



Development and Income Distribution: The Case of Puerto Rico

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Summary. — Using data spanning half a century the study addresses the trends and factors behind changes in income distribution in one of the earliest examples of development through integration to the world economy. Results show remarkable income growth that generated an ambiguous long-term change in inequality but a drastic reduction in poverty. Public transfers played a decisive role in restraining growth in inequality and in reducing poverty levels that were also affected favorably by changes in the distribution of female earned income. Finally, although rising schooling levels and their absolute returns increased households' income generating capacities, the realization of the potential was hindered by increasing levels of unemployment and economic inactivity.

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1. INTRODUCTION

In the decade of the 1950s Puerto Rico embarked on what was then a novel development strategy based not on an internal development process but on the attraction of foreign direct investment through the provision of generous tax incentives and considerable spending in infrastructure.¹ Evaluation of the Island's early experience was resoundingly positive and the model was recommended as one to be emulated by other developing countries (Baer, 1959). But, subsequent analyses performed in the context of economic crises related to the recessions of the 1970s and early 1980s were not as enthusiastic, and the discussion revolved at best about the limits of the model to its utter failure at worst (Dietz, 1986; Meléndez, 1990; Weiskoff, 1985). More recent work by Baumol and Wolff (1996) placing Puerto Rico in an international context concluded that while the economy's speed of growth receded after the mid-1970s, the model still produced impressive results in *per capita* GDP growth that placed the Island among the world's top performers during 1950–90. The authors argued that the Puerto Rican experience held valuable lessons for developing countries and provided an important counterexample to the Asian model.

The objective of this study is that of adding another dimension to the debate in analyzing

the distributional consequences of the strategy. The long-held belief that inequality increases with growth before it declines has given way to the proposition that the *type* rather than the *stage* of growth holds the key to the understanding of the factors that cause distribution to change (Fields, 2001). The Puerto Rican experience is of special interest as it represents one of the earliest examples of development through integration to the world economy.

Results will show that over the long-term Puerto Rican outward-oriented growth has been effective in reducing poverty and more so in raising market incomes at the higher end of the distribution. Such effects have not produced considerably greater levels of household income dispersion due to the stabilizing effects of transfer payments that also account for a considerable share of the recent progress in alleviating poverty. The fact that countries such as Taiwan and South Korea have been able to achieve trade-based growth with significantly less market income pressure on inequality (see Bourguignon, Fournier, & Gurgand, 2001; Fields & Yoo, 2000) and reliance on transfers suggests that the relevant issue connecting growth and income distribution is indeed the specifics of how growth is achieved rather than its stage.

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Sections 2 and 3 survey the literature and lay out the data sources and trends in income distribution over 1953–99 when the Island transformed itself from an agrarian to an industrial to a service-based economy. Section 4 discusses and implements a methodology for analyzing the role of important income sources on changes in distribution while Section 5 examines the issue of poverty from the viewpoint of self-reliance. Section 6 concludes with a summary and a discussion of the implications of results.

2. SURVEY OF THE LITERATURE

The issue of the relationship between economic growth and inequality was taken up in a study that explored it from a temporal perspective using data on Argentina, Mexico, and Puerto Rico (Weisskoff, 1970). Although results were inconclusive, ensuing work by Mann (1985) based on a longer span of Puerto Rican data ascertained an inverted-U relationship between growth and inequality. But, Sotomayor (1996) later established through decomposition analysis that falling levels of dispersion were not linked to a new equalizing stage of development but to transfer payments from the United States. Interestingly, earlier work by Santiago and Thorbecke (1988) and Weisskoff and Wolff (1981) had suggested that the Island had reached an inequality plateau from which further reductions in inequality would come only through government intervention.

As the bulk of the international evidence mounted against the existence of a Kuznets process (Fields, 2001), attention turned to another interesting question: that of whether the poor benefited from growth. Blank and Blinder (1986) and Blank and Card (1993) addressed it in the context of the US economy and found an inverse relationship between growth and poverty that grew weaker during the decade of the 1980s but regained force during the 1990s (Blank, 2000). Work based on international data (de Janvry & Sadoulet, 2000; Ravallion & Chen, 1997; Ravallion & Datt, 2002; Squire, 1993) supports the assertion, although the specific estimates of elasticities of poverty with respect to growth imply anywhere from weak to very strong relationships. Moreover, the strength of conclusions of many studies is diminished by data comparability problems and the examination of a time-series proposal from a cross-section perspective.²

3. DATA AND TRENDS

The study draws data from the Puerto Rican public use microdata sample files of the 1970 to the 2000 US Census of Population and Housing. Poverty is identified through the official Census definition that is also employed in the construction of a measure of equivalent income used in inequality comparisons.³ All observations are weighted by household size as well as by the weights provided by the Census for producing representative samples. The information is complemented by the 1953 and 1963 Income and Expenditure Surveys carried out by the Puerto Rican Department of Labor, whose main advantage is that of being the only source of information on income distribution during the Island's early stages of growth. Their drawback is a lack of microdata causing dependence on published tables that only contain tabulations of the distribution of total household income. Poverty and inequality statistics are thus calculated from grouped data through the use of the methodology laid out in Ravallion and Datt (1992), based on the estimation of Lorenz curves through parametric means.

Income levels, translated to 1999 dollars using the personal consumption implicit price deflator, show remarkable growth in the early stages of development when *per capita* income increased at an average annual rate of 5.2% during 1953–73. The post-1973 period was marked by diminished rates, although *per capita* income still rose by an average annual rate of 1.9% during 1973–99.⁴ Inequality measurements indicate that the rapid income growth occurring during 1953–63 was mildly unequalizing with respect to the Gini coefficient, although a comparison of Lorenz curves (Table 2) shows that not all inequality indices would be in agreement with that assessment: Lorenz curves cross at around the 90th percentile. Ensuing developments translated to an unambiguous fall in inequality during 1969–89 and an unambiguous increase during the decade of the 1990s, with the net result for 1969–99 being contingent on the conception of inequality.⁵ The bottom-sensitive Atkinson measure with parameter value of 0.8 estimates a fall of 10% while the top-sensitive Atkinson measure with a parameter value of 0.2 estimates an 11% increase.

In order to obtain an assessment of the economy's poverty reduction record during the early stages of growth, a measurement of pov-

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