout the period in a stop-and-go fashion but most clearly in 1967 with the election of a new Colorado government. The latter *desarrollista* attempt was cut short after just a few months due to the chaotic economic situation and the lack of strong political support.

The experience of Uruguay during this period shows that government distributive policies in favour of the industrial sector, and the urban sector more generally, were implemented without much resistance as long as the economy was growing and international agricultural prices were favourable. Indeed, as long as the pie was growing, all sectors were able to increase their portions' size. With the deterioration of the terms of trade and the stagnation of the economy, however, the distributive process turned into a zero-sum game. Hence, the behaviour of the different groups changed accordingly. The cattle raising sector, and the export sector more generally, started to press the government to devalue the currency in order to increase their income shares. The industrial sector, in turn, pressed the government for further subsidies and protectionist measures --rent-seeking behaviour-- and started to seek a reduction in the level of real wages. The inflationary effect of the devaluations and the wage demands of the industrial sector were strongly resisted by a well organized working class used to steadily improving standards of living. The result of this redistributive struggle was spiral inflation, particularly after 1963, which gradually developed into social and political instability.

The working class was the clear loser *vis-à-vis* the capitalist class in this redistributive struggle. Real wages steadily declined throughout the period after reaching a peak in 1957. Nonetheless, after falling to 90% of their 1957 level in 1959, workers were able to maintain the level of real wages relatively stable until 1963. The latter, however, was not true for public sector employees who saw their wages falling a further 18% in 1959-61 (Instituto de Economía, 1969, p. 274). From 1963 on, however, real wages for the whole economy kept falling and in 1968 accounted to only 73% of their 1957 level. The bargaining position of the workers *vis-à-vis* the capitalist class was weakened by the high level of unemployment which characterized the Uruguayan economy during this period: 10.4% in 1964 and an average 7.9% between 1965 and 1969. These high rates of unemployment --since then a characteristic of the Uruguayan economy-- were reached despite the following two important facts: on the one hand, public employment was expanding very rapidly from 168.5 thousand in 1955 to 193.8 thousand in 1961 and to 230.0 thousand in 1969 (Rama, 1991, p. 112),<sup>1</sup> and on the other, more than 30 thousand Uruguayans emigrated during the 1960s (calculated from data in Melgar, 1981b).

The reduction in the level of real wages suggests a deterioration in the distribution of income from 1957 on. This view is also reinforced by the fact that average real pensions steadily declined throughout the period, reaching in 1967 a level 45% lower than in 1957 (Papadópulos, 1992, p. 191). Though income distribution might have worsened, there are no definite data available to support this claim for the period 1957-61. The available data do show, however, significant changes in total

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<sup>1</sup> Public employment accounted for 22% of the labour force in 1969 (Allen and Labadie, 1994, p. 7). The fact that the number of public employees was growing at the same time that their wages were falling --in both relative and absolute terms-- lends support to the view that the State became the employer of last resort. González and Notaro (1979, p. 7) point out that without the creation of new relevant activities, the public sector accounted for 50% of all new employment between 1955 and 1961, and at least for 35% in the period 1961-69 (cited in Fortuna, 1980, p. 75).

household income distribution for Montevideo between 1961-62 and 1967.<sup>2</sup> Increasing rates of inflation proved to be a very efficient venue for the regressive redistribution of income.<sup>3</sup>

**Table 1. Total Household Income Distribution, Montevideo**

| % of households | 1961-62     |            | 1963        |            | 1967        |            | 1976        |            |
|-----------------|-------------|------------|-------------|------------|-------------|------------|-------------|------------|
|                 | % of income | Cumulative | % of income | Cumulative | % of Income | Cumulative | % of income | Cumulative |
| - 5             | 1.0         |            | 0.9         |            | n.a.        |            | 0.3         |            |
| 10              | 2.5         | 2.5        | 2.4         | 2.4        | 1.3         | 1.3        | 1.3         | 1.3        |
| 20              | 4.0         | 6.5        | 3.9         | 6.3        | 3.0         | 4.3        | 3.0         | 4.3        |
| 30              | 5.0         | 11.4       | 5.0         | 11.3       | 4.4         | 8.7        | 4.1         | 8.4        |
| 40              | 5.9         | 17.1       | 6.0         | 17.3       | 5.6         | 14.3       | 5.3         | 13.7       |
| 50              | 7.0         | 24.1       | 7.3         | 24.6       | 6.8         | 21.1       | 6.5         | 20.2       |
| 60              | 8.2         | 32.4       | 8.6         | 33.2       | 8.4         | 29.5       | 7.8         | 28.0       |
| 70              | 9.7         | 42.3       | 10.3        | 43.5       | 10.1        | 39.6       | 9.7         | 37.7       |
| 80              | 11.8        | 54.1       | 12.7        | 56.2       | 13.0        | 52.6       | 12.1        | 49.8       |
| 90              | 15.2        | 69.3       | 16.3        | 72.5       | 16.9        | 69.5       | 16.2        | 66.0       |
| 100             | 30.7        | 100.0      | 27.5        | 100.0      | 30.5        | 100.0      | 34.0        | 100.0      |
| + 5             | 20.7        |            | 16.8        |            | n.a.        |            | 23.0        |            |
| Gini index      | 0.386       |            | 0.371       |            | 0.418       |            | 0.450       |            |
| Theil index     | 0.246       |            | 0.219       |            | 0.292       |            | 0.335       |            |

**Source:** Melgar, 1981b, p. 16.

Though the data in Table 1 was obtained from different surveys not strictly comparable,<sup>4</sup> they do show a clear trend towards a greater concentration of income between 1961-62 and 1967. The 1961-62 and the 1963 surveys are very close in time and the similarity of results (except at the top) serves to confirm the reliability of the figures. These two surveys show a relatively egalitarian distribution of income even if the situation might have been worsening since 1957. Indeed, as shown in Table 2, the 1963 Gini coefficient of 0.37 --0.39 in 1961-62-- indicates a degree of income concentration that compares favourably with that of most developing and developed countries. A

<sup>2</sup> The available data for urban areas in the rest of the country do not allow definite conclusions but suggest that income concentration might have diminished between 1963 and 1976 (see Cancela and Melgar (1985) and Bensión and Caumont (1979)). However, it must be noted that income concentration was much higher in the rest of the country to start with --Gini coefficient of 0.45 in 1963 compared to 0.37 in Montevideo.

<sup>3</sup> The average rate of inflation was 17% in 1955-59, 24% in 1960-62, and 55% in 1963-67 with a peak of 136% in 1967.

<sup>4</sup> The 1961-62 data are from a Consumption Survey by the Statistical Institute of the Faculty of Economic Sciences of the University of the Republic; the 1963 data are from a Household Survey by CIDE; and the 1967 data are from a survey by the Instituto de Economía of the University of the Republic (see Melgar, 1981a and 1981b). The 1976 data are from a Household Survey by the Dirección General de Estadísticas y Censos (DGEC), nowadays renamed Instituto Nacional de Estadísticas (INE).

comparison between the data of these two surveys and that of the 1967 survey shows, however, a clear deterioration in the distribution of income. The Gini coefficient increased from 0.39 in 1961-62 and 0.37 in 1963 to 0.42 in 1967, and the ratio between the 20% of households with the highest income and the 20% with lowest rose from 7 in 1961-62 and 1963 to 11 in 1967. The sectors most affected were the 50% of households with the lowest income who experienced a decrease in their shares from about 24.5 to 21% during this period. Among this group, those households in the first two deciles had their shares reduced more significantly from 2.5 and 4.0% to 1.3 and 3.0% respectively. Households in the 6-9 deciles kept their shares relatively unchanged while those in tenth decile had theirs increased from 27.5% to 30.5%. Nonetheless, the higher Gini coefficient of 0.42 in 1967 still compares favourably with those of most Latin American countries as shown in Table 2.

**Table 2. Income Concentration in Uruguay and Other Countries**

|                      | Year | Income per capita<br>(1974 US\$) | Gini<br>Coefficient |
|----------------------|------|----------------------------------|---------------------|
| Uruguay <sup>1</sup> | 1963 |                                  | 0.371               |
|                      | 1967 |                                  | 0.418               |
|                      | 1976 | 1,190                            | 0.450               |
| U.S.A.               | 1966 |                                  | 0.402               |
|                      | 1970 |                                  | 0.407               |
|                      | 1972 | 6,670                            | 0.417               |
| United Kingdom       | 1968 | 3,590                            | 0.339               |
| Germany              | 1968 |                                  | 0.386               |
|                      | 1970 | 6,260                            | 0.394               |
| Brazil               | 1970 | 920                              | 0.570               |
| Ecuador              | 1968 | 480                              | 0.526               |
| Chile                | 1968 | 830                              | 0.507               |
| Mexico               | 1968 | 1,090                            | 0.611               |
| Venezuela            | 1971 | 1,960                            | 0.622               |

<sup>1</sup> Montevideo (Melgar, 1981b).

**Source:** Bensión and Caumont, 1979, p. 58.

The data show a significant concentration in the distribution of earned income as well (Table 3). This indicates that the redistributive process might not only have taken place between capital and labour, but also within the working class itself.<sup>5</sup> Indeed, the Gini coefficient for earned income distribution in Montevideo increased from 0.31 to 0.37 between 1962 and 1968, while the ratio between the 20% of households with highest labour income and the 20% with lowest rose from about

<sup>5</sup> It must be borne in mind that wages/salaries are the main source of earned income since wage/salary earners account for more than 70% of the economically active population.

5 in 1962 to 7 in 1968.<sup>6</sup> The sectors most affected were also those in the lower strata and particularly those in the first two deciles who had their shares significantly reduced from 3.5 and 4.9% to 2.1 and 4.0% respectively. Here, not only those households in the tenth but also those in the ninth decile had their shares increased from 15% and 24.7% to 16.1% and 27.4% respectively. It appears that non-unionized workers as well as those belonging to weak unions (e.g., rural workers) were among those most affected by this concentration of income (Instituto de Economía, 1969, p. 232). Nonetheless, as it was the case with total household income distribution, the higher Gini coefficient of 0.37 in 1968 still compares favourably with those of most Latin American cities as shown in Table 4.

**Table 3. Earned Household Income Distribution, Montevideo**

| % of households | 1962        |            | 1968        |            | 1973        |            | 1976        |            |
|-----------------|-------------|------------|-------------|------------|-------------|------------|-------------|------------|
|                 | % of income | Cumulative | % of income | Cumulative | % of income | Cumulative | % of income | Cumulative |
| - 5             | 1.4         |            | 0.7         |            | 0.9         |            | 0.7         |            |
| 10              | 3.5         | 3.5        | 2.1         | 2.1        | 2.4         | 2.4        | 2.0         | 2.0        |
| 20              | 4.9         | 8.4        | 4.0         | 6.1        | 4.1         | 6.5        | 3.5         | 5.5        |
| 30              | 5.9         | 14.3       | 5.1         | 11.2       | 5.2         | 11.7       | 4.7         | 10.2       |
| 40              | 6.8         | 21.1       | 6.2         | 17.4       | 6.2         | 17.9       | 5.6         | 15.8       |
| 50              | 7.8         | 28.9       | 7.4         | 24.8       | 7.3         | 25.2       | 6.8         | 22.6       |
| 60              | 8.9         | 37.8       | 8.7         | 33.5       | 8.6         | 33.8       | 8.2         | 30.8       |
| 70              | 10.3        | 48.1       | 10.4        | 43.9       | 10.3        | 44.1       | 10.0        | 40.8       |
| 80              | 12.2        | 60.3       | 12.6        | 56.5       | 12.4        | 56.5       | 12.5        | 53.3       |
| 90              | 15.0        | 75.3       | 16.1        | 72.6       | 15.8        | 72.3       | 16.4        | 69.7       |
| 100             | 24.7        | 100.0      | 27.4        | 100.0      | 27.7        | 100.0      | 30.3        | 100.0      |
| + 5             | 15.2        |            | 17.0        |            | 17.5        |            | 19.3        |            |
| Gini index      | 0.309       |            | 0.369       |            | 0.366       |            | 0.406       |            |
| Theil index     | 0.153       |            | 0.218       |            | 0.214       |            | 0.244       |            |

**Source:** Melgar, 1981b, pp. 10 and 14.

The available data suggest that, in Uruguay, the deterioration in the distribution of income started about the time the period of economic expansion based on import-substitution industrialization ended. Hence, the process of concentration of income definitely commenced prior to the period of liberalization and opening of the economy proper. Thus it appears that the change in the behaviour of, and forms of interactions among, the different economic actors --and between these and the State-- following the stagnation of the economy might be mostly responsible for this worsening in income distribution. The evidence also suggests that it was the different capitalist groups --and not the working class-- who after the exhaustion of the ISI model attempted to increase their income shares by altering the rules of the game and thus ending the implicit class alliance that had characterized the Uruguayan society since the beginning of the century. Instead of pursuing higher rates of profit through increases in productivity --which would have required the adoption of new technologies and greater investment in fixed capital-- the strategy of the capitalist class was to use their increasing political power to boost their income shares and reduce workers' income in absolute terms. The more

<sup>6</sup> Most likely 1968 was the year showing the most unequal income distribution of the decade since real wages fell the most in that year (15%).

militant activity of the working class during the 1960s thus appears to have been a reaction to the increasing deterioration of their standards of living as exemplified by the loss of about 20% in the real wage between 1957 and 1966. The State --until then considered by many as "referee" of class conflicts-- gradually took sides with the capitalist class in opposition to the interest of the working class, thus becoming a decisive actor in the deterioration of the situation of the latter.<sup>7</sup> From the late 1950s on the army was called several times to repress labour and in October, 1965 the government declared the equivalent of a state of siege (*Medidas Prontas de Seguridad*), prohibiting strikes, arresting union leaders, and closing down leftist newspapers and radio stations. In the next section we will examine the consolidation of the imposed new social arrangement which prepared the stage for the military coup of 1973.

**Table 4. Earned Income Concentration in Montevideo and Other Latin American Cities**

| City       | Year    | Gini Coefficient | Poorest 40% | Richest 5% |
|------------|---------|------------------|-------------|------------|
| Asuncion   | 1970    | 0.547            | 9.12        | 26.6       |
| Bogota     | 1967    | 0.508            | 11.6        | 26.6       |
| Caracas    | 1966    | 0.425            | 14.3        | 18.0       |
| Lima       | 1968    | 0.502            | 11.4        | 25.4       |
| Quito      | 1967-68 | 0.508            | 10.8        | 23.6       |
| Montevideo | 1962    | 0.309            | 21.1        | 15.2       |
| Montevideo | 1968    | 0.369            | 17.4        | 17.0       |
| Montevideo | 1973    | 0.366            | 17.9        | 17.5       |
| Montevideo | 1976    | 0.406            | 15.8        | 19.3       |

**Source:** Melgar, 1981b, p. 48.

Though the working class was the loser in the redistributive struggle between capital and labour, it appears that it was neither the only nor the main loser in the regressive redistribution of income which took effect in the economy as a whole during the 1960s. As indicated above, the main instrument used to carry out this redistribution of income was the inflationary tax which "is higher for the poorest, for whom currency represents a larger share of total wealth" (Rama, 1991, p. 121). Thus it appears that pensioners might have been among those who suffered the most during this process of income redistribution. The number of pensioners dramatically increased during the 1960s from 298.5 thousand in 1961 to 454.7 thousand in 1969, an increment of 53% (*ibid.*, p. 112). This fact might help to explain the apparent puzzle depicted in Table 5 where, contrary to what would have been expected, the share of wages and salaries in Gross National Income increased significantly from 36.9% in 1960-61 to 42.4% in 1962-65. The fact that the share of "other family income" in Gross National Income decreased at a time when the number of pensioners was dramatically increasing suggests that the situation of the latter might have dramatically deteriorated in relative and

<sup>7</sup> It appears that a similar situation might have developed in Argentina in the second half of the 1970s, particularly in 1976-78, when income distribution deteriorated rapidly "as the military government fixed wages, repressed trade unions, eliminated collective bargaining and the right to strike, and reformed the labour code to the detriment of workers" (Marshall (1998); see also Marshall (1995) and Berry (1995, p. 24)).

absolute terms during this period. This was indeed the case since pensions declined 45% in real terms between 1957 and 1967 while real wages were reduced 14% in that period. This was the result of pension adjustments systematically lagging that of wages throughout most of the 1960s as exemplified by the fact that pensions grew 490% in nominal terms while wages rose by 920% in 1964-68 (Favaro and Bensi3n, 1993, p. 261). Though there is no data available, most likely the share of undistributed corporate profits in Gross National Income might have decreased during this period thus also contributing to the increase in the participation of wages and salaries.<sup>8</sup>

**Table 5. Composition of Gross National Income (percentages)**

|   | 1955-59 | 1960-61 | 1962-65 | 1966-69 | 1970-71 | 1972-75 |
|---|---------|---------|---------|---------|---------|---------|
| Wages and salaries                                      | 38.0    | 36.9    | 42.4    | 40.2    | 40.1    | 35.7    |
| Employers contributions                                 | 4.4     | 5.1     | 7.1     | 6.2     | 5.6     | 6.1     |
| Other family income and undistributed corporate profits | 44.9    | 44.8    | 38.2    | 37.8    | 37.2    | 40.8    |
| Other government revenues                               | 0.4     | 0.4     | 0.3     | 0.4     | 0.4     | 0.7     |
| Depreciation  | 4.1     | 3.7     | 3.7     | 3.5     | 3.6     | 3.3     |
| Indirect taxes less subsidies                           | 8.2     | 9.1     | 8.3     | 11.9    | 13.1    | 13.4    |
| Total   | 100.0   | 100.0   | 100.0   | 100.0   | 100.0   | 100.0   |

**Source:** Melgar, 1981b, p. 56.

The concentration of income during the period of economic stagnation fostered an increase in the incidence of poverty in Uruguay. Following the methodology developed by Altimir (1979),<sup>9</sup> Melgar (1981b) estimates that the percentage of households below the poverty line increased from 9% in 1963 to 15% in 1967, and of households below the indigence line from 4% to 7% (Table 6). This increase in the incidence of poverty confirms its cyclical behaviour: increasing during periods of recession/stagnation and decreasing during periods of economic expansion. It also appears to lend support to the view that the process of income concentration started in the early 1960s at the latest, though, as we will see in section IV, it acquired greater intensity after the 1973 coup d'état. However, despite the worsening experienced during this period, the situation of urban poverty in Uruguay still compared favourably with that of most other Latin American countries (Table 6). As Melgar (1981b, pp. 49-50) indicates, this situation can be explained by the fact that, its contemporary problems notwithstanding, Uruguay had one of the highest income per capita of the region.

<sup>8</sup> In the National Accounts, the figures for "undistributed corporate profits" are presented together with those of "other family income".

<sup>9</sup> Altimir defines the indigence line as the minimum income required by an individual to purchase a given basic food basket. Similarly, the poverty line is defined as an income equal to twice the cost of this food basket.



**Table 6. Incidence of Urban Poverty in Latin America, c.1970**

| Country                   | Percentage of households below the poverty line | Percentage of households below the indigence line | Percentage of Households below the relative poverty line <sup>1</sup> |
|---------------------------|---|---|---|
| Argentina                 | 5   | 1   | 27  |
| Brazil                    | 35  | 15  | 52  |
| Colombia                  | 38  | 14  | 43  |
| Costa Rica                | 15  | 5   | 34  |
| Chile                     | 12  | 3   | 38  |
| Honduras                  | 40  | 15  | 40  |
| Mexico                    | 20  | 6   | 44  |
| Peru                      | 28  | 8   | 34  |
| Venezuela                 | 20  | 6   | 37  |
| Uruguay 1963 <sup>2</sup> | 9   | 4   | n.a.  |
| Uruguay 1967 <sup>2</sup> | 15  | 7   | n.a.  |
| Uruguay 1970              | 10  | 4   | 25  |
| Uruguay 1976 <sup>2</sup> | 25  | 12  | 35  |
| Latin America             | 26  | 10  | n.a.  |

<sup>1</sup> Defined as half the average family income.

<sup>2</sup> Melgar, 1981b.

**Source:** Altimir (1979), cited in Melgar, 1981b, p. 50.

### III. THE HETERODOX STABILIZATION ATTEMPT (1968-1973)

After just nine months in office, President Gestido passed away in December of 1967 and was replaced by Pacheco Areco. Quite on the contrary to the initial *desarrollista* approach of his predecessor, Pacheco sought the support of the most powerful capitalist groups from the outset and broke definitely with the implicit social alliance that had prevailed in Uruguay for most of the century. Nevertheless, the chaotic economic situation remained unchanged. Following the directives of the IMF --and despite a prior devaluation of 100% in December 1967-- the exchange rate was devalued by 25% in April 1968. Though this measure might have helped to alleviate external imbalances, it contributed to have the annual rate of inflation skyrocketing to 183% in June 1968.

The Pacheco administration accepted the IMF view that inflation was the result of excess demand which in turn was understood to be caused by excessive credit expansion, fiscal deficits, and wage increases. Thus, in June 1968, the government made a drastic change of direction and decreed the freezing of wages and prices, and created the *Productivity, Prices, and Income Commission* (COPRIN) to replace the Wage Councils --a wage bargaining mechanism operating at the sectoral level with the State as mediator-- and administer all future wage and price increases. Not by accident, the wage and price freeze took place just three days prior to the scheduled wage adjustment after

prices had risen 64% in the first six months of the year. Though prices rose only 2% in the second half of 1968, that year real wages reached the lowest level of the decade and represented only 73% of their 1957 level (Table A1).<sup>10</sup>

The unorthodox stabilization programme of June 1968 had some positive macroeconomic effects during the following two years, not only helping to reduce the level of inflation but also to increase exports and international reserves. Strict control of prices --mainly those affecting the wage basket and the calculation of the CPI-- and a reduction in the fiscal deficit resulted in inflation rates of only 14.5% and 20.9% in 1969 and 1970 respectively (Favaro and Bensi3n, 1993, p. 248).<sup>11</sup> GDP grew by 6.1% and 4.7% in those years and real wages increased by 10% between 1968 and 1970 while still remaining 20% below their 1957 level. Pensions also increased by 73% during those two years, thus reaching their 1965 level but still 40% lower than in 1955-57 (Papad3pulos, 1992, p. 191).

Juan Mar3a Bordaberry --a minister in Pacheco's government-- took office in 1972 and continued with the pro-business and anti-labour policy characterizing the previous administration. The new government implemented an economic adjustment programme which included a 112% devaluation of the peso, a gradual elimination of price controls, and an increase in public utilities' rates. The immediate result of this economic adjustment was a recession --GDP fell by 3.3%-- and an increase in the rate of inflation to 94.7% in 1972 (Cancela and Melgar, 1985, p. 45). The cost of the adjustment was borne by workers and pensioners, real wages falling by 17% and pensions by 22% (*ibid.*).

A new attempt to liberalize the economy also took place in 1972 with the presentation of the *New Development Plan* (NPD). The NPD identified the wrong international insertion and the lack of market-based allocation of resources as the causes of economic stagnation. It emphasized the need to open the economy to trade, finance, and foreign investment, thus promoting an export-led growth model where the traditional agricultural sector would become the key economic sector once again. It also stressed the role of the market in the allocation of resources, thus reducing that of the State to the formulation of economic policy to assure the proper environment where the private sector would flourish. The NPD also identified the wrong use of short-term instruments (interest rate, wage policy, and exchange rate) as the cause of inflation. Thus it proposed tight monetary policy with positive real rates of interest, wage increases aligned with changes in productivity, and exchange rates in line with domestic and foreign prices. The adoption and implementation of this plan, however, will have to wait until after the coup of 1973.

The drop in wages and pensions would suggest a worsening in the distribution of total

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<sup>10</sup> The reduction in real wages was even more significant in the public sector: a loss of 40% between 1957 and 1967 (Allen and Labadie, 1994, p. 8). It is interesting to note that also not by chance the year 1968 was chosen as base year for future official statistics on real wages.

<sup>11</sup> The fiscal deficit was reduced from 3.2% of GDP in 1967 to 0.2% in 1968 (Favaro and Bensi3n, 1993, 248). The deficit was brought down mainly through a 25% reduction in wages, pensions, and office expenses of the public sector (Lichtensztejn, 1969, p. 57). Pensions declined 36% in real terms in 1968, reaching a historical low equivalent to 35% of their 1955-57 level (Papad3pulos, 1992, p. 191).

household income between 1968 and 1973, but there exist no definite data showing such a deterioration. Indeed, the available data indicate that total household income distribution significantly worsened between 1967 and 1976 but there is none to show something similar taken place in the subperiod 1968-73. Though the distribution between capital and labour might have worsened after 1968, the share of wages and salaries in Gross National Income decreased only marginally between 1962-65 and 1970-71 (Table 5). With respect to household earned income distribution for Montevideo, the figures for 1968 and 1973 are similar for all deciles, with a Gini coefficient of 0.37 in both cases (Table 3). Thus it appears that after the initial worsening between 1962 and 1968, the distribution of earned income did not deteriorate further at least until 1973.<sup>12</sup> Of course, the increase both in the number of hours worked per worker and in the number of working members per household might have contributed to explain this outcome to a large extent. Nonetheless, the incidence of poverty among income earners increased significantly between 1968 and 1973. Indeed, considering only labour as a source of income, the percentage of households below the indigence line increased from 11.1% in 1968 to 14.3% in 1973, while the percentage of those below the poverty line rose from 36.8% to 48.4% (Table 7).<sup>13</sup> This result is consistent with the fact that average income per capita in Montevideo decreased 8% between 1968 and 1973, though the incidence of poverty might have also temporarily decreased in 1971 when both wages and pensions rose.

**Table 7. Levels of Poverty and Indigence in Montevideo Considering only Labour Income**

| Year | Percentage of households below the poverty line | Percentage of households below the indigence line |
|------|---|---|
| 1968 | 36.8  | 11.1  |
| 1973 | 48.4  | 14.3  |
| 1976 | 27.2  | 8.8   |
| 1977 | 29.8  | 9.4   |
| 1978 | 30.6  | 9.5   |
| 1979 | 38.7  | 12.6  |

Source: Melgar, 1981b, p. 39.

It appears that the 1968-73 years were as much characterized by economic stagnation as the previous 1956-68 period. Indeed, while GDP increased in 1968-70, it declined thereafter leaving the level of GDP in 1973 the same as in 1968 --thus implying a clear deterioration in the level of GDP per capita. Hence, it appears that the period of "take-off" of the Uruguayan economy could not have occurred prior to 1974. The structure of the economy also remained unchanged, and it was not until 1972 that a new economic growth model was proposed to change the structure of the economy and

<sup>12</sup> And most likely it might even have improved between 1968 and 1971 when real wages increased almost 16%, and deteriorated thereafter.

<sup>13</sup> The figures in Table 7 cannot be compared to those in Table 6 since they are obtained using different methodologies. Most likely they are also affected by under declaration of income, and thus we should not be concerned with their absolute values. Notwithstanding these caveats, they are quite useful when analyzing changes in the incidence of poverty over time.

end the long period of stagnation. The main difference between this period and the previous one rests, however, on the definite breakdown of the implicit class alliance that had characterized the Uruguayan society for most of this century. More particularly, it was in 1968 that the Uruguayan State definitely abandoned its characteristic conciliatory role to take clearly sides with the capitalist class. It was also at this time that the most powerful capitalist groups took direct control of the government, thus ending a three-quarter of a century tradition of defending their interests through political mediation. The capitalist class attempted to restore growth in the economy --i.e., the profitability of their enterprises-- through the redistribution of income rather than through the restructuring of the productive base. The latter would have required a significant increase in productive investment as well as the opening of the economy, the latter implying the inevitable emergence of winners and losers within the capitalist class itself. Hence, class solidarity --and the long-term interest of powerful capitalist groups-- determined that the losers had to be the working class and the popular sectors, who thus saw their incomes and political clout decreasing. It was also the latter's opposition to the change of the rules of the game that created the proper social and political environment in which the restructuring of the economy could then take place. It was the social and political unrest brought about by this redistributive struggle that catapulted the military into centre stage as a political actor. It also prepared the path for the 1973 coup and the consequent implementation under military rule of the *New Development Plan* (NPD) proposed in 1972.

#### **IV. ECONOMIC LIBERALIZATION AND STRUCTURAL ADJUSTMENT (1973-1984)**

By the early 1970s it was quite evident that the traditional ISI model that had characterized the Uruguayan economy for the last 40-50 years could not regain the dynamism required for a long-term developmental strategy. At the same time, social and political turmoil prevented the government from obtaining the required political support to implement a different strategy such as the one outlined in the NPD. The Plan was strongly opposed by the working class and popular sectors in general, since the strategy to reactivate the economy entailed a reduction in wages to allow a corresponding increase in profits. In addition, the implementation of the NPD also encountered the opposition of important rent-seeker sectors of the capitalist class which had flourished during the period of import-substitution industrialization. As we have seen, the latter had no viable developmental alternative of their own and only attempted to maintain their levels of income during the long period of economic stagnation at the cost of a marked deterioration in the income levels of workers in general. It was this redistributive struggle among the different interest groups that created an unstable social and political environment in which it was actually impossible to implement any clearly defined developmental strategy.

Supporters of the NPD --mainly the agricultural and export sectors-- soon came to recognize the impossibility of restructuring the economy under democratic rule. Thus they sought the support of the armed forces whose increasing role in the repression of the labour movement and in the war against the guerrilla had already brought it to central stage in the political arena. In June 1973 Bordaberry called in the army and closed the Parliament, thus preparing the stage for the implementation of the new outward-oriented development model. The labour movement reacted to the coup with a general strike that lasted 15 days. The response of the government was to ban the

National Confederation of Workers (CNT) and give all employers the right to dismiss anyone who did not return to work. For many observers it was quite clear that one of the main objectives of the military coup was to break the labour movement (see, e.g., Gillespie (1991) and Handelman (1981) cited in Allen and Labadie, 1994, p. 10).<sup>14</sup>

**Table 8. GDP Structure, 1970-1985 (percentages)**

| Year    | Private<br>Consumption<br>(1) | Public<br>Consumption<br>(2) | Fixed Gross<br>Investment<br>(3) | Exports<br>(4) | Imports<br>(5) |
|---------|-------------------------------|------------------------------|----------------------------------|----------------|----------------|
| 1970-73 | 76.2                          | 13.4                         | 12.9                             | 13.2           | 13.4           |
| 1974    | 74.4                          | 14.5                         | 10.7                             | 16.2           | 19.0           |
| 1975-78 | 65.4                          | 13.2                         | 17.3                             | 18.8           | 20.9           |
| 1979-82 | 63.6                          | 13.9                         | 20.3                             | 15.4           | 19.6           |
| 1983-85 | 61.9                          | 14.9                         | 12.3                             | 26.2           | 22.6           |

**Source:** (1), (2) and (3): calculated from data in Favaro and Bensi3n, 1993, Table B-11; (4) and (5): calculated from data in World Tables.

Starting in July, 1974, sweeping structural reforms were gradually introduced with the aim of stabilizing the economy and resuming economic growth. The government chose gradual adjustment mechanisms to solve both domestic and external disequilibria. In order to change relative prices and promote the production of exportables, the government abolished import licenses and quotas, reduced the average level and dispersion of tariffs, introduced further subsidies to nontraditional exports, and lowered export taxes to traditional products. In addition, it kept the exchange rate in line with domestic and foreign prices and abolished all restrictions to the flows of capital in order to finance the current account deficit. On the internal front, the government gradually decontrolled many consumer prices,<sup>15</sup> liberalized the domestic capital market, and pursued fiscal balance through the tightening of government expenditure and a reform of the tax system.<sup>16</sup> The goal was to reduce government expenditure relative to GDP, mainly through a reduction in the wages of public sector's employees.<sup>17</sup> Thus while public sector wages fell 24% between 1973 and 1977

<sup>14</sup> Allen and Labadie (1994, p. 11) report that "according to Bronstein (1989), 12,000 workers in the public sector (about 4 percent) and 5,000 to 10,000 in the private sector were fired. In interviews conducted in 1976, Handelman found that 40 percent on the employers said they used the occasion to get rid of trade union officials, whereas others used the chance to get rid of excess employees."

<sup>15</sup> Nonetheless, the prices of 46% of all items in the CPI basket were still being controlled by March 1978 (Favaro and Bensi3n, 1993, p. 273).

<sup>16</sup> The major tax changes were the elimination of personal income tax, the widening of the value added tax (VAT), and the reduction of social security taxes on labour.

<sup>17</sup> Public sector wages fell 24% between 1973 and 1977 (Favaro and Bensi3n, 1993, p. 339). It must be noted that expenditures on wages and social benefits accounted for 60-75% of total government expenditures during this period (see Table 9).

(Favaro and Bensi3n, 1993, p. 339), the share of wages in total government expenditures went from 62.0% in 1975 to 55.3% in 1978 (Table 9). The fiscal deficit of the central government was thus gradually brought down from 4.5% of GDP in 1974 to 1.2% in 1977 (Table A1). In addition to the fiscal deficit, the government considered nominal wage increases above productivity gains as one of the main underlying causes of inflation. Thus wage policy became the main antiinflation area of action and real wages fell 22% in 1974-78.<sup>18</sup> Nonetheless, despite wage repression, the reduction in the fiscal deficit, and tight monetary policy, inflation remained high throughout the period --reaching 57% in 1977-- mainly due to the inflow of foreign capital.

**Table 9. Structure of Central Government Expenditure, 1975-1984**

| Year | Wages and Salaries | Social Security | Transfers | Capital Expenditure | Interests | Rest | Total |
|------|--------------------|-----------------|-----------|---------------------|-----------|------|-------|
| 1975 | 62.0               | 16.7            | 3.1       | 10.4                | 5.6       | 2.2  | 100.0 |
| 1976 | 62.2               | 14.4            | 3.4       | 11.5                | 7.2       | 1.3  | 100.0 |
| 1977 | 47.7               | 11.8            | 1.8       | 12.4                | 6.4       | 9.8  | 100.0 |
| 1978 | 55.3               | 13.2            | 1.9       | 15.6                | 5.6       | 8.3  | 100.0 |
| 1979 | 53.3               | 13.7            | 2.6       | 17.8                | 4.4       | 8.2  | 100.0 |
| 1980 | 48.3               | 18.5            | 2.5       | 17.1                | 2.2       | 11.5 | 100.0 |
| 1981 | 39.1               | 24.9            | 2.4       | 16.4                | 1.9       | 15.3 | 100.0 |
| 1982 | 37.8               | 32.3            | 3.2       | 9.6                 | 2.6       | 14.5 | 100.0 |
| 1983 | 37.3               | 29.3            | 3.1       | 9.7                 | 6.1       | 14.6 | 100.0 |
| 1984 | 26.4               | 30.2            | 12.2      | 8.9                 | 9.5       | 12.8 | 100.0 |

**Source:** ECLAC, *Economic Survey 1984*, p. 666

Led by an export upsurge, the Uruguayan economy experienced relatively rapid economic growth during the 1974-78 period: GDP growing at an average of 3.9% per annum (Table A1). The change in relative prices --mostly policy induced rather than the result of market forces-- fostered expansion and export growth and thus also a modification in the structure of production. Exports, in particular, caused the manufacturing sector to grow at 4.8% per annum and its share in GDP to rise from 22.6% in 1973 to 25.2% in 1978. The expansion and restructuring of the economy in 1974-78 was mainly based on the inflationary process. It was the high rates of inflation characterizing the period that facilitated the required change in relative prices --and particularly the fall in real wages. Starting in 1978, however, the economic policy of the government focused on price stability. To this end, the Central Bank adopted the monetary approach to the balance of payments and the exchange rate was unified and essentially used to combat inflation rather than to promote exports. The central feature of this stabilization programme consisted in setting the exchange rate in advance --the "tablita"-- in order to curb inflationary expectations. The stabilization programme was accompanied

<sup>18</sup> Repressive wage policy represented an important stimulus for exports produced by labour-intensive techniques as well.

by a second wave of structural reforms including a predetermined tariff reduction programme,<sup>19</sup> the deregulation of agricultural prices, the elimination of exports taxes and subsidies, the further reduction of social security taxes, and the extension of the coverage of the VAT.

The stabilization programme was successful in the short-run and the rate of inflation fell from 83% in 1979 to 29.4% in 1981 and to 11% in the first 11 months of 1982 (Cancela and Melgar, 1985, p. 53). However, while the rate of inflation was falling, tight monetary policy kept the nominal rate of interest relatively stable at 60-70% per annum, thus causing the real rate of interest to soar to unprecedented and unsustainable levels. The previous liberalization of the capital market, confidence in the "tablita", and high interest rates attracted a massive inflow of foreign capital which helped to finance the economic boom of 1979-80 when GDP grew at 6.2% and 6.0% per annum. This inflow of capital contributed to the further appreciation of the peso and the deterioration of the trade and current account, and thus to the ensuing contraction of 1981-82 --with GDP falling 15% between 1982 and 1984.

The initial response of the government to the worst economic crisis in Uruguay's history was to accelerate the rate of devaluation and freeze wages while maintaining expansionary fiscal policy. Higher expenditures and lower revenues resulted in an enormous fiscal deficit of more than 14% of GDP in 1982 (Table A1). Increasing current account deficits and capital flights rapidly reduced international reserves and increased the external debt from \$2.15 billion in 1980 to \$3.13 billion in 1981 and to \$4.26 billion in 1982 (Table A2). In November, 1982 the monetary authorities were forced to abandon the "tablita" and let the exchange rate float, thus causing the peso to fall more than 150% in the next three months.

The programme designed to overcome the crisis as well as the economic policies to be implemented in the period of transition to civilian rule (in 1985) were outlined in the *Letter of Intention* signed with the IMF in February, 1983. The main objective was to eliminate external sector imbalances in order to assure international creditors the prompt service of the enormous debt accumulated during the last few years. It was expected that internal and external stabilization would reactivate the economy and produce a trickle-down effect to achieve the social objectives. On the fiscal front, the main measures involved a reduction in government expenditures and an increase in public utilities' rates. Monetary policy, in turn, became more restrictive. After decreeing an increase in wages of 15%, the government left the private sector to freely determine future increases (except the minimum wage). Public sector wages and social security transfers continued to be set unilaterally by the government according to fiscal possibilities. The absence of strong labour unions determined an unequal negotiating position and thus real wages fell 11% in 1983.

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<sup>19</sup> While the import-liberalization measures implemented in 1974-77 focused mainly on the elimination of NTB, in this second phase the average tariff was brought down from 101% at the beginning of the period to 47% in 1981 (Cassoni *et al.*, 1994, p. 3) and the number of tariff rates was reduced from 29 in 1980 to 5 in 1983 (World Bank, 1994, p. 24). Rama (1991, pp. 86 and 101) argues that the reforms implemented in 1978 eliminated the degree of superfluous protection but left the degree of effective protection of domestic production relatively unchanged.

As indicated above, wage repression became the centrepiece of the government developmental strategy during the military period. Wages, which were previously set through collective agreements, were now set only by the State and entrepreneurs. Thus average real wages deteriorated all throughout the period, including during the years 1974-79 of relatively rapid economic expansion and of significant reduction in unemployment (Table A1). After dropping 17% in 1972 and almost 2% the following year, real wages fell 33% in 1974-78, and another 8% in 1979-80. They recovered some ground in 1981-82 (7%) but decreased a further 28% in 1983-84. During the whole 1973-85 period, real wages decreased by 49% and by 1984 they represented 35% of their peak level of 1957.<sup>20</sup> Thus the share of wages in national income steadily declined from 40% in 1968-73 to 34.6% in 1974-78, and to 27.5% 1979-82 (Cancela and Melgar, 1985, p. 62). Indeed, the wage policy of the government was the cornerstone of the restructuring and liberalization programme implemented since 1974: lower wages helped to abate inflation, increased the degree of competitiveness of domestic production, and reduced the level of consumption in order to increase investment. The latter was officially recognized by the government in its *1978 Economic Report*:

Concerning the ratio between salaries and the development of the Uruguayan economy in the past few years, it must be stressed that the decline in real wages can be attributed, *inter alia*, to the alternative between consumption and investment required by the growth process, which implied a large effort for the re-equipment necessary to strengthen production (Ministry of Economy and Finance, 1979, p. 59; official translation).

Thus real wages fell 25% and industrial profits increased 47% in 1973-77 (Torres, 1979, p. 39), and though investment did improve during this period --reaching 20% of GDP in 1979-82-- the increase was neither sufficient nor did it last long enough to translate into significant gains in productivity for the economy as a whole. Moreover, the adoption of more capital intensive technologies appears to have produced excess capacity in the economy (Longhi and Stolovich, 1991, pp. 44-5). Thus it appears that the fall in real wages coupled with reductions in social contributions paid by employers might have been responsible for most of any increase in the degree of international competitiveness domestic production might have achieved during this period.<sup>21</sup>

After worsening during the 1960s, total household income distribution for Montevideo deteriorated further until 1976-77, and then improved in 1980-81 when real wages temporarily recovered some ground and the unemployment rate was relatively low. By the end of the period there was another significant improvement in the distribution of total income in Montevideo. Indeed, the available data show that the Gini coefficient first increased from 0.39 in 1961-62 to 0.42 in 1967 and

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<sup>20</sup> The minimum wage --which decreased 40% between 1973 and 1984-- came to have almost no effect in the labour market. At the present time it is used as a term of reference to set social security benefits and to determine the maximum unemployment insurance benefit, health insurance benefits, and family allowance (Cassoni *et al.*, 1994, p. 22).

<sup>21</sup> Employer's contributions to the social security system were reduced from 28% to 17% of the wage bill in January 1980 and to 14% in June of the same year. The allocation of alternative revenues from the VAT were not sufficient to offset this reduction and thus the deficit of the social security system increased from 1.1% in 1977-79 to 43.8% in 1981-82 (ECLAC, *Economic Survey 1984*, p. 667).



to a peak of 0.45 in 1976, decreased to 0.42 in 1980 and 1982, and then declined further to 0.39 in 1984 (see Tables 1 and 10). By the end of the period, therefore, the distribution of household total income was similar to that of the early 1960s, before the process of income concentration ensued.<sup>22</sup> The increase in income inequality during the late 1960's and the first half of the 1970s hurt the middle income strata of the population, mainly those in the third and fourth quintile who saw their share declining from 38.3% in 1967 to 36.1% in 1976. Those in the first quintile --who were the most negatively affected between 1963 and 1967-- suffered no further, while those in the second suffered a reduction from 10.0% to 9.4% during this period. The only segment positively affected was the top decile whose share increased from 30.5% in 1967 to its historical peak of 34.0% in 1976. During the period of reversal of this distributive trend that followed, the sectors improving the most were those in the first and second quintile who increased their shares from 4.3% and 9.4% in 1976 to 6.0% and 10.4% in 1984 respectively, while those most negatively affected were in the upper 5% of the income scale. The data in Table 10 also show that the ratio between the 20% of households with the highest income and the 20% with lowest fell from 11.9 in 1976 to 8.6 in 1980 and 1982, and to 7.7 in 1984.

**Table 10. Total Household Income Distribution, Montevideo**

| % of households | 1976        |            | 1980        |            | 1982        |            | 1984        |            |
|-----------------|-------------|------------|-------------|------------|-------------|------------|-------------|------------|
|                 | % of income | Cumulative | % of income | Cumulative | % of Income | Cumulative | % of income | Cumulative |
| - 5             | 0.3         |            | 0.70        |            | n.a.        |            | 0.85        |            |
| 10              | 1.3         | 1.3        | 2.0         | 2.0        | 2.1         | 2.1        | 2.3         | 2.3        |
| 20              | 3.0         | 4.3        | 3.4         | 5.4        | 3.6         | 5.7        | 3.7         | 6.0        |
| 30              | 4.1         | 8.4        | 4.4         | 9.8        | 4.4         | 10.1       | 4.7         | 10.7       |
| 40              | 5.3         | 13.7       | 5.4         | 15.2       | 5.4         | 15.5       | 5.7         | 16.4       |
| 50              | 6.5         | 20.2       | 6.6         | 21.8       | 6.6         | 22.1       | 6.9         | 23.3       |
| 60              | 7.8         | 28.0       | 7.9         | 29.7       | 8.0         | 30.1       | 8.3         | 31.6       |
| 70              | 9.7         | 37.7       | 9.7         | 39.4       | 9.5         | 39.6       | 10.0        | 41.6       |
| 80              | 12.1        | 49.8       | 12.1        | 51.5       | 12.6        | 52.2       | 12.4        | 54.0       |
| 90              | 16.2        | 66.0       | 16.0        | 67.5       | 16.6        | 68.8       | 16.2        | 70.2       |
| 100             | 34.0        | 100.0      | 32.5        | 100.0      | 31.2        | 100.0      | 29.8        | 100.0      |
| + 5             | 23.0        |            | 21.6        |            | 20.0        |            | 19.0        |            |
| Gini index      | 0.450       |            | 0.424       |            | 0.415       |            | 0.394       |            |

**Source:** For 1976 and 1980, Melgar (1981b); for 1982, Rossi (1982) cited in Favaro and Bensi3n (1993); for 1984, Melgar (1995).

This marked reversal in distributive trends appears to be the exception in Latin America along with Costa Rica's perhaps (see Table 11). In most countries the opening of the economy has been accompanied by a concentration in the distribution of income which appears to remain afterwards even during periods of economic expansion (see Berry, 1995). Argentina, for instance, also

<sup>22</sup> For the rest of the country the improvement in income distribution was even more remarkable as the Gini coefficient fell from 0.45 in 1963 to 0.39 in 1984 (Melgar and Villalobos, 1986, p. 131).

experienced an early and dramatic worsening in income distribution in the mid-1970s --the Gini coefficient increasing eight percentage points between 1975 and 1977. This situation, however, got worse in the late 1980s and could not be reversed even during the boom years of the early 1990s. Income distribution also seriously deteriorated in Chile in the mid-1970s --the Gini coefficient rising nine percentage points between 1974 and 1976-- and remained more or less unchanged until the 1990s when a weak improvement appears to have been occurring. It appears that, in the case of Uruguay, the increase in the number of workers per family and in the number of hours worked per labourer might have helped to offset to a large extent the decline in real wages observed during the whole period.

**Table 11. Income Distribution in Selected Latin American Countries**

| Year       | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 |
|------------|------|------|------|------|------|------|------|------|------|------|------|------|
| Argentina  | 0.36 | 0.36 |      | 0.44 |      |      |      |      | 0.42 |      | 0.41 |      |
| Brazil     |      |      |      |      |      | 0.59 |      | 0.58 |      | 0.59 | 0.59 | 0.59 |
| Chile      | 0.45 | 0.47 | 0.54 | 0.53 | 0.52 | 0.52 | 0.53 | 0.52 | 0.54 | 0.54 | 0.55 | 0.53 |
| Colombia   |      |      | 0.50 |      | 0.48 |      | 0.46 |      |      | 0.46 |      | 0.47 |
| Costa Rica |      |      |      |      |      |      | 0.40 | 0.40 | 0.42 | 0.38 | 0.38 | 0.37 |
| Uruguay    |      |      | 0.45 |      |      |      | 0.42 |      | 0.41 |      | 0.39 | 0.41 |

**Sources:** **Argentina:** Marshall, 1998; **Brazil:** Paes de Barros *et al.* (cited in Morley, 1994); **Chile:** Riveros, 1998; **Colombia:** Berry and Tenjo, 1998; **Costa Rica:** Gindling and Berry, 1992; **Uruguay:** Rossi, 1982 (cited in Favaro and Bensi3n, 1993); Melgar, 1981b and 1995.

The data also show a significant concentration in the distribution of earned income until 1979 (Table 12). Indeed, after increasing dramatically during the 1960s (see Table 3), the Gini coefficient for earned income distribution in Montevideo jumped from 0.37 in 1973 to 0.49 in 1979 with most of the increase occurring after 1976.<sup>23</sup> The worsening in earned income distribution is much greater than for total income, thus suggesting that the redistributive process might have taken place particularly within the working class itself. This comes as no surprise since the prohibition of union activity translated into greater flexibility and wage dispersion in the labour market with the income of university graduates relative to that of workers with incomplete primary education rising from 2.1 in 1972 to 5.6 in 1979 (Favaro and Bensi3n, 1993, p. 200). In this process of income concentration both the lower and medium strata had their shares significantly reduced: the lowest two quintiles decreasing theirs from 17.9% in 1973 to 13.2% in 1979 and the next to quintiles from 38.6% to 31.8%. The segment benefiting the most was the upper 5% in the income scale who saw their share jumping from 17.5% in 1973 to 31.1% in 1979. The ratio between the 20% of households with highest labour income and the 20% with lowest rose from 6.7 in 1973 to 11.0 in 1979.

After 1979 this process of concentration of household earned income started a gradual and

<sup>23</sup> Melgar (1981b, p. 11) concedes that the 1977 and 1979 figures for the highest decile might be exaggerated due to methodological shortcomings in the survey's questionnaire. Notwithstanding, she argues that the actual figures could not be lower than 35%. She also explains that the lower 1978 figure for this decile might be the result of a year of relatively low inflation and small fall in real wages.

mild reversal but without completing the full circle as in the case of household total income. Indeed, after reaching a maximum in 1979, the Gini coefficient dropped to 0.48 in 1981 and to 0.47 in 1984 (Table 12). The segments benefiting the most in this upswing were those in the middle strata --those in the II, III, and IV quintile-- who saw their shares increasing from 40.5% in 1979 to 45.3 in 1984. Households at both extremes of the income scale became relatively worse off: those in the lower quintile having their share reduced further from 4.5% in 1979 to 3.2% in 1984, and those in the upper quintile having theirs shrinking from 55.0% to 51.5% during this period. The loss was relatively greater for the lowest quintile and thus the ratio between the 20% of households with highest labour income and the 20% with lowest rose from 11.0 in 1979 to 16.1 in 1984.

**Table 12. Earned Household Income Distribution, Montevideo**

| % of households | 1976        |            | 1977        |            | 1978        |            | 1979        |            |
|-----------------|-------------|------------|-------------|------------|-------------|------------|-------------|------------|
|                 | % of income | Cumulative | % of income | Cumulative | % of Income | Cumulative | % of income | Cumulative |
| - 5             | 0.70        |            | 0.59        |            | 0.61        |            | 0.54        |            |
| 10              | 2.0         | 2.0        | 1.7         | 1.7        | 1.8         | 1.8        | 1.6         | 1.6        |
| 20              | 3.5         | 5.5        | 2.9         | 4.6        | 3.2         | 5.0        | 2.9         | 4.5        |
| 30              | 4.7         | 10.2       | 3.8         | 8.4        | 4.2         | 9.2        | 3.9         | 8.4        |
| 40              | 5.6         | 15.8       | 4.8         | 13.2       | 5.2         | 14.4       | 4.7         | 13.1       |
| 50              | 6.8         | 22.6       | 5.9         | 19.1       | 6.3         | 20.7       | 5.8         | 18.9       |
| 60              | 8.2         | 30.8       | 7.2         | 26.3       | 7.6         | 28.3       | 7.0         | 25.9       |
| 70              | 10.0        | 40.8       | 8.9         | 35.2       | 9.3         | 37.6       | 8.5         | 34.4       |
| 80              | 12.5        | 53.3       | 11.3        | 46.5       | 11.6        | 49.2       | 10.6        | 45.0       |
| 90              | 16.4        | 69.7       | 15.3        | 61.8       | 15.5        | 64.7       | 14.2        | 59.2       |
| 100             | 30.3        | 100.0      | 38.3        | 100.0      | 35.2        | 100.0      | 40.8        | 100.0      |
| + 5             | 19.3        |            | 27.6        |            | 24.6        |            | 31.1        |            |
| Gini index      | 0.405       |            | 0.478       |            | 0.447       |            | 0.491       |            |
| Theil index     | 0.244       |            | 0.390       |            | 0.335       |            | 0.422       |            |
|                 | <b>1981</b> |            | <b>1984</b> |            | <b>1985</b> |            | <b>1986</b> |            |
| 10-20           | 3.7         |            | 3.2         |            | 4.5         |            | 4.4         |            |
| 30-80           | 43.5        |            | 45.3        |            | 46.0        |            | 44.3        |            |
| 90-100          | 52.8        |            | 51.5        |            | 49.5        |            | 51.3        |            |
| Gini index      | 0.481       |            | 0.473       |            | 0.442       |            | 0.459       |            |

Sources: Melgar, 1981b, pp. 10; Melgar, 1988, p. 34.

Following the methodology developed by Altimir (1979) and considering only labour income, Melgar (1981b) estimates that the percentage of households below the poverty line decreased from an extremely high level of 48.4% in 1973 to 27.2% in 1976, and of households below the indigence line from 14.3% to 8.8% (Table 13).<sup>24</sup> This decrease in the incidence of poverty took place at a time when wages were falling and thus suggests the existence of important countervailing mechanisms at work --e.g., emigration, increase in the number of hours worked, higher participation rates, etc.

<sup>24</sup> Unfortunately there are no sufficient data on consumption to adjust income data.

(Melgar, 1981b, p. 42). Many of these mechanisms found their physical limits and as real wages continued to decline, the incidence of poverty started to rise and in 1979 38.7% and 12.6% of households were below the poverty line and the indigence line respectively. Melgar sustains that the increase in the number of families below poverty line was the result of changes in relative prices. Though income concentration did not worsen in the early 1980s, the level of poverty in Montevideo did increase significantly with the number of people below the poverty line doubling between 1982 and 1984 (Cancela and Melgar, 1985, p. 63). Data on consumption lends support to these findings as private consumption decreased 18% and became more concentrated in 1981-83. In 1982, for instance, individuals in the highest quintile consumed 2.7 more than those in the lowest quintile in Montevideo and 3.8 times in some other urban centres (Cancela and Melgar, 1985, p. 64). These authors also indicate that the situation appears to have worsened after 1982.

**Table 13. Incidence of Poverty (Montevideo), 1968-1979 - Labour Income**

| Year | Percentage of households below the poverty line | Percentage of households below the indigence line |
|------|---|---|
| 1968 | 36.8  | 11.1  |
| 1973 | 48.4  | 14.3  |
| 1976 | 27.2  | 8.8   |
| 1977 | 29.8  | 9.4   |
| 1978 | 30.6  | 9.5   |
| 1979 | 38.7  | 12.6  |

Source: Melgar, 1981b, p. 39.

## V. REGIONAL INTEGRATION AND STRUCTURAL ADJUSTMENT (1985-1995)

The process of transition to democratic rule --which started in the late 1970s-- experienced a delay in 1980 when a military proposal to amend the constitution was rejected in a national referendum. The deep economic crisis of 1982-84, however, had the opposite effect and accelerated the transfer of power to a civilian government. Relatively free election were held in late 1984, and in March 1, 1985 Julio Sanguinetti took office as the first democratically elected president since 1972. While the medium- and long-run objectives of the government focused on the solution of the old structural problems and of those newly added by the structural adjustments of the 1970s, its immediate task was to confront the acute problems inherited from the 1982-84 crisis. Indeed, the fragile new democracy had to face very serious internal and external imbalances, with a level of economic activity almost 16% lower than in 1981, a historically high rate of unemployment close to 14%, a consolidated public sector deficit representing almost 9% of GDP, a rate of inflation over 60%, an increasing current account deficit, falling terms of trade, and an external debt which had ballooned to \$4.7 billion.

The government also had to design the appropriate short- and long-run economic policies under a different set of rules where negotiation and the search for consensus substituted for authoritarianism. The new rules made the design and implementation of economic policy more difficult --at least in the short-run-- since all social sectors had high expectations and specific demands of their own, particularly workers who had seen their wages falling almost 50% in real terms during

the military period and 28% since 1981. Given the economic and political constraints, the democratic government adopted a gradual internal and external stabilization programme with an income policy aimed at slowly recovering past levels of real wages. The programme was based on an agreement signed with the IMF as a condition to facilitate the renegotiation of the external debt and the securing of contingency external credit. The programme specified several quantitative targets which would gradually bring the fiscal deficit and the rate of inflation down while allowing moderate economic growth led by the export sector.

After decreasing for three years in a row, GDP grew moderately in 1985 and at historically very high rates of 8-9% in the next two years, thus slightly surpassing by 1987 the pre-crisis level of economic activity. This rapid economic recovery was to a large extent the result of positive developments in the external sector with merchandise exports increasing by almost 40% between 1985 and 1987 (Table A2). The increase in exports was the result of a combination of factors including the devaluation of the U.S. dollar against other hard currencies and, in 1986, the effect of the Austral and Cruzado Plans on Argentine and Brazilian demand for Uruguayan products. After decreasing for five years in a row, the volume of merchandise imports also jumped by almost 70% in 1985-87 though still remaining at a level 30% lower than in the pre-crisis years (Table A2). Thus, the degree of openness of the Uruguayan economy increased from about 35% in 1981-84 to 40% in 1985-86 and to almost 51% in 1987. In addition to fiscal restraint, higher tax revenues, stability in State enterprises, and a reduction in international interest rates brought the deficit gradually down from 8.9% in 1984 to 4.1% in 1987 (Table A1). It must be noted that government accounts showed a primary surplus in 1987 since interests on the external debt alone amounted to more than 5% of GDP. The rate of inflation was also brought down from 83% in 1985 to 57% in 1987, but still above the targeted rate of 50%. Inflation remained high all through this period due to the fact that the monetary base expanded more rapidly than planned as a result of a larger than expected increase in foreign reserves.

Economic growth came to a halt during the last two years of the Sanguinetti administration --with no growth in 1988 and only a 1.3% expansion in 1989-- despite a 35% increase in exports between 1987 and 1989. Both the fiscal deficit and the rate of inflation quite exceeded the government targets of about 3.5% and 50% respectively. The fiscal deficit increased and reached 6.4% of GDP in 1989 as a result of relatively unchanged expenditures and a fall of 8% in revenues (ECLAC, *1989 Economic Survey*, p. 628). Again, interest payments on the external debt contributed to turning a small primary deficit into a substantial overall fiscal deficit. Contrary to the experience of previous years, the deficit was mainly financed through money creation thus causing the rate of inflation to rise in 1989 to its highest level since 1974 (89.2%).

The Blanco Party won the presidential election held in late 1989 and Alberto Lacalle (1990-95) took office in March, 1990. The economic policy of the new government focused on the fight against inflation mainly through a dramatic reduction in the fiscal deficit --thus abandoning the gradualist approach followed by the previous administration. Indeed, the fiscal deficit that in 1989 amounted to 6.4% of GDP was abruptly brought down to 2.5% and 0.5% in 1990 and 1991

respectively, and in 1992 the public accounts showed a small surplus for the first time since 1979.<sup>25</sup> The deficit was abated mainly through an increase in revenues as a result of higher taxes --particularly consumption taxes and contributions to social security--, reduced tax evasion, and higher prices for goods and services provided by the State, and through a significant reduction in wages of the central government.<sup>26</sup> This situation was reversed in 1993-94 as government spending increased faster than revenues thus resulting in a deficit of 1.5% of GDP in 1993 and of 4.0% in 1994. A drop of 3% in revenues together with higher than expected increases in public sector wages and a growing deficit in the social security system contributed to the creation of the 1993 fiscal deficit.<sup>27</sup> The 1994 deficit was the result of an increase in government spending which reached 23% of GDP in that election year. It must be noted that the 1993-94 deficits were financed mainly through external borrowing to reduce their impact on the rate of inflation.

The new government deepened the process of *apertura* and significantly reduced the level of tariffs during this period as a means of increasing competition and improving productivity in the economy as well as of curbing the rate of inflation. Trade liberalization measures were pursued through further negotiations with regional partners --which culminated in the creation of the Free Market of the South (MERCOSUR)-- and through unilateral concession to the rest of the world. The government's exchange policy was also subordinated to the fight against inflation and thus the Uruguayan peso rapidly appreciated as the rate of inflation remained high throughout the period. As a result of both the reduction in tariffs and the appreciation of the currency, the volume of imports (in current US\$) increased dramatically by more than 130% in 1989-94 and its share in GDP rose from about 23% in 1989 to almost 32% in 1993. While all components of imports --with the exception of fuel-- increased in absolute terms, the share of consumer goods in total imports rose the most and jumped from 12% in 1988 to 28% in 1993. Exports, in turn, also increased but only by 20% over the 1989-94 period and thus after eight years of surpluses the trade account showed an increasing deficit from 1991 on.<sup>28</sup> Higher imports and exports caused the degree of openness of the Uruguayan economy to rise from 51.8% in 1989 to 64.6% in 1993.

The period of economic stagnation which characterized the last two years of the Sanguinetti administration continued during 1990 when GDP grew by less than 1%. During the next four years, however, the level of economic activity expanded quite rapidly with GDP growing at an average of

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<sup>25</sup> Fiscal balance would have been achieved even earlier had not been for an increase in expenditures on social security of 1% of GDP per annum as a result of a constitutional amendment approved in 1990 which required old age pensions to be adjusted every four months based on the national average wage index.

<sup>26</sup> Notwithstanding the reduction in wages of the central government, total government expenditures as a percentage of GDP remained relatively constant at about 19% while revenues increased from 16.8% of GDP in 1988 to 19.6% in 1992 (ECLAC, *1992 Economic Survey*, p. 420).

<sup>27</sup> The adjustment of social security benefits according to the wage index resulted in a 40% deficit in the system (7% of GDP) in 1993 which was covered by the central government (ECLAC, *1993 Economic Survey*, p. 468).

<sup>28</sup> In 1994 the trade deficit was \$873 million and represented 45% of exports. It must be noted that the increase in exports in 1989-94 was mainly the result of increasing trade in non-traditional products within MERCOSUR since the volume of traditional exports remained relatively stagnant throughout the period.

5% per annum. Economic expansion was particularly important in 1992 and 1994 as a result of favourable regional external conditions. In 1990, both GDP per capita and gross national income finally surpassed their 1980 levels. Though the rate of inflation was gradually brought down from 129% in 1990 --the second highest level ever-- to 44.1% in 1994, it remained quite above the targeted levels throughout the period. High rates of inflation were mainly the result of two factors: on the one hand, widespread indexation based on past levels of inflation and, on the other, monetary expansion due to massive purchases of foreign exchange by the Central Bank. Revaluation of the Argentine and Brazilian currencies in 1990 had an effect on total demand similar to a devaluation of the Uruguayan peso and thus also contributed to the extremely high rate of inflation reached that year. Another important factor explaining the high rates of inflation realized in 1992-94 was the expansion of credit to the private sector and to consumers. It must be noted that these high rates of inflation were realized despite the fiscal discipline of the government and the overvaluation of the Uruguayan peso relative to the US dollar.

The return to democratic rule also brought about significant changes in the labour market. Workers' expectations were high after twelve years of labour repression resulting in a loss of almost 50% in the level of real wages. The income policy of the new government called for a redressal of this situation through gradual wage increases which, at the same time, would bolster domestic demand and aid to reactivate the economy. Until the end of the military period, wages in the private sector were set administratively. The new democratic government reinstated the Wage Councils to negotiate wage increases at the sectoral level every four months, with the government setting public sector wages and the minimum wage. The adjustment of wages in the private sector was initially based on the inflation rate of the previous period plus an additional percentage to recover gradually from the loss suffered during the previous decade. Afterwards, the criteria changed several times during the Sanguinetti administration -- e.g., projected inflation, average of past and projected inflation, a percentage of past inflation-- in order to remain consistent with government inflation targets. In 1990, the Lacalle administration attempted to eliminate wage indexation and decreed maximum wage increases equal to the inflation targets. Shortly after, however, the acceleration in the rate of inflation prompted the reintroduction of wage indexation.<sup>29</sup> After 1985 and throughout the period, however, public sector wages were set by the government based on projected inflation which was systematically lower than actual inflation.

During the first year of democratic rule, private and public sector average real wages rose by 14% and 16% respectively. Thereafter, private sector wages continued to rise until 1989 while wages in the public sector increased almost 5% in 1986, remained relatively stagnant during the following two years, and then fell 3.5% in 1989. Indeed, public sector wages increased only 2% in 1986-89 while wages in the private sector rose 22% in real terms during that period. Passive indexation resulted in a loss of 7% in real wages in 1990, while workers' real income was reduced by more due to increases in social security contributions and income tax (ECLAC, *1990 Economic Survey*, p. 425). The reintroduction in 1991 of wage indexation based on past inflation --at a time when inflation was

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<sup>29</sup> In early 1992, the government withdrew from the Wage Councils but set a maximum wage increase of 35% (significantly lower than expected inflation) which was seldom complied to in labour and management negotiations.

falling-- allowed private sector real wages to recover important ground until 1994. Though public sector wages also increased in 1991-94, the gap between private and public sector wages widened during this period. Indeed, in 1994 the public sector average wage was the same as in 1985 while private sector average wage increased 22% during this period.<sup>30</sup>

Within the public sector itself, however, real wages followed different trends. Indeed, real wages of the central government fell by 14% during the 1985-94 period, while wages of State enterprises and provincial governments rose by 40% and 99% respectively. This great wage dispersion within the public sector took place after 1990 during the Lacalle administration. In the period 1985-89, real wages increased in all subsectors with State enterprises leading the rise with a relatively moderate 18%. Between the last quarter of 1989 and the third quarter of 1994, however, real wages of the central government fell by 16% while those of State enterprises and provincial governments increased by 18% and 88% respectively. Two factors help to explain this wage dispersion within the public sector: on the one hand, the central government's attempt to reduce the deficit through --among other things-- a drastic reduction in the wage bill --as in the military period-- and, on the other, the triumph of the *Frente Amplio* --a leftist coalition-- in the provincial election in Montevideo.

Real wages trends varied among branches within the private sector as well. In Montevideo, for instance, wages in the manufacturing sector were higher than the provincial private sector average during the 1986-91 period while in 1991-94 they fell below it. This pattern is consistent with the observed behaviour of the sector: expansion until 1987-88 and relative contraction thereafter. Wages in the construction sector, for Montevideo, also followed the observed general behaviour of the sector: quite below the provincial private sector average in 1985-86, improving significantly during the 1987-89 period, and then exploding in 1991-94. Wage trends in branches within the service sector are also consistent with changes in their relative levels of activity with a significant improvement after 1991, particularly in transportation and communications. The only exception is "other services" whose level of activity increased about 25% --the average increase being 35%-- in 1983-94 while real wages rose almost 70% --the average increase being 45%-- in 1985-94. Sectoral trends in real wages closely following sectoral levels of activity suggests a high degree of flexibility in the labour market --i.e., relative wages rapidly adjusting to sectoral changes in economic activity.

After reaching a historically high rate of almost 14% in 1984, the rate of unemployment declined to 9.1% in 1987 and then remained relatively constant at around 8.5% until 1994. The rate of subemployment, in turn, declined steadily during this period, from 12.8% in 1985 to an average of 7.5% in 1986-90 and then to an average of 4.3% in 1991-94. Contrary to the experience of the first half of the 1980s, the duration of unemployment also steadily declined since 1985 from an average of 34 weeks in 1985-86 to 30 weeks in 1987-90 and to 26 weeks in 1991-94. Systemic

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<sup>30</sup> The participation of public sector wages in total income first increased from 16.3% in 1984 to 17.6% in 1986, and then steadily decreased to 14.0% in 1989 and to 11.8% in 1992. The share of private sector wages, in turn, increased from 30.0% in 1984 to 36.6% in 1989 and then remained relatively constant (Bucheli and Rossi, 1994, p. 7).



discrimination in the labour market on the basis of age and gender also persisted during the period. Indeed, the average rate of female unemployment was 11.7% while that of men remained at about 5.7% during 1987-92; for youth and adults, the respective averages were 24.8% and 5.2% during that period. The realization of high rates of unemployment during a period of relatively rapid economic expansion suggests the existence of important structural changes in the Uruguayan economy, particularly during the 1990s. Indeed, while unemployment trends followed the economic cycle during the second half of the 1980s --GDP expanding 19% and the unemployment rate decreasing 4.8 percentage points in 1984-87-- no such correlation could be observed in the 1990s --GDP increasing 22.5% in 1990-94 and the rate of unemployment remaining relatively constant at about 9%.<sup>31</sup> The data thus suggest, on the one hand, an important increase in overall labour productivity and, on the other, that the "natural" rate of unemployment might have increased in the Uruguayan economy as a result of the adoption of more capital-intensive technologies and of greater intensity in the exploitation of the labour force. For the economy as a whole --though not necessarily for all sectors-- it appears that the adoption of newer, more capital-intensive technologies cannot be considered the main explanatory variable for gross domestic investment as a percentage of GDP remained very low throughout the period. At the same time, it must be noted that if the capital/labour ratio has been actually increasing for the whole economy, then even much greater investment ratios will be required in the future in order to make a significant dent in the employment situation.

After steadily improving during the first half of the 1980s, total household income distribution for Montevideo worsened in 1985 with the Gini coefficient rising to 0.412 from 0.394 in 1984 (Table 14). This deterioration was the result of household income falling 5% on average in 1985 while those in the first three quintiles had their incomes reduced by 10%. Income distribution improved in 1986-87 with the Gini coefficient falling to 0.384 in 1987, as income of those in the highest quintile did not expand in the same proportion as that of the rest of the population. This trend came to a temporary halt in 1988 with the income of those in the top 5% of the population increasing much faster than the rest causing the Gini coefficient to jump to 0.405 in that year. This situation was soon reversed and the Gini coefficient fell to 0.39 in 1989-90. The improvement in 1989 was the result of a significant increase in the income of those in the lowest quintile and a decrease in the income of those in the highest decile. In 1990, the Gini coefficient remained relatively unchanged though household income fell more than 3% with all the loss being borne by those in the lowest and highest quintiles.<sup>32</sup> Income distribution then worsened in 1991-92 as measured by the increase in the Gini coefficient to about 0.41-0.42. This deterioration took place at a time when household income was growing quite rapidly --average income rising 20% in 1991-92. In 1991, average household income increased 8% with the income of those in the first three quintiles remaining relatively unchanged and that of those in the highest quintile rising by almost 15% --and by 21% for those in the upper 5% in the distribution scale. Income distribution --as measured by the Gini coefficient-- remained relatively unchanged in 1992

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<sup>31</sup> More particularly, the rate of unemployment increased slightly in 1992 and by almost a full percentage point in 1994 when GDP expanded by 7.9% and 6.8% in those two years.

<sup>32</sup> This situation differs from that of 1985, where the Gini coefficient rose at a time when household income fell by 5% on average.

**Table 14. Total household Income Distribution, Montevideo (1984-1988)**

| % of households | 1984        |            | 1985        |            | 1986              |            | 1987              |            | 1988              |            |
|-----------------|-------------|------------|-------------|------------|-------------------|------------|-------------------|------------|-------------------|------------|
|                 | % of income | Cumulative | % of income | Cumulative | % of income       | Cumulative | % of income       | Cumulative | % of income       | Cumulative |
| 10              | 2.27        | 2.27       | 2.20        | 2.20       | 2.15              | 2.15       | 2.42              | 2.42       | 2.24              | 2.24       |
| 20              | 3.72        | 5.99       | 3.48        | 5.68       | 3.65              | 5.80       | 3.77              | 6.19       | 3.65              | 5.89       |
| 30              | 4.72        | 10.71      | 4.43        | 10.11      | 4.71              | 10.51      | 4.76              | 10.95      | 4.63              | 10.52      |
| 40              | 5.75        | 16.46      | 5.45        | 15.56      | 5.77              | 16.28      | 5.79              | 16.74      | 5.64              | 16.16      |
| 50              | 6.89        | 23.35      | 6.61        | 22.17      | 6.96              | 23.24      | 6.96              | 23.70      | 6.75              | 22.91      |
| 60              | 8.26        | 31.61      | 8.01        | 30.18      | 8.39              | 31.63      | 8.38              | 32.08      | 8.08              | 30.99      |
| 70              | 9.99        | 41.60      | 9.82        | 40.00      | 10.17             | 41.80      | 10.16             | 42.24      | 9.77              | 40.76      |
| 80              | 12.37       | 53.97      | 12.36       | 52.36      | 12.63             | 54.43      | 12.64             | 54.88      | 12.11             | 52.87      |
| 90              | 16.20       | 70.17      | 16.53       | 68.89      | 17.56             | 71.99      | 16.58             | 71.46      | 15.92             | 68.79      |
| 100             | 29.83       | 100.00     | 31.11       | 100.00     | 28.01             | 100.00     | 28.54             | 100.00     | 31.21             | 100.00     |
| Gini            | 0.394       |            | 0.412       |            | 0.392             |            | 0.384             |            | 0.405             |            |
| % of households | 1989        |            | 1990        |            | 1991 <sup>b</sup> |            | 1992 <sup>b</sup> |            | 1993 <sup>c</sup> |            |
|                 | % of income | Cumulative | % of income | Cumulative | % of income       | Cumulative | % of income       | Cumulative | % of income       | Cumulative |
| 10              | 2.49        | 2.49       | 2.16        | 2.16       | 2.08              | 2.08       | 2.21              | 2.21       | 2.61              | 2.61       |
| 20              | 3.80        | 6.29       | 3.69        | 5.85       | 3.38              | 5.46       | 3.50              | 5.71       | 4.02              | 6.63       |
| 30              | 4.75        | 11.04      | 4.76        | 10.61      | 4.35              | 9.81       | 4.46              | 10.17      | 5.06              | 11.68      |
| 40              | 5.72        | 16.76      | 5.82        | 16.43      | 5.38              | 15.19      | 5.47              | 15.64      | 6.08              | 17.76      |
| 50              | 6.83        | 23.59      | 7.00        | 23.43      | 6.55              | 21.74      | 6.62              | 22.26      | 7.20              | 24.96      |
| 60              | 8.14        | 31.73      | 8.42        | 31.85      | 7.98              | 29.72      | 8.01              | 30.27      | 8.48              | 33.43      |
| 70              | 9.82        | 41.55      | 10.18       | 42.03      | 9.81              | 39.53      | 9.81              | 40.08      | 10.05             | 43.49      |
| 80              | 12.15       | 53.70      | 12.62       | 54.65      | 12.39             | 51.92      | 12.31             | 52.39      | 12.40             | 55.88      |
| 90              | 15.91       | 69.61      | 16.47       | 71.12      | 16.63             | 68.55      | 16.44             | 68.83      | 16.13             | 72.01      |
| 100             | 30.39       | 100.00     | 28.88       | 100.00     | 31.45             | 100.00     | 31.17             | 100.00     | 27.99             | 100.00     |
|                 | 0.393       |            | 0.390       |            | 0.419             |            | 0.412             |            | 0.363             |            |

<sup>a</sup> First semester. <sup>b</sup> Annual average. <sup>c</sup> Second semester.

Source: Melgar, 1995.

as that year's household average income increase of 11% was more evenly distributed. Hence, no dramatic changes took place in the distribution of income in 1984-92, with the Gini coefficient oscillating between 0.390 and 0.419. The situation in 1993 was quite different, with a significant improvement in the distribution of income and the Gini coefficient plummeting to 0.363 while average household income remained relatively unchanged. This dramatic change in the distribution of income was the result of an increase of more than 10% in the income of those in the first three quintiles -- 15% for those in the first quintile-- and a decrease of 8% in the income of those in the highest quintile --and of 13% for those in the upper 5% in the income scale.<sup>33</sup> In 1994, however, this downward trend in the concentration of income was reversed and the Gini coefficient rose to 0.39 as a result of a decrease in the income shares of those in the first two quintiles and a significant increase in the income share of those in the top decile. These swings in the degree of income concentration have no clear explanation and thus suggest the possibility of 1993 being an outlier.

**Table 15. Percentage of Urban Households Below the Poverty Line**

| Year    | Montevideo |         |             | Rest |         |             |
|---------|------------|---------|-------------|------|---------|-------------|
|         | INE        | Altimir | Gerstenfeld | INE  | Altimir | Gerstenfeld |
| 1989    |            | 9.2     | 16.8        |      | 12.7    | 22.8        |
| 1989-90 | 22.3       |         |             | 18.2 |         |             |
| 1992    |            | 6.6     | 11.9        |      | 12.3    | 20.8        |
| 1993    |            | 3.8     | 9.9         |      | 9.4     | 19.4        |
| 1994-95 | 13.9       |         |             | 15.6 |         |             |

Source: Melgar (1995) and Rama et al. (1996).

Independently of the methodology used, the percentage of households below the poverty line has decreased significantly during the last decade. Using INE's consumption basket, Rama et al. (1996) report that the percentage of families below the poverty line decreased in Montevideo from 29.3% in 1989-90 to 20.4% in 1994-95. According to these authors, this reduction in the incidence of poverty was fully the result of economic growth since the distribution effect was marginal and in the opposite direction. Using Altimir's consumption basket, Melgar (1995) reports that the percentage of households below the poverty line decreased in Montevideo from 9.2% in 1989 to 3.8% in 1993 (and from 12.7% to 9.4% in the rest of the country). Using the poverty line developed by Gerstenfeld in 1988, Melgar also reports a decrease in the incidence of poverty from 16.8% of households to 9.9% in Montevideo during that period (and from 22.8% to 19.4% in the rest of the country). These percentages increase further if we consider the number of individuals instead of the number of households. Indeed, using Gerstenfeld's methodology, in 1993 the percentage of individuals below the poverty line was 14.6% in Montevideo and 29.2% in the rest of the country, and the percentage below the poverty line among the population under 14 years of age was 27.7% in Montevideo and 47.2% in the rest of the country.

<sup>33</sup> The increase in the level of pensions after 1990 explains almost 50% of the increase of average household income between 1989 and 1993, while income from wages and from self-employment explain 18% and 23% of that increase respectively. For the first two quintiles, however, the explanatory power of pensions and wages is about 37% and 25% respectively (Melgar, 1995, p. 126).

## VII. CONCLUSIONS

Uruguay has experienced a long and incomplete process of economic liberalization. The first attempt to dismantle the protectionist apparatus that had characterized the Uruguayan economy since the last quarter of the nineteenth century took place as early as 1959. This timid and unsuccessful attempt was followed by a greater impulse in 1968 and most particularly after the 1973 coup d'état. Indeed, it was after 1974 that the military government introduced gradual and sweeping structural reforms that radically changed the Uruguayan economy and society. This gradual process of economic liberalization continued after 1985 under the new democratic governments.

It is safe to conclude that the implicit social alliance that prevailed in Uruguay for most of this century came to an end in 1968 as the State experienced an important loss of its relative autonomy with respect to class conflicts. Though real wages have been falling since 1957, the evidence suggests that wage repression became the essential component of the development strategy followed after 1968. The level of wages, previously established through collective agreements between workers and entrepreneurs, were now determined only by the State and the entrepreneurs after that year. The average real wage suffered an important loss in 1968-73 as a result of the antiinflation policy of the government, and in 1973 represented only 69% of its 1957 level. Despite high emigration, the rate of unemployment remained high at an average of 7.9% during 1968-73. The response of the families to the fall in real wages translated in an increase in both the number of hours worked per employed person and in the number of working members of the family unit. The military government continued with the policy of wage repression and the average real wage fell 49% in 1973-85, thus reaching in 1984 a level equivalent to 35% of its 1957 level. The wage policy of the government played an essential role in the restructure and liberalization of the economy after 1974, particularly in the fight against inflation, in the improvement in the degree of international competitiveness, and in the reduction of domestic consumption.

The restoration of democracy brought about the reinstatement of the *Wage Councils* and, therefore, a greater role of the labour movement in the determination of the level of wages in the private sector. Thus the wage gap between the public and private sector increased during the period 1985-94: the average wage in the private sector increasing 22% while in the public sector it remained unchanged between the beginning and the end of the period. There was great wage dispersion within the public sector, wages of the central government falling 14% while those of the parastatals and the provincial governments increasing 40% and 99% respectively. This dispersion can be explained by the effort of the central government to reduce the deficit through a reduction in wages and the triumph of the *Frente Amplio* in the provincial election of Montevideo. Private sector wages showed great flexibility, rapidly adjusting to changes in the relative activity of the different sectors.

The impact of the economic reforms on the distribution of income are not conclusive in Uruguay. The data show that the process of income concentration started during the period of stagnation of the economy, that is, during the period of exhaustion of the ISI model and prior to the adoption of the export-oriented model after 1968 and most particularly after 1974. The concentration

of total household income increased between 1961-62 and 1967 as shown by the jump in the Gini coefficient from 0.39 to 0.42. When considering household earned income, the process of income concentration appears more striking as the Gini coefficient rose from 0.31 in 1962 to 0.37 in 1968. The data suggest that this worsening in the distribution of income was caused by the deterioration of wages as a result of the working class losing the distributive struggle with the capitalist class. This process of concentration of household total income might have continued between 1968 and 1973, but there is no data to confirm it. The data thus show, however, that the distribution of earned income for Montevideo did not worsen during this period.

The distribution of total household income deteriorated further during the first years of military government with the Gini coefficient rising to 0.45 in 1976. Income distribution improved afterwards with the Gini coefficient falling to 0.39 by the end of the military period. This marked reversal in total household income distributive trend appears to be one of the few exceptions in Latin America, the general rule being an immediate and permanent increase in income concentration after the liberalization of the economy. The situation is different when considering earned income alone. Here, the data shows a marked deterioration until 1979 --with the Gini coefficient increasing from 0.40 in 1976 to 0.49 in 1979, and then a mild improvement during the next few years with the Gini coefficient reaching 0.44 in 1985. The distribution of total household income remained relatively stable during the new democratic period until 1992, with the Gini coefficient oscillating around 0.39-0.41. In 1993 there a sudden improvement with the Gini coefficient falling to 0.36, to be reversed the following year (Gini of 0.39). There is no clear explanation for these drastic swings, and thus the 1993 figure appears to be an outlier.

The incidence of poverty also appears to follow the economic trends --increasing during periods of recession/stagnation and decreasing during periods of economic boom. There is an increase in the percentage of households below the poverty line --using Altimir's consumption basket-- from 9% in 1963 to 15% in 1967 --and below the indigence line from 4% to 7%--, and then an improvement until 1970 when GDP grew at relatively high rates. The incidence of poverty then increased dramatically during the first years of military government, with the percentage of households below the poverty and indigence lines jumping to 25% and 12% respectively. Considering only labour income, the data show that the incidence of poverty in Montevideo increased significantly in the period 1968-73, improved in 1976-77 and then deteriorated again in 1979. The available data also show that the poverty situation have been continuously improving since the late 1980s, with the percentage of households below the poverty line in Montevideo --using Altimir's consumption basket-- falling to 3.8% in 1993. It must be noted that when compared to other Latin American countries, the poverty situation in Uruguay appears to be quite moderate.

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Table A1. Selected Macroeconomic Indicators (1955-1995)

| Year | GDP<br>(1968=100) | % Change<br>in GDP | % Change<br>in CPI | Rate of<br>Unemployment | Real Wages<br>(1957=100) | Government Surplus<br>as % of GDP |
|------|-------------------|--------------------|--------------------|-------------------------|--------------------------|-----------------------------------|
| 1955 | 95.4              | n.a.               | 10.3               | n.a.                    | 92.7                     | n.a.                              |
| 1956 | 97.1              | 1.7                | 6.1                | n.a.                    | 91.4                     | n.a.                              |
| 1957 | 98.1              | 1.0                | 18.3               | n.a.                    | 100.0                    | -1.1                              |
| 1958 | 94.6              | -3.6               | 19.6               | n.a.                    | 96.9                     | -2.2                              |
| 1959 | 91.9              | -2.8               | 48.7               | n.a.                    | 89.7                     | n.a.                              |
| 1960 | 95.2              | 3.6                | 36.2               | n.a.                    | 89.7                     | n.a.                              |
| 1961 | 98.1              | 3.0                | 10.3               | n.a.                    | 84.6                     | -1.0                              |
| 1962 | 95.9              | -2.2               | 11.2               | n.a.                    | 89.5                     | -3.8                              |
| 1963 | 94.9              | -1.0               | 43.6               | 10.4                    | 88.2                     | -2.9                              |
| 1964 | 98.4              | 3.6                | 35.4               | n.a.                    | 84.9                     | -2.1                              |
| 1965 | 99.3              | 1.0                | 88.0               | n.a.                    | 81.1                     | -5.1                              |
| 1966 | 102.6             | 3.4                | 49.4               | 7.2                     | 80.5                     | -1.3                              |
| 1967 | 98.4              | -4.1               | 136.0              | 8.4                     | 86.0                     | -3.2                              |
| 1968 | 100.0             | 1.6                | 66.3               | 8.4                     | 73.2                     | -0.2                              |
| 1969 | 106.1             | 6.1                | 14.5               | 7.5                     | 81.6                     | -2.5                              |
| 1970 | 111.1             | 4.7                | 20.9               | 7.5                     | 80.5                     | -1.7                              |
| 1971 | 111.2             | 0.1                | 35.7               | 7.6                     | 84.7                     | -4.7                              |
| 1972 | 109.4             | -1.6               | 94.7               | 7.7                     | 70.2                     | -2.5                              |
| 1973 | 109.9             | 0.4                | 77.5               | 8.9                     | 69.0                     | -1.4                              |
| 1974 | 113.3             | 3.1                | 107.0              | 8.1                     | 68.4                     | -4.5                              |
| 1975 | 119.9             | 5.9                | 66.8               | n.a.                    | 62.4                     | -4.4                              |
| 1976 | 124.7             | 4.0                | 40.0               | 12.7                    | 58.7                     | -2.6                              |
| 1977 | 126.2             | 1.2                | 57.0               | 11.8                    | 51.7                     | -1.2                              |
| 1978 | 132.9             | 5.3                |                    | 10.0                    | 49.9                     | -1.3                              |
| 1979 | 141.2             | 6.2                | 83.1               | 8.3                     | 45.8                     | 0.2                               |
| 1980 | 149.6             | 6.0                | 42.8               | 7.1                     | 45.7                     | 0.0                               |
| 1981 | 152.5             | 1.9                | 29.4               | 6.7                     | 49.1                     | -0.1                              |
| 1982 | 138.2             | -9.4               | 20.5               | 12.0                    | 48.9                     | -14.7                             |
| 1983 | 130.0             | -5.9               | 51.5               | 13.5                    | 38.8                     | -12.2                             |
| 1984 | 128.6             | -1.1               | 66.1               | 13.9                    | 35.2                     | -8.9                              |
| 1985 | 130.5             | 1.5                | 83.0               | 13.1                    | 40.7                     | -6.8                              |
| 1986 | 142.1             | 8.9                | 70.7               | 10.1                    | 43.1                     | -5.2                              |
| 1987 | 153.3             | 7.9                | 57.3               | 9.1                     | 45.1                     | -4.1                              |
| 1988 | 153.3             | 0.0                | 69.0               | 8.6                     | 45.7                     | -4.5                              |
| 1989 | 155.3             | 1.3                | 89.2               | 8.0                     | 45.6                     | -6.4                              |
| 1990 | 156.7             | 0.9                | 129.0              | 8.5                     | 41.9                     | -2.5                              |
| 1991 | 161.7             | 3.2                | 81.5               | 8.9                     | 43.9                     | -0.5                              |
| 1992 | 174.5             | 7.9                | 58.9               | 9.0                     | 44.9                     |                                   |
| 1993 | 179.8             | 3.0                | 52.9               | 8.3                     | 47.0                     |                                   |
| 1994 | 192.0             | 6.8                | 44.1               | 9.2                     | 47.4                     | -4.0                              |
| 1995 | 187.4             | -2.4               | 35.4               | 10.3                    | 46.1                     | -5.3                              |

**Source:** Aguiar (1988), Allen and Labadie (1994), Cancela and Melgar (1985), COMCORDE (1977), Favaro and Bensi3n (1993), Instituto de Econom3a (1969), O.P.P. (1977), *Semanario B3squeda* (No. 847), Torello and Noya (1992).

Table A2. External Sector Indicators (millions of current US\$)

| Year | Exports | Imports | Merchandise Account | Current Account | Real Exchange Rate (1961=100) | Terms of Trade (1961=100) | External Debt |
|------|---------|---------|---------------------|-----------------|-------------------------------|---------------------------|---------------|
| 1955 | 183.0   | 237.6   | -54.6               | -56.1           | 54.6                          | 115.3                     | 181.1         |
| 1956 | 215.7   | 209.1   | 6.6                 | 5.0             | 62.0                          | 103.0                     | 158.8         |
| 1957 | 136.0   | 252.9   | -116.9              | -117.9          | 72.2                          | 107.0                     | 193.9         |
| 1958 | 155.4   | 143.1   | 12.3                | 14.8            | 63.0                          | 93.9                      | 220.9         |
| 1959 | 108.3   | 176.2   | -67.9               | -46.8           | 54.1                          | 95.7                      | 255.5         |
| 1960 | 129.4   | 217.5   | -88.1               | -74.4           | 121.3                         | 107.5                     | 286.7         |
| 1961 | 174.7   | 210.9   | -36.2               | -18.2           | 100.0                         | 100.0                     | 306.2         |
| 1962 | 153.7   | 230.5   | -76.8               | -67.6           | 92.0                          | 105.1                     | 433.1         |
| 1963 | 165.2   | 176.9   | -11.7               | -0.8            | 99.5                          | 101.9                     | 412.0         |
| 1964 | 178.9   | 197.7   | -18.8               | -0.8            | 82.0                          | 116.7                     | 471.8         |
| 1965 | 191.2   | 150.7   | 40.5                | 72.0            | 98.9                          | 112.3                     | 480.8         |
| 1966 | 185.8   | 164.2   | 21.6                | n.a.            | 122.9                         | 116.6                     | 480.2         |
| 1967 | 158.7   | 171.4   | -12.7               | n.a.            | 109.5                         | 110.6                     | 450.9         |
| 1968 | 179.2   | 159.3   | 19.9                | n.a.            | 107.1                         | 95.9                      | 477.5         |
| 1969 | 200.4   | 197.3   | 3.1                 | -55.3           | 104.3                         | 104.8                     | 531.8         |
| 1970 | 232.7   | 230.9   | 1.8                 | -72.4           | 90.9                          | 101.1                     | 564.5         |
| 1971 | 205.8   | 228.9   | -23.1               | 47.2            | 76.5                          | 113.9                     | 674.2         |
| 1972 | 214.1   | 211.6   | 2.5                 | 18.1            | 95.9                          | 133.2                     | 771.2         |
| 1973 | 321.5   | 184.8   | 136.7               | -118.0          | 83.7                          | 175.0                     | 717.9         |
| 1974 | 382.2   | 486.7   | -104.5              | -136.3          | 72.3                          | 92.4                      | 955.1         |
| 1975 | 383.8   | 556.5   | -172.7              | -197.8          | 82.3                          | 74.3                      | 1,031.2       |
| 1976 | 546.5   | 587.2   | -40.7               | -82.4           | 85.4                          | 81.2                      | 1,134.9       |
| 1977 | 607.5   | 729.9   | -122.4              | -171.6          | 80.4                          | 78.3                      | 1,320.0       |
| 1978 | 686.1   | 774.3   | -88.2               | -132.7          | 77.7                          | 81.8                      | 1,239.5       |
| 1979 | 788.1   | 1,230.8 | -442.7              | -362.7          | 67.2                          | 80.9                      | 1,682.4       |
| 1980 | 1,058.6 | 1,602.5 | -543.9              | -715.8          | 54.0                          | 77.4                      | 2,152.7       |
| 1981 | 1,215.4 | 1,598.9 | -383.5              | -468.2          | 52.9                          | 69.7                      | 3,112.0       |
| 1982 | 1,022.9 | 1,110.0 | -87.1               | -245.0          | 60.6                          | 68.1                      | 4,238.0       |
| 1983 | 1,045.1 | 787.5   | 257.6               | -71.0           | 76.6                          | 66.5                      | 4,572.0       |
| 1984 | 924.6   | 775.7   | 148.9               | -139.0          | 70.6                          | 66.9                      | 4,671.0       |
| 1985 | 853.6   | 675.4   | 178.2               | -131.0          | 70.7                          | 64.7                      | 4,900.0       |
| 1986 | 1,087.8 | 870.0   | 217.8               | 6.0             | 70.8                          | 72.7                      | 5,238.0       |
| 1987 | 1,182.3 | 1,141.9 | 40.4                | -169.0          | 73.1                          | 72.3                      | 5,887.5       |
| 1988 | 1,404.6 | 1,176.9 | 227.7               | -37.0           | 78.6                          | 75.7                      | 6,330.5       |
| 1989 | 1,599.0 | 1,202.8 | 396.0               | 113.0           | 78.2                          | 75.4                      | 6,993.6       |
| 1990 | 1,692.9 | 1,342.9 | 350.0               | 162.0           | 90.7                          | 67.7                      | 7,382.6       |
| 1991 | 1,604.7 | 1,636.5 | -31.8               | 2.0             | 79.2                          | 70.2                      | 7,166.5       |
| 1992 | 1,702.5 | 2,045.1 | -342.6              | -236.0          | 74.6                          | 71.8                      | 7,697.1       |
| 1993 | 1,645.3 | 2,325.7 | -680.4              | -408.0          | 66.1                          | 75.3                      | 7,899.0       |
| 1994 | 1,913.4 | 2,786.1 | -872.7              | -396.3          | n.a.                          | 76.0                      | 8,786.7       |
| 1995 | 2,105.9 | 2,866.9 | -761.0              | -473.5          | n.a.                          | n.a.                      | 10,015.6      |

Sources: Cancela and Melgar (1985), *Economic Survey*, Favaro and Bensi3n (1993), Instituto de Econom3a (1969), Torres (1979), *Semanario B3squeda*, and *World Tables*.