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Varieties of functional income inequality in Latin America: Chile and Mexico compared

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Abstract

Contributing to a better understanding of the varying inequality patterns within Latin America, this article examines the drivers of the private sector labour shares of Chile and Mexico between 1980 and 2011. Over this period, Chile's labour share has declined, similar to many advanced economies, while Mexico's labour share has remained relatively stable. Our historical and econometric analysis suggests that in Chile high private indebtedness has undermined wage demands and induced wage cuts, while policies of small government have also contributed to the decline in its wage share. Chile's natural resource exports have benefited from Latin America's commodity boom and exhibited some limited positive effects on its wage share. Contrariwise, we find that Mexico, as a more capital-intensive economy, has experienced significant substitution effects, which have undermined its wage share. Yet, high government spending has counterbalanced the negative effects of globalization. These comparative results challenge popular narratives around hyper-globalization and policy homogenization.

Key words: political economy, Latin America, developing countries, inequality

JEL classification: D33, P16, N10

1. Introduction

The discussion on the distribution of income has been one of the core debates in social sciences since the times of classical political economists. After the 2008 global financial crisis, there has been a resurgence of interest in the drivers of income inequality. A growing body of literature looks at increasing GINI coefficients, growing wage dispersion and rising top income shares (e.g. see Daudey and García-Peñalosa, 2007; Dell'Aringa and Pagani, 2007; Roine et al., 2009; Volscho and Kelly, 2012; Piketty, 2014; Flaherty, 2015; Huber et al.,

2019). Rising income inequality has been accompanied by a steep fall in wage shares since the 1980s, which has been identified as a stylized fact of neoliberalism (ILO, 2008; Kristal, 2010; Karabarbounis and Neiman, 2014; IMF, 2017). Overall, for decades, the income distribution literature (especially within economics) has focused on personal income inequality and functional income distribution has started re-gaining more attention since the early 2000s (Atkinson, 1997; Atkinson and Bourguignon, 2000).

One explanation for this omission is the contention that sources of income are no longer relevant for the determination of class boundaries, as members of the working class receive both wage and capital income. Moreover, as Milanovic (2017) demonstrates, changes in the functional distribution of income do not affect overall income inequality if capital ownership is equally distributed. However, this is a highly restrictive criterion for a wide array of societies, particularly less developed and emerging economies, where the ownership of firms and assets is highly concentrated (Kristal, 2013; Piketty, 2014; Milanovic, 2017). Given that practices like profit sharing, employee ownership schemes and bonuses are far less common in most developing economies, the employer–employee distributional conflict and thus, the functional distribution of income, remains an important object of scholarly inquiry.

Furthermore, from a policy perspective, understanding the determinants of functional income inequality in different Varieties of Capitalism (VoC) is fundamental for growth and capital accumulation dynamics. Glyn and Sutcliffe's (1972) profit-squeeze explanation of the stagflation crisis initiated the contemporary debate around the growth effects of functional income inequality. Mazier et al. (1999) and, later, Bhaduri and Marglin (1990) offer a more nuanced perspective of the growth-distribution nexus by stressing the importance of differentials in propensities to consume out of wages and profits. The former is typically significantly larger than the latter. An increase in the labour share will have a negative impact on investment and a positive effect on consumption, as wages are both a source of demand and a production cost. Therefore, it is the size of the relative effects that determine the growth effects of changes in the functional distribution of income (Lavoie and Stockhammer, 2013). In general, there is evidence that domestic demand is wage-led in many advanced and developing economies (Onaran and Galanis, 2014), identifying the determinants of functional income distribution is key for inclusive growth strategies.

Recently, several empirical studies on the drivers of the labour share by economists, sociologists and political scientists have appeared in the literature. Declining labour militancy, welfare state retrenchment, trade and financial globalization and financialization has been highlighted as key factors behind the reduction of the labour share (e.g. see Kristal, 2010, 2013; Lin and Tomaskovic-Devey, 2013; Bengtsson, 2014*a*,*b*; Alvarez, 2015; Dünhaupt, 2017; Wood, 2017; Köhler et al., 2019; Flaherty and Riain, 2021; Gouzoulis, 2021). Yet, despite political awareness of unequal income distribution in the Global South, most of the literature is centered on advanced countries. Rare exceptions are Onaran (2009), Guschanski and Onaran (2017), Stockhammer (2017), Ibarra and Ross (2019) and Jayadev and Narayan (2020). However, due to poor data availability, these studies cover relatively short periods, mainly after the mid-1990s.

In this work, we use the new dataset developed by Astorga (2017) to answer two key questions in the cases of Chile and Mexico. What are the stylized facts of the functional distribution of income from 1980 to 2011? Which factors have driven the dynamics of the functional income distribution over this period? We explore these questions through a

comparative-historical and econometric method. While the Latin American region is considered one of the more unequal regions in the world, Chile and Mexico are a striking contrast. Astorga's (2017) data show that the Chilean labour share had steeply declined since 1980, like in most advanced economies, while Mexico's labour share had remained relatively stable over the 1980–2011 period. We find this contrast of particular interest since both countries have consistently followed a neoliberal agenda since the early 1980s. Moreover, Latin American economies are typically classified as Hierarchical Market Economies, i.e. high-income inequality countries with product markets dominated by large business groups, and significant presence of multinational corporations, highly segmented labour markets and skill shortages (Schneider, 2013).

The second part of our study estimates the determinants of the Chilean and the Mexican labour shares between 1980 and 2011, through a parallel time series approach (Flaherty and Riain, 2021; Gouzoulis, 2021). Our econometric findings confirm general results from pooled analyses, i.e. economic liberalization increases functional income inequality, and that government consumption is a positive driver of the wage share (e.g. Kristal, 2010; Bengtsson, 2014*a*,*b*; Stockhammer, 2017). However, the results also produce several interesting puzzles. Private debt is an important explanation for why wage shares have fallen in Chile, but we find no evidence of this channel in Mexico. Also, we find similarly varied effects of globalization on the respective wage shares: trade openness indicators exhibit positive and negative effects on the Chilean and Mexican wage shares, respectively. These country-specific results demonstrate the importance of national political configuration in explaining varied distributional outcomes.

These results present three key insights. First, public spending is the most consistent driver of functional income inequality in both economies. Secondly, free trade does not unambiguously lower inequality in developing countries and the 'export basket' matters for distributional outcomes. Compared to Chile, the larger share of Mexican exports is machinery and complex manufactured goods, which are comparatively more price elastic and ergo, justifies more intense wage restraint. It is well known that the commodity boom in recent decades had lowered income inequality in Latin America, and Chile is no exception (Sanchez-Ancochea, 2019).[1] Thirdly, private debt can serve as a powerful propeller for functional income inequality. This is a sharp contrast to a recentInternational Monetary Fund (IMF) study that calls for extensive reforms to expand financial deepening in Mexico (Herman and Klemm, 2017). Our finding is hardly supportive of poor credit intermediation, rather, it adds pause to the finance-growth nexus and lay bare the adverse distributional effects.

The remainder of this article is organized as follows. Section 2 discusses the empirical literature on the drivers of inequality with a focus on functional income distribution. Section 3 presents a comparative historical analysis on the evolution of Chile's and Mexico's economies and societies since the rise of neoliberalism. In Sections 4 and 5, we outline our empirical strategy and present our results, respectively. Finally, Section 6 discusses the socio-economic implications of our findings and concludes.

1 Also, it is worth noting that recent research has challenged previous stylised facts about inequality trends in Latin America, by adjusting survey data with administrative data that include high income earners and capital gains (De Rosa et al. 2020).

2. The political economy of income distribution: theory and evidence

The expanding literature on the determinants of functional income distribution has highlighted several complementary channels. These include public welfare expenditure, labour's organizational capacity, exposure to globalization and the impact of the financialization of non-financial sectors of the economy (Stockhammer, 2017; Köhler et al., 2019; Gouzoulis, 2021). The rest of this section discusses the key theoretical arguments, empirical findings and the main gaps in the literature.

2.1 Labour market deregulation and welfare state retrenchment

The *Power Resources Theory* (PRT) (Stephens, 1979; Korpi, 1983) is the most widely used framework for the analysis of shifts in the balance of power between social classes. The PRT literature emphasizes that strengthening collective bargaining processes and welfare provision for workers, empowers labour and leads to more egalitarian income distribution by limiting the cost of job loss (i.e. the pay gap between the average income of the unemployed and the average wage). Several empirical studies have demonstrated that the deregulation of the labour market, declining labour militancy and welfare state retrenchment since the early 1980s have increased the cost of job loss, thus, engendered higher functional income inequality and wage dispersion.

Cowling and Molho (1982) provide evidence that strike activity and union density increased the wage share of the UK in 1968 and 1973, using sectoral-level data. Fichtenbaum (2009) scrutinize the impact of unionization on the wage share of non-supervisory employees in the USA between 1949 and 2009 and find strong positive effects. Similar econometric evidence is also provided by Kristal (2013) and Bengtsson (2014*a*) who find positive effects of social spending and labour militancy on the wage shares of Israel and Sweden, respectively.

Moreover, panel data studies like Kristal (2010) and Bengtsson (2014b), also provide evidence in favour of the PRT as they find that union density and public welfare increases the labour shares in advanced economies over the period since the 1960s. Furthermore, Hancke (2012) uses a panel dataset of 14 OECD countries for the period 1973–1999 and reports econometric evidence that conservative central bankers' reaction to strengthened collective bargaining reduces the labour share. More recently, Bengtsson et al. (2020) estimate the drivers of the capital share using panel analysis for 20 countries since the late 1800 s and provide evidence that the universal suffrage of the early 1900s decreased capital shares and the post-1980 trade union erosion has been increasing them. Lastly, Guschanski and Onaran (2021) use industry-level data for 14 OECD economies and show that inter-industry variations in the wage shares are primarily driven by variations in labour's bargaining power and government spending rather than by labour-saving technological change.

Finally, beyond functional income distribution, the literature also shows that centralized bargaining leads to lower earnings inequalities since the 1970s. Leslie and Pu (1996) scrutinize Britain between 1970 and 1993 and show that the decline in labour's power has raised earnings inequality. Dell'Aringa and Pagani (2007) report that strengthened collective bargaining reduced pay dispersion in 1995, based on survey data for Belgium, Italy and Spain, while Pontusson (2013) finds that, between 1975 and 1995, earnings inequality has been substantially lower in the more unionized OECD economies. Bargaining centralization has also been a key determinant of wage dispersion among male workers in Italy since the mid-1980s (Devicienti et al., 2019).

2.2 Trade globalization and capital mobility

Beyond labour market institutions and welfare state retrenchment, trade and production globalization are important determinants of functional income inequality. Trade openness has made export-oriented firms cut overhead costs, e.g. wages to maintain price competitiveness. Additionally, the globalization of value chains (Gereffi et al., 2005) allows multinational companies to relocate to low-wage economies, which undermines labour's bargaining power in both advanced and developing countries (Rodrik, 1997). Therefore, the uniform decline in labour's bargaining power allows capital owners to obtain an increasing share of the GDP.

Harrison (2002), Jayadev (2007), ILO (2008), IMF (2017) and Stockhammer (2017) provide macro-level empirical evidence that different dimensions of globalization have been contributing to the decline in wage shares since 1970. Their proxies include trade openness, capital account openness, FDI and the share of foreign assets and liabilities. Flaherty and Riain (2021) report time series macro-level evidence that trade openness and FDI decreased Ireland's wage share but did not affect functional income distribution in Denmark between 1960 and 2012. They claim that these discrepancies stress the key role of domestic institutions and politics, which underscores the importance of country-level studies. Böckerman and Maliranta (2012) use longitudinal plant-level data for the period 1976–2007 and show that rising export share and foreign ownership have triggered intra-industry restructuring in Finland, which forced high labour share plants to exit their industries and led to declining labour shares.

Only a handful of studies focus on the distributional effects of globalization in developing countries and these are largely panel-based analyses that do not allow for an in-depth understanding of important institutional differences. One exception is Onaran (2009), who shows that globalization has reduced the manufacturing labour shares of Korea, Mexico and Turkey between the late 1970s and 2003. Globalization indicators like the FDI, imports and exports value-added are particularly influential for Mexico and Turkey, while nominal exchange rate depreciations have a negative effect in all countries. According to Onaran, these findings highlight that the distributional effects of trade depend on domestic industrial policy strategy and thus, institutional innovation. The governments of Turkey and Mexico have followed an orthodox wage suppression policy to shift the growth model toward an export-oriented strategy since the 1980s. This is consistent with the argument that trade globalization encourages labour-saving technical change and empowers capital. In contrast, Korea's export strategy was based on investment in skill- and technology-intensive goods rather than wage suppression, hence the insignificant impact of trade openness on Korea's wage share. However, Korea's integration with the world economy exposed it to financial and exchange rate crises, which explains why the nominal exchange rate is an important driver of its wage share.

The second exception is Guschanski and Onaran (2017), these scholars find that offshoring toward emerging economies and financial integration has reduced the labour share in Korea, Mexico, Turkey, Brazil, China, Indonesia and India, for the period 1995–2009 using industry-level panel datasets. These results confirm that trade globalization can be particularly harmful to the working class in developing countries. Guschanski and Onaran also find negligible effects of labour-saving technical change as proxied by capital intensity.

Ibarra and Ross (2019) examine Mexico over the period 1990–2012 using sectoral data and claim that the relative decline of the labour shares in the formal sectors is due to lagging productivity in the informal non-tradable sector and the reduction of the US manufacturing labour share. Finally, Jayadev and Narayan (2020) study functional income inequality in

India's formal industrial sectors between 1983 and 2016 using plant-level data and show that the overall reduction of the labour share has been the results of greater informalization, privatizations, and rising capital intensity.

2.3 Income inequality and the rise of finance

Another strand of the literature focuses on the financialization of non-financial sectors. Financialization has been highlighted as a driver of inequality through three distinct channels: the financialization of households; the financialization of non-financial firms via corporate indebtedness and shareholder value orientation; and the rise in the financial profits of non-financial sectors. Froud et al. (2002) and Langley (2007) argue that the financialization of households through the accumulation of debt has induced a loss aversion behavior by workers on the fear of defaulting on their debt. This leads them to accept stagnant or even lower wages and avoid union participation to demonstrate 'good' behavior to their employers. Wood (2017), Guschanski and Onaran (2018), Köhler et al. (2019) and Auhtor1 (2020) demonstrate that rising household indebtedness causes declines in the labour shares, especially in advanced liberal market economies with indebted low-income households and weaker labour market protection.[2]

Financialization also includes non-financial firms. Over the last four decades, firms borrow for at least two reasons. First, to invest in capital accumulation and, secondly, to buy back their shares. The latter motive has been identified as a common practice due to the separation between the management and the owners of contemporary firms. Shareholders' income ultimately depends on dividend payments, i.e. on increases in the value of a company's stocks. Thus, shareholders press managers to become short-termists and boost share prices to maximize their income. As noted by Lazonick and O'Sullivan (2000), managers undertake corporate debt and engage in share buybacks to boost share prices, which worsen the financial position of the firm. To improve the latter, managers endeavour to cut costs/wages by downsizing (Medoff and Harless, 1996, p. 37, Froud et al., 2000; Thompson, 2003). This process has triggered a decline in real long-term investment (Stockhammer, 2004), the liberalization of industrial relations (Gospel and Pendleton, 2003; Palpacuer et al., 2011; Appelbaum et al., 2013) and increased functional income inequality in advanced economies (Dünhaupt, 2017; Köhler et al., 2019).

An important dimension of financialization is the rise in financial profits of non-financial firms (Krippner, 2005; Lapavitsas and Mendieta-Muñoz, 2019). The liberalization of financial activities allowed non-financial firms to become more flexible and expand their activities to financial investments. Lin and Tomaskovic-Devey (2013) claim that this shift towards financial profits makes profitability less dependent on labour and value creation. Using industry-level data for the USA, they demonstrate that rising financial incomes decreased the labour share between 1970 and 2008. Similarly, Alvarez (2015) reports that financial profits and interest payments reduced the labour share of 6980 French non-financial corporations over the period 2004–2013.

2 Darcillon (2015), Kollmeyer and Peters (2019) and Meyer (2019) show that financialization has played a role in the decline in employment protection and unionization in advanced countries since the 1980s.

3. Comparing the Chilean and Mexican VoC

In this section, we present a comparative analysis of key economic domains that relate to the determinants of the functional distribution of income namely, labour market institutions, government welfare, globalization and finance. Figure 1 presents the private sector wage share for both countries between 1973 and 2011.

In the case of Chile, the private sector wage share increased between 1980 and 1982, and peaked at 65%. Subsequently, it experienced a secular decline until 1995, with several periods of booms between 1982 and 1995. The wage share showed no trend and fluctuated around an average wage share of 44% from 1995 to 2003. However, it eventually dipped below 40% for two years (2005–2007) and had recovered and stabilized in subsequent years at 40%. Notwithstanding these variations, it is transparent from Figure 1 that the Chilean wage share has undergone a secular decline since 1982. In contrast, it is evident from Figure 1 that Mexico's wage share shows little variation since 1980. Its average wage share throughout this period has been ~40–45%, notably higher than Chile's.

Like Stockhammer (2017), Chortareas and Noikokyris (2021) and Gouzoulis (2021), we approximate the private sector wage share as follows:

$$\mathrm{WS} = (1 - \mathrm{GCONS}) * \mathrm{PWS} + \mathrm{GCONS} * \mathrm{GWS} \Rightarrow \mathrm{PWS} = \frac{\mathrm{WS} - \mathrm{GCONS}}{1 - \mathrm{GCONS}}$$

where WS is the (gross) wage share, PWS the private sector wage share, GCONS is government consumption and GWS the government sector wage share. Given that the government is non-profitable, its labour share (GWS) is by definition, 100%. This is important for conceptual and methodological reasons. First, the nature of wage bargaining between the private and the government sector is vastly different. Theories of functional income distribution generally refer to the former, focusing mainly on non-managerial employees.[3] Secondly, given that government consumption includes public sector wages, estimations using this indicator as a proxy for government size will create endogeneity biases. The wage share series used for this calculation come from Astorga (2017)—the dataset with the longest time dimension. It must be noted that these series do not include fringe benefits and managerial income, thus, they should be interpreted as '*…a lower bound value of labour earnings*' (Astorga, 2017, p. 327).[4] While the literature generally uses the adjusted wage share, Astorga's approximation is comparable to Fichtenbaum's (2009) calculation of the income share of production and non-supervisory workers in the formal sectors of the

3 For instance, shareholder value maximization increases income inequality since firm owners press managers to suppress the wages of the remaining workforce to balance the firm's worsening financial position (Lazonick and O'Sullivan 2000).

4 Astorga's series are estimated based on Economically Active Population (EAP)-weighted averages of skilled, semi-skilled and unskilled wages over income per worker. *Unskilled wages* include rural and urban minimum wages, *semi-skilled wages* reflect urban wages in the construction sector, and *skilled wages* are the wages of urban white-collar and specialised blue-collar workers in banking, manufacturing, and the public sector. It is worth noting that the derived wage share is gross of capital depreciation. Yet, despite in both countries the rate of capital depreciation is increasing over the last decades, it remains very small (<0.05%) to exhibit a significant impact on functional income inequality.

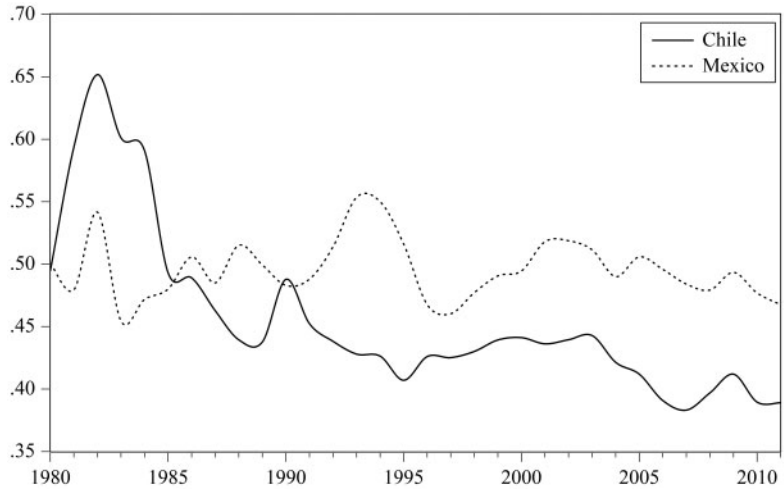

Figure 1. Private Sector Wage Shares, 1980–2011. *Notes*: Authors' Calculation using data from Astorga (2017) and the World Bank.

economy. Thus, our interpretation is that its dynamics reflect wage bargaining outcomes for this part of the working class.

3.1 Chile

Chile enjoyed some welfare programmes and strong labour market institutions between 1932 and 1973 until the overthrow of the democratically elected socialist president, Salvador Allende (Kurtz, 2002). The military dictatorship was led by General Pinochet, who was counselled by a team of economists educated at the University of Chicago—the so-called 'Chicago Boys'. Their economic agenda was to establish a society based on supply side, pro-capital principles, where the pursuit of private enterprise improves societal welfare through trickle-down effects. To this end, the Pinochet regime banned unions, suspended labour laws and prohibited strikes in the early period of his regime (Davis-Hamel, 2012). The economic rationale is based on the idea that unions and other labour market institutions lead to excessive wage growth and unemployment.

By 1979, the repression of labour was institutionalized by the so-called 'Labour Plan'. It outlawed unionization in the public and agricultural sectors, reduced legal protection for union bosses, limited industrial action to a particular firm and permitted dismissal without cause (Collins and Lear, 1995, p. 27; Roberts, 1998, p. 114; Durán-Palma et al., 2005). After the end of the military regime, some labour reforms were acted by centre-left governments, but these did little to strengthen labour market institutions. In democratic Chile, labour had the right to unionize, no worker could be dismissed without cause, a labour court was established, the 60-day limit on industrial action was removed, and other labour rights were re-enacted (Barnett, 2001; Durán-Palma et al., 2005). However, the rate of unionization and membership numbers declined during the reform period. Many loopholes abound that tilt the balance of

power in favour of employers. For example, firms are permitted to hire replacement workers during a strike and/or establish agreements with small groups of strikers.

The Pinochet regime also undermined several key social welfare programmes. As Davis-Hamel (2012) notes, the regime reduced social spending and privatized education, electricity and water supply, healthcare, social security, telecommunications and banking. More concretely, the 'pay as you go' pension system was replaced by an individualized capitalization scheme, and workers were obliged to pay for private health insurance (Bizberg, 2014). Notable reforms under democratic Chile included health coverage to 80% of the population, universalization of non-contributive pension for the poor and minimum salary pensions etc. (Bizberg, 2014). Notwithstanding these reforms, Chile has not lost its literal political economy character—the state subsidies a private healthcare system that expels the elderly and sick (Riesco, 2009; Bizberg, 2014).

Predictably, these reforms led to fiscal surpluses, massive capital inflows and rapid growth in private investment that produced the so-called economic miracle (Davis-Hamel, 2012). Chile's economic foundation under both Pinochet and democracy is built on the export of commodities and agro-based goods—fish, copper, wine and wood pulp (Rodrik, 2010). In present-day Chile, the export of copper has led to the establishment of a stabilization fund, which is used as a countercyclical instrument. Incidentally, Chile's commodity-based exports have allowed it to benefit from the so-called 'China Shock', i.e. China's growing demand for primary resources. During 2004–2005, Chile had recorded its largest trade surplus with that country (Skira, 2007). Further, since the dictatorship, Chile had aspired for world integration and maintains open capital accounts and competitive exchange rates (Madariaga, 2017). Such forceful integration into global trade has labelled Chile the 'poster child' of economic liberalization.

Consistent with its principle of 'small government' and 'free markets', Chile's financial system has been dominated by private banks. Under military rule, they were permitted to accumulate foreign currency-denominated liabilities, and during the early 1980s, 50% of the domestic credit was denominated in foreign currency (Meller, 1991). Moreover, given the privatization of key social services, debt commitments for the private sectors and particularly households, increased significantly since the late 1970s–early 1980s (Gonzalez-Lopez, 2021). Indicatively, total private debt in Chile grew from 44% in 1980 to 116% of GDP in 2018. Given the importance of private indebtedness for wage bargaining (see Section 2), the growth of the private sector's debt commitments is likely to have negatively influenced the trajectory of Chile's labour income share.

Entrenched fiscal surpluses, significant devaluations, private debt dynamics and the removal of labour market institutions can partly explain the dramatic decline in the Chilean wage share since 1980 (see Figure 1). But, why has Pinochet's economic model persisted? Since 1990, coalition governments have governed the country with extensive intra-elite contestations regarding the role of the state. The orthodox faction won the day and controlled the Ministry of Finance, which rejected interventionist state policies but kept in place free trade, fiscal conservatism and fundamentalist pro-capital economic policies (Weyland, 1999; Madariaga, 2017; Bril-Mascarenhas and Madariaga, 2019).

Pinochet's rule created a strong business constituency, particularly the export-oriented sectors that profited under an official policy of small government (Kurtz, 1999). This constituency serves as an important source of 'check' on government policy. For example, Bril-Mascarenhas and Madariaga (2019) argue that the private sector threatens state officials

with disinvestment should the role and scope of government expand. Moreover, according to Bril-Mascarenhas and Madariaga, captains of industry were graduates of the University of Chicago, schooled in monetarism and therefore, genuine sceptics of government. Campero (1993) and Frieden (1991) argue that the socialist experiment infused an anti-statist value system in the private sector that persists in democratic Chile. Given the enormous de facto political power of the business community, the main economic objective of successive coalition governments is to build the trust of the private sector by maintaining the status quo (Kaplan, 2013).

3.2 Mexico

After the Mexican revolution against the Porfirio Diaz dictatorship, President Cardenas united his country under a strong nationalist government with a social vision, 1934–1940. His presidency marked the emergence of a historical alliance between government and unionized labour. The discovery of oil in the late 1970s led to increased foreign borrowing that supported public consumption and investment (Silva Herzog, 2007). The government called the growth period of 1971–1979 'Shared Development', and faced increasing private sector opposition to rising taxes and nationalization (Morton, 2003). During this period, the government invested heavily in the petrochemical industry and infrastructure and subsidized domestic consumption to maintain real wages (Ortiz, 2019). The oil boom increased both private and public external indebtedness, and a decline in the price of oil and rising interest rates led creditors to question Mexico's ability to repay.

After Mexico defaulted on its external debt obligations in 1982, reform was inevitable, particularly labour reform. In the early years after the debt crisis (1986–1992), the private sector was keen to advance a policy of 'unilateral flexibility', which included flexible firm-level adjustments in the size of employment, hours of work, job rotation, etc. (Haagh, 2002; Berg et al., 2006). The key implication is that this significantly reduced the scope of union power. But, President Carlos Salinas de Gortari (1988–1994) sought to re-establish the historical alliance between government and unionized labour, and called for a 'new unionism'. This led to a National Agreement for Productivity and Quality (ANPEC) among labour, firms and government. ANPEC expanded the definition of labour productivity to include the enrichment of the conditions of work and increases in pay, labour-management cooperation, and unions' role in firm modernization (Haagh, 2002; Berg et al. 2006). Labour made further gains after national disputes over the North American Free Trade Agreement (NAFTA), which led to a national agreement on wage-productivity indexation, and a system of productivity bonuses (De la Garza Toledo and Carrillo, 1997). Notwithstanding these relative gains in labour relations, Mexico maintains a dual labour market, where informal labour are paid low wages and have little to no union representation (González and McKinley, 1997; Schneider and Karcher, 2010).

After the Mexican debt crisis, reforms extended beyond labour relations. The government had introduced a value-added tax, agreed to cut public employment, increased provision of public goods, liberalized trade, floated the foreign exchange rate and imposed a public sector wage freeze (Ortiz, 2019). However, unlike the case of Chile, Mexico's technocrats were not dogmatic about these policies; they were keen to increase public spending to mitigate the adverse social effects (Kurtz, 2002; Morton, 2003). One instance of this pragmatism is the National Solidarity Programme between 1989 and 1994. This was largely a poverty alleviation strategy that involved the citizenry in both design and implementation. It

included public funds for community development projects and applied the principle of 'Tequio', a form of labour organization where members contribute labour time and resources (*ibid.*). Laurell (2015) highlights additional components of Mexico's social policy: conditional cash transfers, robust public education and health care. A similar program was implemented between 1995 and 2001 known as PROGRESA.

In the early reform period, Mexico established several export processing zones that employed cheap labour to produce light manufacturing goods (González and McKinley, 1997; Schneider and Karcher, 2010). This early stage of trade openness was further supported by Mexico's unilateral reduction of tariff barriers, and the announcement of its intention to participate in the General Agreement on Tariffs and Trade (Tornell and Hernandez, 1997; Esquivel and Rodriguez-Lopez, 2003). In 1992, Mexico signed the NAFTA agreement with Canada and the USA, which completed the structural change in its trade policy. As a consequence of NAFTA, Mexico's trade volume accelerated, where the import penetration of its manufacturing sector increased from 45% in 1988, to more than 150% in 2000 (Esquivel and Rodriguez-Lopez, 2003). These scholars find strong evidence that the NAFTA agreement increased wage inequality in Mexico.

Increased openness to trade accompanied policies that lowered corporate tax rates, liberalized the capital account and de-regulated key financial activities (Laurell, 2015). Mexico's banking system is highly concentrated, where banks act as holding companies and provide credit to underperforming areas, even at the expense of the holding company (Marois, 2011). In the early years of the reform period, the financial sector was poorly regulated and thus, a banking crisis ensued in 1995 (Husted and Serrano, 2002; Marois, 2011). Because of this recent history, corporate debt is limited, so that bank profitability is driven by consumer credit (Levy, 2003).

Overall, Mexico's post-1980 growth model was a hybrid one since it did not involve a retreat of the state but a reorganization of state institutions. The latter is based on the assembly of light manufacturing, low wages for the export industry and large migrant and remittance flows. This brief analytical narrative suggests that Mexico's relatively stable wage share can be potentially explained by the hybrid nature of its growth model, i.e. strong public consumption/investment that compensates for the adverse effects of pro-capital trade policies.

4. Empirical design

4.1 Econometric methodology and baseline specification

Given the historical analysis of Section 3 and the theoretical framework presented in Section 2, our econometric inquiry asks three key questions related to the political economies of Chile and Mexico. How does government retrenchment affect the capital-labour conflict? Which social class/factor of production has benefited from trade openness? Has the financialization of non-financial sectors shift the balance of power towards capital? To answer these questions, we experiment with several explanatory variables.

Our investigation relies on annual macroeconomic data that cover the 1980–2011 period for several reasons. First, neoliberalism begins in earnest in the late 1970s. Secondly, there were early signs of democratic transition in both countries around the early 1980s. For example, the 1980 Chilean constitutional referendum and President Miguel de la Madrid's attempt to organize free elections in Mexico in 1983. Thirdly, many of our key explanatory

variables are only available for the period under consideration. Finally, to preserve consistency and avoid introducing biases, we do not combine Astorga's (2017) series—the only annual macro series that extend to 1980—with more recent data that proxy the wage share.[5] Descriptive statistics and data sources can be found in the Supplementary Appendix.

From an econometric methodology perspective, we estimate our single-equation model using the unrestricted Error-Correction Model (UECM), pioneered by Sargan (1964) and Davidson et al. (1978). This econometric specification accounts for the serial correlation issues of the standard OLS model by including both the short-run (first-differenced) and the long-run (level) effects of the independent variables. Moreover, the UECM is commonly used in the analysis of small size macro datasets. Our interest is targeted on the long-run coefficients, i.e. the long-term structural processes, rather than on the short-term coefficients, i.e. the reactions to temporary shocks. The two necessary conditions for the implementation of the UECM is that all variables must be either I(0) or I(1) and that there must be a cointegrating relationship among the dependent and the independent variables. In our case, both conditions are satisfied.[6]

The UECM model is widely used in the comparative political economy literature on the wage share (e.g. Kristal, 2010; Bengtsson, 2014*a*,*b*; Flaherty and Riain, 2021; Gouzoulis, 2021). Therefore, our baseline specification is the following:

$$\begin{aligned}\Delta(\text{Private Wage Share})_t = {} & \beta_0 + \beta_1(\text{Private Wage Share})_{t-1} \\ & + \beta_2(\text{Government Consumption})_{t-1} + \beta_3(\text{Trade Openness})_{t-1} \\ & + \beta_4(\text{Terms of Trade})_{t-1} + \beta_5(\text{Private Debt})_{t-1} \\ & + \beta_6(\text{Stocks Traded})_{t-1} + \sum_{n=1}^{N} \gamma_n \Delta z + \varepsilon_t\end{aligned}$$

where the terms β_0 and ε_t are the constant and the error terms, respectively, while z is a vector that includes the short-run (first-differenced) coefficients. The growth rate is included as a short-run control variable to account for the cyclicality of the wage share. Adopting the most common UECM specification, the long-run coefficients are in lagged form to prevent simultaneity issues.

Government Consumption (final expenditure excluding military spending as a share of GDP) is included as a proxy for welfare spending and public investment, which decreases the cost of job loss, thus, empowers labour and increases the wage share. Using the private sector wage share prevents endogeneity issues, given the lack of welfare spending data (Stockhammer, 2017).

Trade Openness (sum of exports and imports as a share of GDP) is a commonly used proxy for the extent of integration into world trade and globalization.

Terms of Trade (Net barter terms of trade index, i.e. the export unit value index over the import unit value index) captures the reaction of employers to changes in international

5 While our sample is relatively short in terms of observations, it is consistent with the statistical 'rule of thumb' of $N > 30$. Also, we are careful to avoid exhausting the degrees of freedom ($N - k - 1 = 32 - 12 - 1 = 19$). Finally, to evaluate issues of multicollinearity we have checked variance inflation factors, which suggest no relevant problems.

6 As reported in the appendix, all variables are either I(0) or I(1). Regarding cointegration, the residuals of the stationary regression between the wage share and the explanatory variables are stationary, thus, a long-run relationship exists.

prices. There are two competing propositions: (a) if higher export prices are due to rising wages, export-oriented firms will squeeze wages to maintain target profitability or price-competitiveness and (b) if higher export prices are on account of global demand, wages may rise with terms of trade.

Private Debt (domestic credit provided by the financial sector as a share of GDP) can undermine the wage share through two channels: (a) household debt increases the costs of job loss and thus, reduces labour's bargaining power and (b) non-financial corporate debt deteriorates firms' balance sheet and wage squeezes/freezes can be relied upon to improve their financial position.[7]

Stocks Traded (total volume as a share of GDP) captures the business philosophy of shareholder value maximization, which is associated with firm downsizing, cost-cutting and share buybacks rather than re-investment, ergo, a lower wage share.

4.2 Additional estimations

We estimate six additional specifications where we include alternative indicators or additional control variables to evaluate additional channels and the robustness/sensitivity of the main results. To avoid exhausting the degrees of freedom, we are careful to add one variable at a time.

Capital Intensity is included as a proxy for how technological progress affects functional income distribution. Given a high elasticity of substitution between workers and machinery (Hicks, 1932), technological progress reduces labour demand and real wages. However, empirical estimates suggest that the elasticity of substitution is significantly less than unity, which implies that technical change need not undermine the wage share (Rowthorn, 1995).

The Manufacturing value-added Share of GDP is incorporated as a control variable to capture the effects of structural changes on income inequality. A rising manufacturing share is expected to increase the wage share through several channels: technology/manufacturing-intensive economic activities have longer job ladders, a wider range of occupational choice, flatter hierarchy of occupational structure, wider diffusion of skills and knowledge, stronger collective bargaining and higher income elasticity in export markets, thus, lower inequality (Hartmann et al., 2016; Constantine and Khemraj, 2019).

Subsequently, we add *Strike Activity* (total number of strikes and lockouts) as an indicator for the degree of labour militancy—due to lack of reliable unionization data—which is expected to exhibit a positive effect on the wage share.

Import Penetration (Imports as a share of GDP) is included as a proxy for the proportion of the market that is supplied via imports. Like Kristal (2013), we use this indicator as an alternative trade-related proxy that depicts how much the state protects domestic industries from the pressures of international competition.

KOF Trade Globalization index is incorporated as another measure of trade globalization/liberalization. In short, the index reflects a comprehensive shift in bargaining power in favour of export-oriented employers and ergo, we expect a lowering of the wage share in the presence of hyper-globalization. To avoid multicollinearity biases the Terms of Trade index is replaced with the KOF Trade Globalization index, which includes trade-related indices.

7 We use the total private debt-to-GDP ratio instead of separate series for household and corporate debt since such disaggregated data do not extend prior to 1995 for either country.

To control for the political regime we include the Polity5 Score, which ranges from −10 (hereditary monarchy) to +10 (consolidated democracy). In a more democratic economy workers and owners of firms are equally represented, which implies that too low wages can be democratically adjusted.

4.3 Further robustness tests

As further robustness checks, we estimate four additional specifications for each country, which are reported in the Supplementary Appendix. First, we include FDI Inflows (Net share of GDP) as an alternative proxy for capital mobility with ambiguous effects on the wage share, depending on the domestic strategy of attracting FDI. If firms are attracted by low wages, then the relocation threat remains high and local workers will accept low wages. Secondly, we add the Nominal Exchange Rate (official exchange rate; LCU per US$, period average) as a control variable, where nominal depreciations/devaluations reduce the wage share. Natural Resources Rents (share of GDP) can also affect the wage share, especially in resource-rich developing economies like Chile and Mexico. When natural resources rents are privately and publicly owned, firm-level costs of production can increase and decrease, respectively. As costs rise, international price competitiveness is undermined, and wages are squeezed.

Finally, we introduce one country-specific dummy variable for each country. For Mexico, the time dummy variable indicates the 1994 implementation of NAFTA, which is anticipated to decrease the labour share due to the higher relocation/globalization threat. For Chile, the time dummy variable represents the 1992 copper privatization Codelco Law. This law indicates the fall of the state-controlled copper sector under the Pinochet dictatorship. Depending on the wage share under the state-controlled firm, privatization can increase or decrease the wage share.

5. Econometric results

5.1 Chile, 1980–2011

Table 1 reports the main econometric results for Chile. In specification (1) we find that both Government Consumption and Private Debt have the expected positive and negative signs respectively and are statistically significant at the 1% level. Stocks Traded has the expected negative sign but is not statistically significant. In contrast, Trade Openness and Terms of Trade exhibit positive effects and are statistically significant at the 5% and 1% levels, respectively. As compared to the magnitude of the coefficients for Government Consumption and Private Debt, these are relatively smaller. In specifications (2) and (3), Capital Intensity and the Manufacturing Share do not produce results that deviate from the baseline findings. In specification (3), the effect of the Manufacturing Share on the wage share is positive and statistically significant at the 10% level. In specification (4), the addition of Strike Activity does not change the baseline results. The control variable itself exhibits the expected positive effect on the labour share but its statistical significance is below the standard threshold.

Specification (5), which includes Import Penetration instead of Trade Openness, confirms the baseline findings. The long-run coefficients of Government Consumption, Terms of Trade and Private Debt keep their signs and are statistically significant at the 1% level. Import Penetration itself exhibits a positive and statistically significant long-run impact on the wage share, like Trade Openness in the baseline. Replacing Terms of Trade with the

Table 1. Chile, 1980–2011—Econometric results

Long-run coefficients	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Private Wage Share$_{t-1}$	−1.25***	−1.51**	−1.60***	−1.25**	−0.65	−0.19	−1.33**
	(0.01)	(0.03)	(0.00)	(0.02)	(0.14)	(0.519)	(0.03)
Government	1.63***	1.82***	1.82***	1.67***	1.66***	1.79***	1.71***
Consumption$_{t-1}$	(0.00)	(0.00)	(0.00)	(0.01)	(0.00)	(0.00)	(0.00)
Trade Openness $_{t-1}$	1.11**	1.31***	1.39***	1.17**			1.05**
	(0.02)	(0.01)	(0.01)	(0.04)			(0.02)
Terms of Trade $_{t-1}$	0.84***	0.77**	0.97**	0.87***	1.01***		1.22*
	(0.03)	(0.02)	(0.01)	(0.01)	(0.01)		(0.08)
Private Debt $_{t-1}$	−1.88***	−1.46**	−1.94***	−1.93***	−2.43***	−1.81***	−1.96***
	(0.00)	(0.02)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Stocks Traded $_{t-1}$	−0.43	−0.23	−0.17	−0.44	−0.02	0.86**	−0.73
	(0.39)	(0.53)	(0.73)	(0.37)	(0.97)	(0.02)	(0.337)
Capital Intensity $_{t-1}$		−0.75					
		(0.32)					
Manufacturing			0.70*				
Share $_{t-1}$			(0.09)				
Strike Activity $_{t-1}$				0.01			
				(0.95)			
Import Penetration $_{t-1}$					1.68**		
					(0.02)		
KOF Trade						0.81**	
Globalization $_{t-1}$						(0.01)	
Polity5 Score $_{t-1}$							0.51
							(0.323)
Adjusted R^2	0.86	0.78	0.80	0.73	0.75	0.61	0.75
BG	0.12	0.23	0.17	0.75	0.21	0.32	0.22
Harvey	0.42	0.17	0.44	0.44	0.79	0.27	0.22
Obs	31	31	31	31	31	31	31

Notes: The dependent variable is the *Private Wage Share* in first differences. The coefficients reported are standardized by multiplying the obtained coefficient with the ratio of the standard deviation of the explanatory variable over the standard deviation of the dependent variable. Values for specification tests are *P*-values. BG (Breusch-Godfrey) test at first lag only. Constant terms and short-run (first-differenced) coefficients are included in the estimations, but not reported. Standard errors are HAC. *$P < 10\%$. **$P < 5\%$. ***$P < 1\%$.

KOF Trade Globalization index in specification (6) does not cause any significant changes, since Government Consumption and Private Debt keep their expected signs and remain statistically significant. Stocks Traded becomes weakly positive and borderline statistically significant. The long-run coefficient of the KOF Trade Globalization index, like the rest trade liberalization measures used, is positive and statistically significant. Finally, in specification (7), incorporating the Polity5 Score does not alter the baseline results, while the control variable itself has the expected positive sign.

Our core findings demonstrate that government consumption and private debt increase and decrease Chile's wage share respectively and these results are robust to various controls.

The magnitudes of these coefficients are striking and underline them as primary drivers of the steep decline of the Chilean labour share since 1980. More concretely, steady decreases in government consumption and the financialization of the non-financial sectors are important explanations for why the Chilean wage share has fallen. The article also finds that exposure to trade globalization increases the wage share. Unlike the robust result in advanced economies that globalization lowers the wage share, Chile's exports of copper and other natural resources that have benefited from Latin America's commodity boom is a boon for its wage share. We find weak evidence that the commodity boom might have engendered a premature de-industrialization that lowers the Chilean wage share. Further evidence for the robustness of our baseline results is provided in Table A2 of the Supplementary Appendix.

5.2 Mexico, 1980–2011

Table 2 presented the main econometric findings for Mexico. In specification (1), Government Consumption, Trade Openness, Terms of Trade and Stocks Traded have their expected signs and are statistically significant, except for the latter. Specification (2) controls for Capital Intensity but does not change the baseline results. The control variable itself has the expected negative sign and is statistically significant at the 10% level. Regarding specification (3), incorporating the Manufacturing Share in the baseline specification does not affect the main findings in terms of signs and statistical significance. Similarly, adding Strike Activity in specification (4) also does not trigger major changes in terms of signs. Yet, in this case, Government Consumption is the only statistically significant determinant of Mexico's wage share. Notably, the effect of Strike Activity is positive, but the coefficient is not statistically significant.

The addition of Import Penetration instead of Trade Openness in specification (5) does not alter the baseline results. The long-run effects of Import Penetration are negative, like Trade Openness, but non-significant. In specification (6), where the KOF Trade Globalization index replaces Terms of Trade, the long-run impacts of Private Debt and Stocks Traded are negative and positive, respectively, and both are statistically significant at the 5% level. Also, the long-run coefficient of the KOF Trade Globalization index is negative and statistically significant at the 1% level. Finally, in specification (7), where we control for the Polity5 Score, the findings remain similar to the baseline results in terms of signs and magnitudes. Regarding statistical significance, Government Consumption and Terms of Trade are the two statistically significant drivers of the wage share, at the 5% and 1% levels, respectively.

Overall, our empirical findings demonstrate that the key drivers of the Mexican labour share are the relative expansion in public consumption—especially after 1995—and its increasing exposure to globalization. The evidence suggests that government consumption compensates for the negative wage share effects of opening the Mexican economy. This can explain why the wage share remains stable between 1980 and 2011 as compared to Chile. We also find some evidence of capital-labour substitution as proxied by Capital Intensity, which indicates that firms were able to take advantage of labour-saving technical progress. The impact of financialization on the functional income distribution is negligible in the Mexican case. Additional robustness checks are reported in Table A2 of the Supplementary Appendix.

Table 2. Mexico, 1980–2011—Econometric results

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Long-run coefficients							
Private Wage Share $_{t-1}$	−0.37	−0.58***	−0.31	−0.45**	−0.30	−0.94***	−0.56**
	(0.11)	(0.00)	(0.20)	(0.01)	(0.15)	(0.00)	(0.07)
Government Consumption $_{t-1}$	0.53**	0.73**	0.87*	0.27	0.39*	0.47	0.48**
	(0.04)	(0.01)	(0.06)	(0.19)	(0.08)	(0.13)	(0.07)
Trade Openness $_{t-1}$	−0.82***	−1.29***	−0.71*	−0.61**		0.22	−1.31
	(0.00)	(0.00)	(0.08)	(0.05)		(0.60)	(0.10)
Terms of Trade $_{t-1}$	−1.20**	−1.36**	−1.20***	−0.62	−1.24***		−1.08***
	(0.03)	(0.01)	(0.00)	(0.10)	(0.00)		(0.00)
Private Debt $_{t-1}$	0.15	−0.21	0.36	−0.10	0.25	−1.13**	0.10
	(0.68)	(0.55)	(0.46)	(0.71)	(0.58)	(0.02)	(0.73)
Stocks Traded $_{t-1}$	−0.21	−0.14	−0.39	0.09	−0.30	1.63**	−0.14
	(0.66)	(0.78)	(0.52)	(0.79)	(0.61)	(0.01)	(0.76)
Capital Intensity $_{t-1}$		−0.50*					
		(0.05)					
Manufacturing Share $_{t-1}$			0.49				
			(0.22)				
Strike Activity $_{t-1}$				0.24			
				(0.22)			
Import Penetration $_{t-1}$					−0.64		
					(0.10)		
KOF Trade Globalization $_{t-1}$						−1.57***	
						(0.00)	
Polity5 Score $_{t-1}$							0.51
							(0.37)
Adjusted R^2	0.46	0.55	0.55	0.70	0.42	0.52	0.43
BG	0.17	0.04	0.09	0.03	0.06	0.38	0.00
Harvey	0.46	0.34	0.42	0.18	0.72	0.35	0.46
Obs	31	31	31	31	31	31	31

Notes: The dependent variable is the *Private Wage Share* in first differences. The coefficients reported are standardized by multiplying the obtained coefficient with the ratio of the standard deviation of the explanatory variable over the standard deviation of the dependent variable. Values for specification tests are *P*-values. BG (Breusch-Godfrey) test at first lag only. Constant terms and short-run (first-differenced) coefficients are included in the estimations, but not reported. Standard errors are HAC. *$P < 10\%$. **$P < 5\%$. ***$P < 1\%$.

6. Conclusion and discussion

Why have wage shares fallen in Chile but remain stable in Mexico? This work presents robust evidence that Chile is more financialized—significantly higher debt levels for firms and households that undermine wage demands and encourage firms to cut wage costs. Also, Chile's history with Chicago trained economists, and its corresponding policy of small government and private provision of social services (Clark, 2017), has led to a significant and persistent decline in its wage share. Chile's pro-capital growth model has come home to roost with a vengeance. We present strong evidence that the positive effects of Chile's integration into the world economy—though substantial—were insufficient to compensate for

the negative effects of its liberal regime that forced both firms and households to incur debt. These are striking findings that illustrate the importance of public services in taming distributional conflict and preventing mass social discontent.

The Mexican case presents an example of how integration into the world economy can lower the private sector wage share, but why trade openness might still remain socially acceptable. As compared to Chile, Mexico is more capital intensive in terms of both input and output, which implies that the competitive forces of globalization engender significant substitution effects. Predictably, this undermines the wage share, but the Mexican case demonstrates that globalization is not destiny. Government consumption has increased in tandem to stabilize its labour share and maintain a comparatively stronger social consensus for globalization. The stronger provision of public services enhanced wage bargaining and reduced the propensity for firm-level and household debt. Mexico proves that the forces of globalization can be managed even when there are strong negative distributional effects from openness.

These comparative results illustrate that the distributional effects of world integration are ambiguous and that policy matters. Both conclusions are contrary to the popular narratives that led to hyper-globalization and the homogenization of policy. In terms of the latter, our comparative study makes a strong case for openly discussing the negative distributional effects of globalization so that an effective compensatory strategy can be democratically devised. However, the Chilean results show that public services remain important for social content even when globalization lowers inequality. In other words, higher wage shares do not reduce the utility of government welfare or justify the privatization of key public services.

Supplementary material

Supplementary material is available at *Socio-Economic Review* Journal online.

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