

Fischer, Karin

**Article**

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## **Policy Reform and Income Distribution: The Case of Honduras**

*Karin Fischer\**

### *Introduction*

Honduras is one of the poorest countries in the Western hemisphere. At the same time, income and wealth are highly concentrated. The policy reforms carried out during past decades promised to reduce poverty and inequality by promoting the productive use of the most abundant asset of the poor – labour (World Bank 1990: 61). If one accepts the assumptions underlying the neoliberal reforms, the 1990s offered bright prospects: Honduras experienced a massive inflow of foreign direct investment (FDI), a surge in labour-intensive exports and

\* Vienna University of Economics and Business Administration.

an unprecedented growth of manufacturing employment. However, poverty remained widespread, per capita income stagnated, and workers' share in income fell. The article explores explanations from both orthodox and heterodox economic theories for the changes in relative income shares of labour and capital in Honduras during the past few decades.

### *The Neoliberal Response to the Crisis of the Late 1970s*

Policy reform in Honduras came about in two different phases: A distinctly Honduran stabilisation and adjustment program during the 1980s and a purely orthodox 'shock therapy' in 1990–1994. The program of the 1980s was designed against the background of popular revolution in the Central American region. Honduras played a strategically important role in the U.S. fight against communism and was awarded with 'military assistance' and a variety of economic programmes. A tenfold increase in aid from the U.S. government between 1979 and 1986 financed the growing external deficit and thereby allowed the country to resist international pressures to devalue the currency. Accordingly, structural adjustment in the 1980s was constrained by the need to control imports and inflation (Lapper 1985: 87, Thorpe 1996: 224f).

By the late 1980s, the Cold War was over, U.S. interest in the region had vanished and Honduras' creditworthiness had diminished. As the country was in desperate need for funds, the government of Rafael Leonardo Callejas (1990–1994) bowed to international pressures and devalued the national currency. Structural adjustment culminated in the purely orthodox 'shock therapy' as recommended by the International Monetary Fund (IMF) and the World Bank. The reform plan 1990–1994 consisted of a number of devaluations of the Honduran currency, the Lempira, interest rate liberalisation, price increases for public utilities and a cutback in public sector employment (Hernández 1992, Thorpe 1996: 227–229).

### *Economic Performance 1980–2000*

The early 1980s saw a marked decline in economic activity. Between 1979 and 1983, per capita income decreased by more than 10%. Although growth rates recovered towards the end of the decade, the average Honduran was poorer in 1990 than ten years before. Between 1990 and 2000, per capita income increased at the modest rate of 0.1% per year – too low to compensate for the decline in income during the 'lost decade' of the 1980s. In the year 2000, the average income of a person living in Honduras was still lower than it was in the pre-crisis years (see Table 1).

While the weak growth rates of the 1980s may be attributed to low rates of investment, the almost equally low performance of the 1990s is largely due to a massive fall in productivity. Despite an enormous increase in investment and a higher labour force participation rate, per capita income almost stagnated. Productivity declined precisely when the productive structure of the economy was reorganised towards exports, production was supposedly made more 'efficient', and massive efforts were undertaken to attract foreign capital (see Table 1).

*Table 1: Indicators of Economic Performance, Annual Average Change in % (Unless Otherwise Indicated), 1980–2000*

	1980–1990	1990–2000
Exports	0.5	7.7
Industrial production	2.5	3.3
Labour force participation	3.8	3.6
Investment to GDP ratio (in %)	18.0	25.0
Labour productivity	0.7	-3.0
GDP	2.5	3.4
GDP per capita	-0.8	0.1

*Source: Own calculations based on BCH, CEPAL (2003: 107, 111, 118, 125) and World Bank (2004).*

Conventional wisdom would suggest a positive relationship between productivity growth and the propensity to export. Not so in Honduras, where manufacturing export growth accelerated while productivity in the sector plummeted (see Table 2). Currency devaluation and the establishment of private industrial parks boosted investment and employment in assembly manufacturing (*maquila* industry). The former converted Honduras' labour force into one of the cheapest in the Americas; the latter provided the infrastructure for investment. Within a few years, the country developed into the leading assembly manufacturer in Central America and is now ranked fifth among major suppliers of clothing to the U.S.-market (Bair/Dussel Peters 2006: 205).

*Table 2: Manufacturing Industry: Value added, Exports, Productivity, and Shares in GDP and Total Exports, 1980, 1990 and 2000*

	1980	1990	2000
Value added (million U.S.-\$, 1995 constant prices)	427.7	573.2	857.8
Exports (million U.S.-\$, 1995 constant prices)	21.5	3.7	653.1
Labour productivity (1980 = 100)	100.0	127.3	66.7
Share in GDP (in %)	16.2	17.1	18.7
Share in total exports (in %)	2.4	0.3	31.0

*Sources: CEPAL (2003: 107, 111, 125) and FLASCO (2005: 147–149).*

The decoupling of export growth from productivity growth is symptomatic of the contradictions of the export-oriented strategy adopted. With globally dispersed production systems, export success is no longer a question of comparative advantage in the production of final goods, but of offering attractive conditions for processing a certain stage in the value

added chain. Instead of end products competing with each other, production locations and workers are put in global competition. Apparently, this is not the type of trade upon which Heckscher-Ohlin theory is based. It is trade initiated by the global sourcing strategies of transnational production networks, by which multinational companies and their junior partners in developing countries – the subcontractors – exploit the *absolute* advantage of low-cost labour in Honduras.

### *Wages and Employment*

The economic crisis of the late 1970s created an increasingly precarious situation for workers. In the 1980s, unemployment was markedly higher than at any time in the 1970s and real wages declined by about ten per cent over the decade (Hernández 1983: 34, Del Cid 1991). Conditions grew even worse after 1990, when President Rafael Leonardo Callejas suspended the 2:1 Lempira-U.S.-dollar convertibility and gave way to the devaluation of the currency. Real wages dropped by almost 40 per cent during the first half of the 1990s, raising the share of urban incomes spent for food products from 37 per cent in the late 1970s to 59 per cent in the early 1990s (Espíndola et al. 2000: 13, Dierckxsens 1990: 59, Thorpe 1996: 233). The resulting collapse of demand, coupled with rising input costs – up to two thirds of inputs to industrial production had to be imported – and higher interest rates, virtually drove every second firm in the country into insolvency and reduced job opportunities in the private sector by 30 per cent between 1990 and 1996 (STSS, Del Cid 1991: 43). At the same time, swelling poverty forced households to incorporate more of their members into the labour market, thereby causing an enormous increase in the labour force while wages and job opportunities were falling.

Productive restructuring in the 1990s was also directed towards the agricultural sector. The Law of Modernisation and Development of the Agricultural Sector (1992) promoted the enforcement of property rights in the rural sector and thus undermined the system of obligatory leasing of unused land, which had benefited the landless peasantry in earlier decades. Consequently, subsistence farming became less feasible as an alternative form of employment, and a large segment of the workforce (more than 15 per cent of the total labour force) migrated to the cities in search for wage labour. However, the urban sectors were incapable of creating productive jobs to employ the seemingly interminable flow of poor people. As with all new entrants into the labour market, unemployment was no option for the rural-urban migrants. Informal employment was the adjustment mechanism of the 1990s. Six out of every ten new jobs created throughout the decade were in informal activities, e.g., in petty trade or domestic services (Del Cid 2002: 24, Macías 2001).

While the domestic economy was shrinking and underemployment rising, the capitalist sector was restructuring production such as to benefit from the new cost advantage: cheap labour. The second half of the 1990s saw a literal boom in investment in assembly manufacturing. By the year 2000, the *maquila* industry created more than 100,000 jobs – three times more jobs than the banana plantations offered in their heyday of the 1950s and twice as many jobs as the entire manufacturing sector provided during the 1980s (BCH

2002: 9, Euraque 2001: 172, FLASCO 2005: 63). However, the employment dynamics of the *maquila* industry have rarely spread to the local economy, and wages in the sector have not generally been sufficient to lift a family out of poverty.

*Income Distribution*

During the early and mid-1980s, workers' share in total income was rising. Although rising unemployment was affecting the working class sectors, the burden of adjustment was mostly borne by capital. After 1986, however, labour's share in income started to decline. Between 1992 and 1995, it dropped from 54 per cent to 46 per cent. In the manufacturing sector, the fall in the wage share was even more dramatic; it declined from 47 per cent in 1992 to 35 per cent in 1996 (see Figure 1). Accordingly, between 1992 and 1996, there was a massive shift in income distribution in favour of the capitalist class.

*Figure 1: Labour's Share in Value Added in %, Total Economy and Manufacturing Sector, 1978–2000*



Note: National accounts do not report profit income from assembly manufacturing. Accordingly, BCH data has been adjusted for total output in the *maquila* industry as reported by Interiano (2004: 48–49).

Source: Own calculations based on BCH and Interiano (2004: 48–49).

*The Neoliberal Policy Recipe*

Theoretical support for the neoliberal policies came from marginal productivity theory and a vulgarised interpretation of its extension to foreign trade by Eli F. Heckscher and Bertil

Ohlin. Based on Stolper-Samuelson and factor price equalisation theorems, it has been argued that economic integration would raise the income of a country's abundant factor of production, i.e. labour in developing countries (Cline 1997: 45–46). Trade liberalisation was supposed to cause a reshuffling of resources in line with comparative advantage, thereby increasing demand for the abundant factor. Foreign direct investment would complement the favourable effect of trade by increasing supply of the scarce factor. As labour is becoming scarcer relative to capital, its share in income would rise.

Unquestionably, Stolper-Samuelson and factor price equalisation theorems rest on highly unrealistic assumptions and are hopelessly divorced from reality (Cline 1997: 36). But besides, there is a more fundamental problem: Heckscher-Ohlin trade theory and its refinements by Paul Samuelson all rest on a theory that has been demolished on logical grounds. Actually, there is no support from neoclassical theory for the proposition that a factor of production would be cheaper because more of it is available (see Bliss 1975: 85, quoted in Cohen/Harcourt 2003: 207). As the Cambridge controversies of the 1950s and 60s have shown, marginal productivity theory is logically inconsistent and unable to account for the distributive shares of capital and labour in a multi-sector economy.

It was for this reason that Paul Samuelson, when deriving the factor price equalisation theorem, used land and labour as the two factors of production (Samuelson 1948). And it is perhaps for the same reason that contemporary research rarely refers to the *shares* of capital and labour, nor attempts to rationalise rising profit shares as a response to a rising marginal productivity of capital (Galbraith 2001: 34). When inequality resurfaced as an issue in the economic discourse, the discussion shifted to wage inequalities. Factor income distribution is conspicuously absent from the mainstream debate, although there is considerable evidence of falling labour shares and rising profit shares all over the world (UNCTAD 1997).

### *Heterodox Theories of Income Distribution*

From a heterodox perspective, income shares are determined by the relative power of capital and labour in the production process. While Marxists stress the importance of the surplus labour pool in determining labour's strength in the wage bargain, Michal Kalecki focuses on the price setting decisions of firms. Prices are supposed to determine the level of *real* wages. They depend on the firms' power to impose a mark-up over costs, which, in turn, is a reflection of the degree of monopoly.

Heterodox theories focus on class relations rather than the mechanisms of perfectly competitive markets. In line with the classical tradition, they emphasise power relations between antagonistic classes, rather than treating factors of production and their income shares symmetrically. Income distribution is the outcome of a bargain between groups whose position in the market is entirely different. Whereas the capitalist class is the group owning the capital goods, the working class is the group owning only its labour power which it sells to the capitalist class. Demand for labour is therefore demand *on the part of capital*, while supply of labour is determined by alternative income opportunities (Sherman 1972: 51, Rowthorn 1980: 199–200).

For Marxist economists, the value of labour power (and hence the wage) is linked to the cost of its production and workers' average standard of living, but eventually determined in a bargain between the two classes. Workers' position is inversely related to the extent of the surplus labour pool, although a militant union organisation can offset to some extent the debilitating effects of unemployment. Marx lays great stress on alternative forms of production, and believes that the existence of non-capitalist modes of subsistence sets a minimum below which wages in the capitalist sector cannot fall. The supply of labour and the value of labour-power are therefore dependent upon opportunities available for work elsewhere, as a peasant, artisan, or state employee, and on the standard of living provided by these alternative occupations (Rowthorn 1980: 205–216).

In Kalecki's theory, class struggle finds expression less in the process of wage setting but more in mark-up determination. Accordingly, the share of profits in income is determined by the power of firms to set prices above costs. The higher the degree of monopoly, the higher the share of profit in value added; increasing competition tends to drive down the mark-up and increases workers' share in income. While trade unions may influence money wages, the real wage is beyond the control of workers and is ultimately determined by the pricing decisions of firms. In this view, inflation expresses a struggle over income shares between classes. The state plays a critical role in this process, since monetary expansion allows for the wage and price claims of workers and employers and hence for inflation (Arestis 1996: 15–19, Sawyer 1996).

#### *A Marxist-Kaleckian Interpretation of Changes in Relative Income Shares*

When Honduras began to feel the impact of the world economic crisis, the political and economic strength of the labour movement was substantial (Bulmer-Thomas 1987). In view of the revolutionary upheavals in the region, capitalists and the capitalist state had little choice but to accommodate, to a certain extent, the demands of the working class. At the same time, the price setting behaviour of firms was constrained by price controls and tight monetary policies designed to keep the 2:1 parity with the U.S.-dollar. In sum, labour was in a relatively strong position, and the burden of adjustment was placed on capital.

By the late 1980s, the Cold War was over and declining economic activity as well as several years of government repression had weakened the vigour of the labour movement (Posas 1990). When Rafael Leonardo Callejas came to power, the national currency was devalued and a Law of Agricultural Modernisation was passed, which enforced property rights for large landholders rather than access to land for needy peasants. While the former allowed price increases by employers, the latter caused a massive expansion of the surplus labour pool which curtailed the power of workers to defend their relative position. As a consequence, workers' share in income registered a catastrophic drop, particularly after 1992.

Devaluation played a crucial role in the redistribution process. Coupled with the elimination of price controls, it created the conditions for firms to raise prices vis-à-vis both foreigners and nationals. The high rates of inflation between the late 1980s and the mid-1990s were the expression of a distributive struggle, during which capitalists were able to increase



their share in total income at the expense of wage earners. Since then, the threat of relocation and constant repression of trade union activity in the *maquila* industry have kept the wage share at levels significantly lower than during the early and mid-1980s.

### *Conclusion*

In principle, there are two different ways to restore profitability in response to a crisis. The progressive way involves a reorganisation of the methods of production, so that productivity is increased and less labour is needed to provide workers with the minimum living standards acceptable (Rowthorn 1980: 211). Alternatively, the wage rate may be reduced, either by extracting more labour from workers for the same pay, or by reducing their pay. This is the conservative response. The massive decline in productivity during the 1990s, the sluggish growth rates, and the fall in workers' share in income suggest that Honduras eventually chose the second way to resolve the crisis. Lower wages rather than higher productivity had to bear the burden of creating competitiveness in the 1990s.

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