

“Poverty and Economic Reforms: Public Policies in Mexico from a Comparative Perspective with Chile and SouthKorea”

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Introduction

Lawrence B. Krause aptly made the point that the story of development is one of a swinging pendulum. At first public policy swings in one direction to a point of exaggeration, later followed by a reaction in the opposite direction (Krause, 1991, p.1). These swings can be detected in Mexico's recent economic history.

Mexico's inward-oriented and government-led strategy went to the extreme of carrying our economy to a grave situation of instability (exchange rate volatility, high foreign indebtedness, very high fiscal deficit and excessive trade and current account deficits). After two decades of stable economic growth of the 1950s and 1960s, this strategy failed to maintain the positive economic performance of those years. When this failure manifested itself in the outbreak of the debt crisis of 1982, there was no other option for Mexico but to enter a program of stabilization and debt repayment, under the strict supervision of the IMF. A few years later, in 1985, the pendulum swung to the other side.

Since then, a radical market-oriented reform has been implemented. Prior to this crisis, the prevalent view in the country was highly skeptical about the free working of the markets. After a few years, government reformers raised the expectations of prosperity and development under economic liberalization programs.

The Mexican government followed the IMF recommendations to the letter. The results, however, were not those expected. By the end of 1998, Mexico had not yet found itself on the path toward sustained growth. The annual growth necessary to create enough employment opportunities to meet the yearly demand for jobs should be over 5%, while the economy has barely grown at an annual average under three percent. As a result unemployment and various forms of underemployment have increased contributing to a considerable expansion of the informal sectors. Poverty, that was already present during the successful years, has considerably increased during the 1980s and 1990s.

So far, one can see that the economic reform program for Mexico has failed. From an economic viewpoint, its failure is shown in the country's poor growth performance, in spite of the successful reorientation towards exports of manufacturing products. From a social perspective, conditions have worsened in aspects ranging from rural and urban poverty to welfare and security. Politically, there is an increasing loss of credibility in the current economic program; while the very recent progress achieved in democratic reforms raised some expectations of possible changes in government leadership. Back in 1983, at the end of the previous economic strategy, the main challenge to government was to stabilize the economy and carry out the required structural transformations. At present, the main challenge consists in restoring social cohesion without falling

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This paper was written under the auspices of the Project on Latin America and the Pacific Rim at the University of California, San Diego, where I was a visiting fellow in January-April 1999; financial support for the UCSD Project came from the Ford Foundation, the Center for Global Partnership, and the Project on International Security Affairs and the Pacific Rim Research Program of the University of California.

back into the economic instability of the late 1970s, and at the same time to further strengthen the democratic process.

Other countries have experienced different results with their peculiar processes of economic reforms. In Latin America Chile has been recognized a country case of successful liberal reforms, and as an example for other Latin American countries. This country has maintained very high growth rates but still has serious problems with poverty and unequal distribution of income.

In East Asia, the economic situation looks quite different from most of the Latin American countries. The predominance of public policies implemented by developmental states in Japan, South Korea, Taiwan, Singapore and Malaysia, led to an impressive capitalist development for a more than three decades. This development was concomitant with a more equitable distribution of income, specially when compared to Latin America standards. However, there are economies in which poverty was eradicated long ago (South Korea, Taiwan, Singapore and Hong Kong) while in others poverty still remains (Thailand, Malaysia, Indonesia).

The main questions of this paper refer to those aspects of the liberalization program that worsened the poverty and unemployment situation of Mexico during the past 15 years. We will analyze these issues in comparison to the experience of reforms in Chile and South Korea.

The main hypothesis of this research is that the economic reform applied in Mexico was faulty in several aspects: (a) trade liberalization was swift and too indiscriminate, disregarding key aspects of the economic system such as the wide disparity in firm's ability to respond to foreign competition, highly unequal distribution of wealth and means of production, and high economic concentration; (b) financial liberalization lacked adequate institutional support to regulate the markets and did not take into account previous experiences of financial liberalization that led to severe financial crisis.

The first section analyses some conceptual and empirical aspects of poverty, followed in Section II by a description of the poverty situation in the world and in a number of Latin American and East Asian countries.

Section III assesses the impact that economic reforms had on Mexico's socio-economic conditions. It compares with the Chilean and South Korean processes of economic reform and social policy. Considering the experience of other Latin American and East Asian countries during certain episodes of their development process, we suggest possible public policy options for Mexico.

I. Concepts and measurement of poverty

In its more general sense, poverty refers to the insufficiency of the capabilities for a human being to have a decent life. In this paper we use the conventional concept that relates poverty to the satisfaction of a minimum set of needs. Thus, a poverty line is defined as a critical threshold of consumption of a variety of goods and services, below which individuals do not satisfy basic needs. There is a wide variety of poverty situations: from extreme poverty in which an individual does not meet the basic biological requirements for his reproduction, poverty arising of the marginalization of families or entire communities, in rural and urban setting, to moderate poverty in which an individual may meet these basic requirements but not all others that are considered socially necessary.¹ Given the availability of data for comparative international purpose it is easier to use the available poverty lines based on income and consumption criteria. It should always be remembered, however, that the instrument of poverty lines is only a gross approximation to the problem, which serves our purpose of making broad international comparisons.

Following Ray (1998), poverty measures can be expressed in algebraic form. Let y denote income and the subscripts i, j, \dots , individuals or households, p denote the poverty line and m the

average income of society. The head count HC is defined as the number of individuals below the poverty lines, while the head count ration HCR is HC divided by the total population N .

Then, $HCR = HC/N$,

Where HC is the number of individuals such that $y < p$.

Other instruments to measure poverty have been introduced in the literature. One is the poverty gap ratio PGR , that is defined as the average income that is needed to raise all poor people just above the poverty line, divided by the average mean income of society. This ratio is important to know the minimal extra income that would be sufficient to wipe out poverty.

The poverty gap ratio is introduced to overcome the limitation of the HCR which consists in counting the number of poor persons without regard to how poor they are. In other words that the HCR does not take into account the consumption distribution among the poor. Other important limitations of HCR remain. (i) the fact that individual or household need vary considerable among various groups of people (Sen, 1992, p. 113); the fact that, within certain limits poor families manage to make a better living with very little income.

One special note should be made of the persistence of great forms of deprivation, over very long periods of time—centuries—, that are characteristic of marginalized communities (as is the case of indigenous communities in several states of Mexico, some of which were exposed to the international community with the uprising of the Zapatista movement since the first day of 1994). These forms of extreme deprivation of both capabilities and freedom clearly do not tend to disappear with economic growth or market liberalization. They pose a special challenge to governments in terms of (a) understanding the problem in its political context, (b) creating a political will to provide solutions taking into account legitimate communal rights on assets and traditions, in harmony with overall development strategies, and (c) in particular, to funnel enough resources to improve living conditions in the communities, while avoiding the corruption that often arises in this circumstances.

Long-term structural determinants of rural poverty relates to asset ownership, as well as to unemployment in both rural and urban areas. In the rural areas the lack of sufficient land to cultivate for peasants is one of the major determinates of its poverty. This combines with insufficient access to well remunerated wage employment in rural enterprises. Poverty, specially extreme poverty, affects the work capacity of the individuals and thus limits its participation in the labor markets. On the other hand, the inability of an economy to provide sufficient jobs to its labor force, affects the income earnings of the unemployed (or under employed) and may force them to fall into poverty. This could be a cyclical (temporal) situation or a long-term characteristic of an economy.

II. Poverty: a few facts

Poverty is a world-wide phenomenon with high contrasts between the underdeveloped and the advanced industrial economies. Extreme poverty has reached stratospheric levels: over one billion people are deprived of basic consumption needs, and the picture of such correlates of poverty as lack of adequate health services, housing, sanitation, is gloom (UNDP, Human Development Report, 1998). Bhagwati's statement about the dramatic contrasts between the affluent industrial countries and the nearly two thirds of the population living on sub-standard income, made more than three decades ago makes evident that not much progress has been made since then (Bhagwati, 1966). Poverty, however, is also a real and serious problem within the most advanced industrial countries such as the United States (Feldstein, 1998, p.5), but differs from the type of poverty that affects most of the underdeveloped world.

Table 1 shows the poverty situation in a few selected countries in Latin America and East Asia. According to the conventional cut-off method, poverty is present in all these countries except South Korea. Considering international poverty lines, similar high levels of extreme and moderate poverty are estimated for Mexico and Chile, followed by Malaysia and Thailand, for year 1992. According to national poverty lines, the higher poverty incidence is found in Peru, with more than half the population living in poverty for year 1991.

Latin America has had a very unequal distribution of income in absolute terms and relative to other regions. A recent study by Deininger and Squire (1996) confirms this pattern: an average Gini coefficient for Latin America and the Caribbean (LAC) since the 1960s is over 50 while the corresponding average for East Asia and the Pacific (EAP) is slightly over 36, with very small changes in the Gini index over time. Based on income shares, we see a very unequal distribution of income in both regions but much more in LAC: the lowest quintile in LAC receive much less (3.42 in the 1960s, 3.69 in the 1970s, 3.67 in the 1980s, and 4.52 in the 1990s) than in EAP (6.44 in the 1960s, 6.00 in the 1970s, 6.27 in the 1980s, and 6.84 in the 1990s). And the top quintile have a lower income share in EAP (45.9 in the 1960s, 46.5 in the 1970s, 45.51 in the 1980s, and 44.33 in the 1990s) than in LAC (61.6 in the 1960s, 54.18 in the 1970s, 54.86 in the 1980s, and 52.94 in the 1990s).

Most Latin American countries also shared a similar evolution of poverty and unequal distribution of income over time. In a very comprehensive study, Londoño and Székely (1997) found that poverty and income distribution improved during the growth episode of the 1970s, worsened during the stabilization period of the 1980s and have not improved significantly during the recovery in the 1990s. Using the income share of the upper quintile as indicator of income concentration in the region, a small reduction is found (of 2 points, from 55.3% down to 53.3%) and a benefit of the lower quintiles, from 1970 to 1982. During the 1980s there is an opposite trend. The income share raises from 53.3 in 1981 to 55.7 in 1990, and remains about the same thereafter, to 58.3 in 1994 and 57.7 the year after.

We can use other indicators that relate to poverty conditions to compare these countries situations. The infant mortality rate indicator is very high for Peru, followed by a high level for Mexico and lower levels for the remaining countries. Chile, South Korea and Thailand register comparable low levels of infant mortality, while Malaysia records a middle level. In respect to female illiteracy, Mexico's and Malaysia's rates are considerably higher than the rest, while for males, the illiteracy rates are higher in Peru and Malaysia.

One of the main failures of Mexico's past industrialization strategy was its inability to eradicate poverty in the rural and urban areas, and achieve a more equal distribution of income.² During the seventies, two administrations (Echeverria and Lopez Portillo) set up policies to deal with these social issues with limited and temporary success, but at the cost of macroeconomic instability specially in the foreign sector (Hernandez-Laos, 1982, p.9). During the reform period, poverty has considerably increased and aggravated based on the evidence from the cut-off line income and expenditure methodologies. However, according to several social indicators, in certain aspects living conditions have improved.

Table 2 shows the evolution of poverty and extreme poverty from 1960 to 1988. In 1963 almost 25 million people (around two thirds of the population) were extremely poor; near to six million fell within the category of moderate poor. Only slightly over eight million (22 percent) escaped poverty at that time. By 1981 extreme poverty had been reduced to fifteen and a half million, but the number of poor people have grown to seventeen million. People living under normal conditions amounted to near thirty nine million (over half of the population). It should be

taken into account that the population grew for the period (1963-1981) by almost thirty three million, difficulting the provision of basic needs for all.

During the period of stabilization and reform (1982-1996), poverty and extreme poverty have increased, thus reversing previous trends. The number of people in extreme poverty has gone back to the levels of the sixties (over twenty million), whereas poor people have declined from a peak number of near thirty millions in 1989 to over twenty six million in 1996. In proportion to the total population, the number of people free from poverty conditions shows an increase from around forty percent during the 1980s to over forty seven percent in 1996.

From the previous description, we can see that poverty did not arise with the neoliberal reforms, but it was certainly aggravated. Since poverty was considerably reduced but not eradicated during the years of high economic growth we can consider two hypothesis about this persistence of poverty: one related to structural factors such as (i) the permanence of a large population living in a diversity of Indian communities which remain marginalized from capitalist spheres and may suffer extreme forms of nutritional, health and educational deprivation; (ii) the contradictions of production in many rural areas in which natural resources are not enough to sustain family life; (iii) the formation of marginalized urban areas filled with migrants from rural areas in search for better opportunities in urban centers, but do not find regular jobs because of insufficient economic growth. A second hypothesis is related to the type of growth strategy chosen, successive stages of import substitution, which discriminated against an specialization based on labor-intensive activities.

In contrast, one of the main achievements of South Korea's strategy was its readiness with which poverty was eliminated in a context of very fast economic growth and rapid structural transformation. Other East Asian countries still have the problem of poverty amidst the sustained economic growth recorded over a long period time in Thailand, Malaysia and Indonesia.

III. Evaluation of economic reforms in Mexico, Chile and SouthKorea

A. Introduction

Here we assess the impact that stabilization and economic reform policies had on the deterioration of social conditions for the great majority of the Mexican population. First we will discuss possible ways in which trade liberalization and financial reform could lead to deterioration in social conditions, paying attention to short run and long run expected results. We will then proceed to make a description of different stabilization episodes, and in the third section we will make a brief comparison with similar episodes of economic reform in South Korea and Chile. We consider important to make a brief reference to land reform, as one of the structural factors that might have contributed to the disparate poverty situations in Korea and Mexico.

B. Causal connections

There are various factors that have considerably worsened poverty conditions during the period of stabilization and reforms. First, since 1983 the economy has performed poorly, with short-lived episodes of economic growth, followed by major economic crisis (in 1982-1983 with the outbreak of the debt crisis; in 1986 with the sharp deterioration of the terms of trade, and in 1984-1985 with the worst financial crisis in decades).

Second, since stabilization policies have not been as successful as expected, they have had a direct negative impact on poverty primarily by means of drastic reductions in public social expenditure. They also had an indirect impact through induced deflation and the consequent loss in employment opportunities and the lowering of real wages. Some studies argue that this negative short-term effect will be offset by the long-term benefits of renewed and healthy economic growth.³

Along the same lines, attacking and reducing inflation has contributed to avoid further deterioration of poverty.

Third, since trade liberalization was carried out very swiftly and did not allow many potential industries to adjust to the new competitive environment, and had a contrasting impact on the production sector. There were industrial groups that had already developed a strong competitive base, took advantage of liberalization to further improve their competitive positions, had access to international credit at low rates, and to foreign markets. On the contrary, there were industrial sectors that suffered given their weak competitive positions and the lack of supportive policies on the part of government. Finally, the benefits obtained through the expansion of the export-oriented sector have been limited due to its weak linkages to an inward-oriented sector which absorbs large amounts of employment.

Fourth, since the policies to modernize the banking and financial sectors failed to achieve their objectives, they have raised obstacles to economic growth due to the insufficiency of credit and its much higher cost compared to international standards. In particular, the privatization of banks was executed too fast, based on wrong criteria and lacked adequate supervisory and regulatory measures to assure the future well function of the bank institutions (Solis, 1998).⁴

Trade liberalization has been at the center of the reforms. From a standard theoretical perspective, opening up to trade should bring benefits to the population in a relatively-backward and low-wage economy. There will be benefits to the country as a whole, given that the new established relative prices will improve allocative efficiency, at the same time that foreign competitive pressures will contribute to reduce technical inefficiencies. How these global efficiency gains will be distributed remains open to question. Presumably, less-skilled abundant workers should gain, since increasing exports would take place in industrial sectors in which this factor will be more demanded; this in turn will push their wages up in relation to other higher-skilled labor and capital incomes. It has been argued that this is one of the main reasons why several East Asian economies that adhere to their comparative advantage did better than Latin American economies that continued with import-substituting policies (Birdsall and Sabot, 1998).

Why is it, then, that so many years after trade liberalization took place (in 1985-1987), these benefits have not materialized for the great majority of people?

One reason is that the principle of comparative advantage assumes that opening up to trade and specialization takes place in a context that assures the maintenance of full employment and equilibrium in bilateral trade. There are reasons to doubt that this has to be the only outcome; following the logic of the Ricardian principle of comparative advantage, Shaikh (1981) derives other possible scenario as a result of the opening up to trade by a country with initial absolute competitive disadvantages in a majority of industries. A foreign trade disequilibrium persists in the presence of higher-than-international domestic interest rates which bring an inflow of foreign capital to fill the trade gap and the domestic market remains below full employment.

Let us look at the Mexican trade pattern after liberation. A substantial trade of Mexico conforms to the interindustry type of trade predicted by the Ricardian theory, as shown by the exports of primary products (crude oil, vegetables, coffee, seaproducts) and the import of manufactures of all kinds. Also, labor-intensive exports have increased although to a considerable extent driven by foreign direct investment as in the very dynamic maquiladora sector. Still considerable trade conforms to the new tendency of intra-industry trade in the world economy as shown by Shaiken (1990), and also carried out mostly by foreign enterprises. This pattern of exports of capital-intensive and high-tech products started previously to the liberalization reform in the geographical context of North America. This corresponds to what Shaikh analyzed as modernization from outside and that is playing an increasing role in Mexico during the first years

of the North American Free Trade Area (Nafta). There is another category of exports that derive from Mexican industries that were successful in the previous stage of import-substituting industrialization, like steel, cement and glass.

Another reason may have to do with economic policy. Under the tenet that the best industrial policy is the absence of any type of industrial policy, government relied in the natural market forces. These led to an specialization that follows increasing integration with the U.S. industrial setting. This has resulted in increasing import coefficients of domestic and export production, and in strong disparities in regional development.

The previous question should be restated:

Given the high prospects of export growth and its diversification, why has there been such a limited effect on the rest of the economic activity, employment and well being of the population? Is it just a matter of waiting for the current market forces to operate in the much longer term or is there some room for a new kind of government policies to be implemented? Under our comparative perspective we will refer to the Korean and Chilean growth experiences to search for answers. In the meantime we proceed to describe several problems with reform in Mexico.

C. Economic reform in Mexico

Since the mid 1980s, the liberal economic reforms were taken by a highly centralized and powerful presidential system unchecked by any other institution in the country. The expectations consisted in bringing the economy to a sound economic basis and resuming economic growth with increasing employment and welfare for the population. This expectation was based on the presumption that liberalizing markets will allow them to work well, including the foreign, money and financial sectors. In the end, the outcome was greater social stability and welfare losses for the working population and the unemployed.

Here we evaluate some of the positive and negative aspects of the economic reforms applied in Mexico, from 1983 to 1998. The main achievements have taken place in the foreign sector and in balancing the government accounts.⁵ Amidst severe drawbacks, inflation has also been reduced to low levels, although still high when compared with Mexico's main trading partners. Nonetheless, several flaws are found both in the design and application of the reform programs.

As part of the Mexican pendulum, the country went from one extremist view of the State--as all powerful to achieve economic development--to the opposite--as the main obstacle to further economic progress. This was the worldwide mood of the 1980s, after the failure of the Keynesian type of welfare state. There was an increasing belief that markets could be perfected and benefit to underdeveloped economies. Consequently the task was simple: rush to minimize the government by means of privatization, economic and financial deregulation, and the abandonment of social programs. The euphoria of privatization, however, went as far as weakening or eliminating certain basic functions of government such as assuring law and social order.

One of the main drawbacks of policy making is to stick to a single solution in the face of evolving economic problems. Perhaps the main support for market liberalization policies in developing economies lies in the fact that markets have worked well in institutional settings of industrial developed economies of North America and Europe after World War II. Amidst severe economic crisis and diverse structural problems, economic growth and technical progress have continued to benefit the population. In the cases of some East Asian countries that successfully transformed, from predominantly backward agrarian societies to modern industrial economies, the story differs from the western model. It was due to a peculiar combination of efficient government and profitable markets (Amsden, 1989; World Bank, 1993; Wade, 1990). In Mexico, however,

liberal policies have been applied without serious consideration of a number of economic and social problems that have evolved in the last two decades.

During the 1980s the Mexican economy stagnated amidst recurrent economic crisis due to external shocks as well as to failures in economic policy. Under the illusion of the oil boom,⁶ the Mexican government followed an irresponsible policy of high deficit expenditure, overvalued currency, and was very slow to react to early signals of economic woes. The economy became extremely dependent on oil revenues, inflation accelerated, the peso became overvalued and exports lost competitiveness. The balance of payment disequilibrium was further aggravated by the sharp increase in international interest rates. The economic legacy to the de la Madrid administration was an unstable economy with inflation running over 50%, a foreign debt of 90\$ billion and with no access to foreign credit.

The first period of stabilization (1983-1985) included (a) sharp fiscal adjustment to reduce fiscal deficit, by means of raising taxes, cutting down government consumption, investment and subsidies as well as raising the prices of government products and services; (b) successive devaluation to maintain an undervalued currency; and (c) price liberalization.

The stabilization program failed and inflation remained high after initial reductions and entered an inertial phase in 1985. This was aggravated by the sharp reduction in oil prices that took place from this year to 1986 when the price per barrel for the Mexican mix fell below \$ 12.

The process of trade liberalization in Mexico followed a radical and mostly unilateral approach. By the end of 1982, in response to the balance of payment crisis, the government established import licenses for all products. Later, during the first stage of reform (1983-1985) there was a partial process of liberalization by lifting licenses for a small proportion of imports. Radical steps to liberalize trade were taken in 1985, when new legislation lifted quantitative restrictions and established a tariff system for most of import categories. The following year the country entered GATT, and by 1987 almost 75% of imports were subject to tariffs. Actually, the proportion of imports subject to import licenses decreased from 92 percent in June of 1985 to 47 percent in December of the this year and to 25 percent by the end of 1987. In some industries liberalization was more radical like in textiles and clothing, than in others like automobile production (Ten Kate, 1992). However, this swift liberalization was initially compensated by the increased protection provided by an undervalued peso and the low import demand generated by sluggish economic growth.

During the period of 1983-1989, GDP per capita fell -2.97 and real incomes deteriorated through a sharp reduction in real wages. Since the minimum wage was used as an anchor to contain inflation, the reduction was very sharp (-46.8 percent between 1982 and 1988); the reduction in average wage was slightly lower for the same period (-40.8 percent). Social expenditure was also sharply reduced. Expenditure in education fell by -57.3 percent for the primary level and -35.6 percent for the secondary level. This period of export-led stagnation was driven mainly for the debt burden in which Mexico incurred during the oil boon episode and the terms-of-trade deterioration.

Open unemployment has increased in Mexico as a result of sluggish economic growth and the informal sector has considerably expanded. The rates of open unemployment were relatively high during the seventies, but declined along with the economic expansion of the oil boom, to a low of 4.2 percent at the outbreak of the debt crisis in 1982, increased to near 7 percent in 1983 and then had a declining trend until the 1994-1995 crisis when again increased to over 6 percent. Compared with the Chilean case, it seems that the adjustment policies in Mexico affected more heavily incomes than the quantity of employment, since in Chile open unemployment rates reached near 20 percent during some adjustment years. However, due to serious difficulties with the

unemployment figures, this statement should be taken only as an approximation to the comparative labor situations in both economies.

In response to the low growth of formal employment opportunities due to the slow economic growth of the 1980s, labor has utilized various strategies: (a) migration abroad increased during the adjustment years from 1981 to 1993 at 240,000 Mexican admitted as permanent residents in the U.S. (OCDE, 1997, p.89); (b) occupation in informal activities increased to reach near 39 percent of the occupied population in urban centers (Jusidman, 1995), and (c) expansion of non-wage occupations.

Brady's plan of debt relief helped the Mexican economy to renew growth and continue the wave of economic reforms (privatization, financial liberalization and deregulation). In sharp contrast with the previous period, GDP per capita recorded a small increase of 5.95 percent from 1989 to 1994, amidst nation- and world-wide optimism on Salinas administration. Also, there was a substantial recovery of the previous fall in social expenditure: From 1988 to 1994 expenditure in primary and secondary education went up by 140 percent and 122 percent respectively. These increases compensated the previous reductions in a way that for the whole period (1982-1994) expenditure per student in primary education registered a small increase of about 7 per cent, while for secondary education it increased near 14 percent.

Private incomes did not registered sustained increases. The real minimum wage continued declining by 27 percent, while the real average wage did register a small increase over 14 percent. By the end of 1994, the minimum wage had lost over 60 percent of its purchasing power, and the average wage only 22 percent (Secretaría de Educación Pública, various issues).

The deep financial crisis that developed since December of 1994 and 1995, showed the fictitious nature of the previous recovery. To a considerable extent this episode resembles the short economic boom that Chile experienced from 1978 to 1981. Basic common aspects were: (a) the reliance on a fixed exchange rate system to reduce inflation that overvalue the currency; (b) high inflows of foreign capital that contributed to increased demand and (c) increasing foreign deficits in current account financed by such capital inflows. One significant difference was the Chilean wage-indexation system at that time that did not existed in Mexico during 1994-1995.

One of the main purpose of the economic reforms was to transform the previous repressed financial system into a modern one based on free market institutions. In order to do this several reforms were taken: (i) reserve requirements were rapidly reduced and eliminated by 1992; (ii) interest rate controls were eliminated; (iii) banks were privatized. In this highly unregulated financial context of 1989 to 1994, the new financial institutions and bankers led the system to a very unstable situation. It is especially noteworthy that given the high price paid for the banks by private groups, there was a rush to increase lending which increased their portfolios of non-performing loans. When capital account liberalization took place, a huge amount of foreign funds entered in a similar fashion to what has occurred in East Asia recently.

Nafta was formed the first day of 1994 and represented for Mexico a continuation of the previously implemented economic reforms as well as a rupture with its long-term policy towards the United States. From an economic viewpoint the opening up to free trade with its main trading partner is a natural extension of the previous liberalization processes, and the signing of the accord signals the seal of a commitment on the part of the Mexican government to the continuation of economic reforms. It is beneficial to the country for its guaranteed access to the U.S. market and an increasing and sustained inflow of North American investment in the country. This, reinforces what has been a long-term tendency manifested in the relocation of industrial plants from North America to primarily Mexico's Northern states, in labor-intensive facilities as well as in other capital-

intensive and high-tech. Production (Shaiken, 1990). On the United States there was a clear interest to bring Mexico into the trade agreement already had with Canada, because of the opportunity to strengthen the U.S. position vis a vis Europe and Japan, for Mexico's oil resources, its cheap labor and the security issue for their long common border (Smith, 1999).

From a political perspective, the move represented a sharp departure from the post-revolutionary nationalist stand that was based on the fear for the historical expansionism of its Northern neighbor. Internally, the trade compromise will affect the traditional political and economic alliances in favor of modernization, and will help to the democratization process and the weakening of traditional authoritarian practices.

D. Economic reform in South Korea

South Korea is one of the best cases for studying economic growth, crisis and stabilization. This country's high growth has taken place amidst a number of severe economic crisis since its take off in the 1960s. It's high economic performance for over 30 years has led the economy to a situation with low unemployment and pressures in the labor market. This contrasts with the situations in Mexico and Chile where sluggish growth for very long periods have produced high unemployment and large informal sectors. Moreover, Korea has shown a special ability to recover soon from economic crisis and stabilization and resume growth.

As it was mentioned above, South Korea was able to provide its population with a system free of the extreme poverty that is found in many other developing countries.⁷ One of the main reasons for this achievement seems to lie in the type of land tenure in the country. When the country was liberated from the Japanese occupation in 1945, Korea underwent a radical and swift agrarian reform from 1949 to 1952.⁸ This created a more egalitarian distribution of land that had a strong positive effect on the future of the economy. However, with the devastation of the civil war, and the division of the country in 1953, the urgent task was the reconstruction of the infrastructure and the industrial facilities destroyed by the war and to stabilize prices (Mason et. Al., 1980, p.126). After the reconstruction period, Korean farmers have been able to retain the full product of their effort without having to give away part to some landlords.

Contrasting with centuries of tradition, South Korea engaged in rapid capitalist change after liberation. The import-substitution strategy applied during the 1950s, was followed by a first major economic reform during the sixties. With the takeover by General Park in 1961, the government shifted toward an export-oriented strategy with the nationalistic goal of strengthening the nation, with the support of the United States and within the Cold War context. Stabilization and liberal economic reforms were implemented in combination with State intervention and selective protectionism to support the export-oriented strategy (Mason et. Al., 1980, pp. 127-32). Import substitution policies continued to be applied selectively to promote new industries. This trend was accentuated during the 1970s with the Heavy and Chemical industrialization (HCI) drive. While there has been considerable debate as to the wisdom of this industrialization program, and its impact on inflation, there was a substantial transformation of the Korea's industrial structure.

The increasing well being of Korean population since the sixties can also be attributed to (a) a sustained rapid economic growth, under a planning system, and (b) a relatively low population growth. Employment grew very fast in the urban centers due to fast economic growth. Between 1965 and 1975, Korean output grew at an average yearly rate of over 10 percent, while manufacturing grew at rates close to 20 percent a year. This led to a rapid structural transformation.

While in 1961 almost agricultural output was near 40% of total output, in 1975 this share has fallen to 25%. Also, the manufacturing output share rose from near 14% to 26% for those years. At the beginning of the 1960s, about 16% of the urban labor force was reported to be unemployed or underemployed, while for the rural areas the unemployment rate was only 3 percent. By year 1976, these rates had drastically fallen to 6.3 and 1 percent respectively (Mason et al.,1980, p.126).

In this respect, Korean early specialization in labor-intensive goods, such as cotton textiles, wearing apparel, and consumer electronics, shows the benefits of a labor-demanding path. However, it should be noted that the impressive export expansion required industrial policies that subsidized export-oriented industries.⁹

A second stage of liberal economic reforms took place after the political and economic crisis aggravated as a consequence of President Park assassination in 1979. Major reforms included bank privatization and trade liberalization. Since Korea had already developed a strong export position in foreign markets, trade reforms at the turn of the eighties were directed at correcting the imbalances and distortions that had been created by the HCI program. It was not aimed, as in the case of Mexico, to shift the economy toward an outward oriented strategy. Moreover, since the economy had already achieved high growth rates of productivity, trade liberalization was not seen primarily as a way to improve efficiency. To a certain extent, liberalization was promoted to balance the incentives toward light industries; but to a greater extent import liberalization was a response to a new wave of protectionism in developed countries and to external pressures to reduce trade surpluses achieved by Korea, especially with the United States (Amsden, 1989; Kim, 1988).¹⁰

A third stage of market reforms started to take place right after the 1997 Asian financial crisis. These are very important structural reforms that will required a separate analysis.

In concluding this section we can make the following remarks: (1) the long and sequential process of liberalization has allowed South Korea to transform and develop a strong industrial exporting sector; (2) since the country has developed a very concentrated economic structure leading by the Chaebol, trade liberalization during the 1980's favored increasing concentration (Amsden, 1979, p176); (3) the export potential of the economy contributed to shorten the periods of adjustment after the 1972 and 1979 economic crisis, and to successfully reduced its debt burden during the latter episode.

E. Economic reform in Chile

Chile can be taken as an example of the long-term success of market-oriented economic reforms, after several years of highly negative impacts on social aspects. During the first decade of stabilization and economic reforms (1973-1983), the economy suffered severe economic contractions and only a few years of high economic growth that proved to be temporary. Unemployment increased to high levels above 10 percent and remained high for the whole decade, reaching almost 20 percent during the deepest phase of the recession in 1982 (Nazmi, 1996, p.73). With some changes in the orientation of economic policy in 1983, Chile entered a new phase of high and sustained growth, under a decisive export-orientation and reduction in poverty. The number of poor people was halved in about ten years: from 5.5 million (45.1 percent of the population) in 1987 to 3.3 million in 1996 (23.2 percent). Extreme poverty was reduced from 17.6 percent of the population to 5.8 percent for the same years (cited in Meller, 1998, p.7).

As in Mexico, stabilization and liberal reform policies applied in Chile (1974-1978) were not completely successful in bringing down inflation (CPI registered an annual average growth of 79 percent for years 1977 and 1978), in spite of the success in reducing fiscal deficit to 1.3 points of GDP for these years. In Chile there was a persistent problem with very high real interest rates that could not be easily explained.¹¹ The next step was to manage the exchange rate to reduce

inflation, and to open up to foreign capitals.¹² The combination of large inflows of foreign capital,¹³ especially during 1978-1981, led to an economic boom and to currency overvaluation. As it has happened in other economies during several financial crisis, an important problem has been the allowance to firms to engage in risky financial operations (rather than productive ones) that ended in widespread banking crisis (Corbo, de Melo and Tybout, 1986, p. 637).

In evaluating the impact of the liberal economic reforms in Chile during the period from 1974 to 1982 it is not easy to highlight the causes of the failure. For one thing, some indexation practices might have contributed a great deal to stabilization efforts. Although trade unions became weak after the military takeover, and “mobility was increased by the new labor laws of late 1979, and the social security reform of 1981, Chilean wages were fully indexed to the consumer price index for the private and public sector” (Corbo, de Melo and Tybout, 1986, p. 613).¹⁴

In this respect, Edwards argue that the Chilean crisis of 1982 can not be directly related to the basic economic reforms (fiscal reform, trade liberalization and social security), but to the financial reform that was carried out without enough supervision. A more serious mistake consisted in the reliance of and “automatic monetary adjustment” on the part of the government when the crisis started to develop.

Concluding remarks

We have compared several episodes of economic reform and stabilization in three semi-industrialized countries, that have had quite different results in terms of poverty and social conditions. The three countries have followed a capitalist road of development with outward orientation but contrasting economic strategies in terms of the combination of public policies and markets. They also had authoritarian regimes throughout most of the period under study and have turned toward democratic paths in recent years. South Korea started its take off in the sixties from a globally poor situation as a result of war devastation, but with a less unequal distribution of income. It has been the most successful in eradicating poverty and increasing the well being of its population.

Chile suffered a decade of increasing poverty and unemployment with the adjustment and reform processes (1973-1984). Thereafter it has been successful in achieving high economic growth, based on a primary-goods specialization, but has not yet eradicated poverty and continued to have one of the worst income distributions in the world.

Mexico, the largest, more populated and diversified, has had the worst economic and social results of the three countries with its free-market reforms. As a result of the increasing loss of credibility in the current political system and economic policy there might be threats to governance. Under these reforms the economy has been transformed toward an export-oriented path, with increasing foreign participation but continuing economic concentration.

The structural determinants of poverty (specially in the rural areas) manifested in the persistence of this evil even during the decades of high economic growth. Economic reform policies have not dealt with the most deep-rooted causes of poverty, namely, a highly unequal distribution of assets, an unsolved long-term agrarian crisis and the structural diversity of the Mexican society . During the reforming period, poverty has expanded in the informal sectors of the urban centers.

South Korea has followed a long-term, gradual and sequential process of free-market reforms. Economic reforms and outward orientation of the Korean economy have spanned since the initial phase by the middle of the sixties, through drastic changes in the eighties, until recent reforms in labor and financial sectors through the 1997 Asian financial crisis. Well known vices of this strategy are found in the high economic concentration and discretionary management of the all

powerful Chaebol (the large Korean conglomerates) together with lack of transparency in financial markets.

The goal of eradicating poverty and improving the well being of the Mexican population has become more difficult to achieve over a reasonable period of time. This is aggravated by the prospect of further social disintegration, increasing lack of credibility in the reform program and threats to governance.

To evaluate the benefits of the free market reforms package in general is difficult given the variety of outcomes in several countries. The application in Mexico, however, has had the following shortcomings: (i) given the deep-rooted extremely unequal distribution of assets, and high economic concentration, in the Mexican economy, the benefits of the successful outward reorientation have accrued mostly to the wealthy groups and a small proportion of firms; (ii) the banking system has not performed well in the past, and is not yet in a situation to do it in the near future; moreover, it has added additional expenses to the public finances to cover for the banking rescue for many decades to come; (iii) it has lost due attention of economic and social needs and narrowly focused on economic targets.

Based on our comparative study we suggest a few guidelines as policies for a more effective strategy to overcome poverty.

1. Complement the export sector with industrial policies that promote increasing integration with domestic production, either by domestic or foreign capital.
2. Focus on creating additional educational, technological and entrepreneurial capabilities as in the case of South Korea and to a lesser extent as in Chile.
3. Asset redistribution seems necessary in terms similar to those stated by World Bank documents that includes "redistributive taxation and asset redistribution" (World Bank, 1999, p.7).

¹ Sen's definition of well being refers to a set of functioning's that vary from such elementary things as being adequately nourished, being in good health, avoiding escapable morbidity and premature death, etc. , to more complex achievements such as being happy, having self-respect, taking part in the life of the community, and so on. As we can see, according to this integral concept of poverty the number of humans out of poverty will considerably reduced.

² As in South Korea, the Mexican land reform consisted in the redistribution of land from large units to poor peasants in small units. The Mexican reform did not give ownership to peasants, but only rights to use the land, in most cases collectively under the Ejido or communal systems, while the State maintained ownership over all land. This system proved compatible with industrialization during the decades of 1950's and 1960s, but after that the rural sector entered a long-lasting crisis that has not been solved. Gross output of the agricultural sector expanded during the 1940 at an average annual rate of 5.0 percent, slowing down during the sixties to 3.4% and recovering during the sixties to 4.7%. Afterwards there was a slowdown: from 1970 to 1975, 3 percent; from 1975 to 1980, 3.6 percent, and from 1980 to 1985 only 2.6% (Maddison, 1992, p. 174). This declining trend in output combined with a speed up in population growth reduced the agricultural surplus that had provided a net surplus of foreign currency to support industrialization. According to this study, the expansion was due primarily to the expansion of the harvested area and of the large irrigation programs carried out by the government. However, the harvested area peaked in 1965 and afterwards growth has been based only on moderate yield increase. During the Cardenas administration, when the first large land redistribution took place, the peasants were organized within a corporatist apparatus under government supervision and used for political purposes of the single-dominant party. Given the lack of ownership on the part of peasants, a whole system of commercialization and credit was developed and managed by public enterprises.

In particular, the very long process of land redistribution created significant problems of instability in agriculture that worked against non-governmental investment in the sector. After the initial episodes of distribution of land of good quality, later The "repartos" were increasingly more of very low quality that contributed to the growth of poor rural families. On the contrary in most other land reforms, specially in Korea the land reform took only a few years, and the rules for land tenure were more clearly established (Powelson and Stock, 1990, p. 37).

³ Stewart (1998) referring to studies by IMF economists such as Heller et al., (1998) and IMF (1986).

⁴ Financial liberalization also had quite a negative impact on the economy. The purpose of the reform was to transform the previous repressed financial system into a modern one based on free market institutions. In order to do this several reforms were taken: (i) reserve requirements were rapidly reduced and eliminated by 1992; (ii) interest rate controls were eliminated; (iii) banks were privatized. In this highly unregulated financial context of 1989 to 1994, the new financial institutions and bankers led the system to a very unstable situation. It is especially noteworthy that given the high price paid for the banks by private groups, there was a rush to increase lending which increased their portfolios of non-performing loans (NPL). When capital account liberalization took place, a huge amount of foreign funds entered in a similar fashion to what has occurred in East Asia recently.

⁵ Mexico has completed its liberalization process and the economy has shifted toward an export-led strategy. The country has also reduced its heavy dependence on oil income. In 1996, the value of manufacturing exports (including that of maquiladora facilities) was seven times that of the oil bill. Still the government revenue continues to be highly dependent on oil.

⁶ In 1980, the price of Mexican oil reached over \$30 per barrel and \$33 the following year.

⁷ There is no information on poverty or poverty lines in Korea (Fields, 1994).

⁸ South Korea underwent agrarian reform after liberation from Japanese rule during the years 1949-1952. There was a radical shift from large land holdings in the period of Japanese domination to small crops. The political climate was favorable for a radical reform since a great part of the land was owned by Japanese and other landlords who had closely collaborated with them; as a consequence, the landlords had a weak political position (Mason et al., 1980, pp. 237-243). There were three types of redistribution schemes: (1) Land previously owned by the Japanese was transferred to the original Korean tenants under a government contract (this amounted to 240,000 hectares); (2) large land holdings were also transferred to tenants on a small-scale basis through the government; a maximum limit of approximately 3 hectares was set for land tenants (330,000 hectares were redistributed under this schema); (3) under the political context of land reform, other land was directly sold to tenants by landlords at low prices (550,000 hectares) (Powelson and Stock, 1987). Since the agrarian reform did not break the actual plots, reform had also a positive impact on agricultural productivity.

⁹ A study by Westphal and Kim (1982) found that, throughout the 1960-68 period, Korea's manufacturing exports were significantly more labor intensive than its manufacturing imports and domestic production. Moreover, the tendency they detected was for exports to become more labor intensive over time.

¹⁰ Trade liberalization reform in Korea differs from that in Mexico in its sequential and selective application. Since industrialization has been based on quantitative restrictions, trade liberalization took the form of transferring items from the restricted list to the automatic-approval list, and has been implemented in a way as to avoid microeconomic disruptions. The program of liberalization has spanned over long periods depending on the competitiveness of the firms involved and has been pre-announced to prepare domestic producers with sufficient time to meet foreign competition. (World Bank, 1987).

¹¹ "the most disquieting sign during phase 1 was the emergence of extremely high real interest rates as soon as deregulation took place" (Corbo, de Melo and Tybout, 1986, p. 636).

¹² The domestic capital market was reformed in early 1975 while foreign capital flows were strictly controlled until mid-1979. Afterwards restrictions on medium- and long-term capital were lifted but not so for short-term capital (Edwards, 1986, p. 538).

¹³ The following semester figures for net capital inflows give a clear picture of capital movements. Starting with the first semester of 1979 net inflows grow as of 1103.4 million of USDLS; 11,44.7; 1,239.1; 1,921.0; 2,044.2; 2,425.1, the latter for the last semester of 1981; afterwards there was a drastic reduction to 889.2 in the first semester of 1982 and 415.1 for the following (Edwards, 1986, p. 539).

¹⁴ In the adjustment policy for Mexico, wages were adjusted but according to expected future inflation rate resulting in decreasing real wages .

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Table 1 Poverty and General Indicators for Selected Countries

	MEXICO	CHILE	PERU	MALAYSIA(a)	SOUTH KOREA	THAILAND
Population Below International Poverty Lines (percentage of total population,1992)						
Below \$1 a day	14.9	15		5.6		<2
Poverty gap	3.8	4.9		0.9		
Below \$2 a day	40	38.5		26.6		23.5
Poverty gap	15.9	16		8.5		5.4
Infant Mortality Rate (1996) (Under -5 mortality rate per thousand)	32	12	42	14	9	34
Female Illiteracy rate (% of people 15 and above,1995)	13	5	17	22	3	8
Male Illiteracy rate (% of people 15 and above,1995)	8	5	6	11	1	4
Population (millones 1997)	95	15	25	21	46	61
Land Area (thousand of sq.km., 1995)	1909	749	1280	329	99	511
GNP (Billones of dollars 1997)	348.6	73.3	60.8	98.2	485.2	169.6
GNP Per capita (Dollars 1997)	8120	12080	4390	10920	13500	6590

Source: World Bank, World Development Report, 1998.

Poverty gap is calculated as indicated in the paper.

(a) poverty indicators for 1989

Table 2 Poverty in Mexico (1963-1988)

	Poverty Indicators for Mexico (1963-1988)* (millions of persons)						1996
	1963	1968	1977	1981	1984	1989	
Extreme poverty	24.4	24.3	19.1	15.5	18.1	17.9	22.7
Poverty	5.7	8	18.4	17.1	27.5	31.9	26.2
Other	8.4	12.9	25.8	38.7	30.5	32.9	43.7
Total Population	38.5	45.2	63.3	71.3	76.1	84.4	92.6

* Based on consumption

Source:Hernandez Laos (1992)

	Poverty Indicators for Mexico (1963-1988)* (percentage)						1996
	1963	1968	1977	1981	1984	1989	
Extreme poverty	63.3	53.8	30.2	21.7	23.8	21.6	24.5
Poverty	14.8	17.7	29.1	24.0	36.1	38.6	28.3
Other	21.9	28.5	40.8	54.3	40.1	39.8	47.2
Total Population	100.0	100.0	100.0	100.0	100.0	100.0	100.0

* Based on consumption

Source:Hernandez Laos (1992,1999)