

**THE INFORMAL SECTOR AND ECONOMIC DEVELOPMENT IN
LATIN AMERICA: A BRIEF STUDY OF THE CHILEAN MODEL**

A Senior Scholars Thesis

by

JORDAN LEE

Submitted to the Office of Undergraduate Research
Texas A&M University
in partial fulfillment of the requirements for the designation as

UNDERGRADUATE RESEARCH SCHOLAR

December 2009

Major: International Studies

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ABSTRACT

The Informal Sector and Economic Development in Latin America: A Brief Study of the Chilean Model. (December 2009)

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A major hindrance to the achievement of steady economic growth is widespread informal employment, also known as the informal sector. The informal sector is a complex phenomenon which is pervasive in developing regions of the world such as sub-Saharan Africa, south Asia, and Latin America. It was my personal encounter with the informal sector while traveling through Peru in September of 2008 as a college student studying abroad that inspired me to further investigate this phenomenon. In this paper I will define what the informal sector is, the types of work performed within it, and how it came into existence. After a basic overview of the informal sector, the social problems and unproductiveness that widespread informal economic activity brings to a nation will be evident. The Chilean model for economic success is one that struggling Latin American economies can emulate, and this argument is well-supported after comparing data on Bolivia, Peru, and Chile and referring to various scholars who have researched the informal sector. Upon review of the economic and human development data and after exploring Chile's historical successes and controversies (the reign of terror under Augusto

Pinochet) we have gathered that institutions are the key to seeing economic development take place. Creating an atmosphere which honors the rule of law, democracy, and private property will transform countries that have been plagued by poverty for decades.

Constructing a framework favorable to economic productivity will allow the development process to take its course. Once development takes place, the informal sector will gradually diminish.

ACKNOWLEDGEMENTS

I would like to thank Dr. Hiroshi Ono, Assistant Professor of Sociology at Texas A&M University, for encouraging me to be a part of the Undergraduate Research Scholars Program. I would also like to thank him for his dedication and his willingness to assist me with this thesis during the spring and fall semesters of 2009.

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CHAPTER I

INTRODUCTION

An income-earning activity where the state does not regulate the business and where taxes are not collected is an informal form of employment (Saavedra and Tommasi 2007).

Unlike fully developed and advanced societies, a substantial amount of people throughout Latin America are not completely incorporated into legally regulated working environments. In the informal sector, workers are almost always unprotected by a “social safety net.” In fact only about 2 to 5% of the self-employed in Latin America have access to social security (Gwynne and Kay 2004).

There are various illegalities within the informal sector. Minimum wage laws do not exist, and there is no regulation of working hours. Failing to adhere to other rules such as registering with authorities so that the business activity is legally recognized, having your business subjected to health and security inspection, and paying taxes all qualify an income-earning activity to be informal and thus illegal.

Usually a minimal amount of technology is required to enter the informal sector, and workers operate on small scales where physical and human resources are scarce (Tokman 1989). Workers may choose to create their own means of employment, when unable to work in the formal sector. Employment in the informal sector is in many cases the only option for some individuals, but for others it is a choice.

This thesis follows the style of the *American Sociological Review*.

CHAPTER II

THE INFORMAL SECTOR IN LATIN AMERICA

Types of informal jobs

The informal sector is not homogeneous, and the different types of work within it are endless. Shoe-shiners, traveling street vendors known in Latin America as “vendedores ambulantes,” selling pirated CDs and DVDs as well as an assortment of other electronics and goods, small-scale producers of food such as street-side bakers and grillers, trash collectors who gather bottles and other refuse to be recycled, home-based hair-dressers and beauticians, street performers like jugglers and musicians, and unlicensed taxi-drivers are examples of workers who are employed in the informal sector. The amount of capital that informal sector workers require to operate their businesses differs as well. For example, an unlicensed taxi driver’s place of business is his vehicle. He must do any necessary repairs to his cab and ensure it is functioning properly, if he wishes to continue earning money. On the other hand, an activity such as trash collecting requires only a bag or basket in order to gather the items that will be recycled.

Informal sector workers earn unequal wages. A shoe-shiner and home-based beautician will likely make different amounts of money, and unlicensed cab-drivers will almost certainly make more money than street performers. Regardless of wage disparities within the informal sector, the difference in earnings and standard of living between formal and informal workers is usually substantial.

Origins of the informal sector

One explanation for the informal sector's existence is the failure of governmental systems. This view emphasizes the fracture between governments and their citizens. Individuals throughout Latin America lack "social contracts" with their governments. In other words, many people throughout the region do not consider their governments and authorities acceptable. Difficult barriers to gaining property rights, widespread tax and labor law evasion, oppressive business regulation, poor quality of state-provided social services (health and education), and skepticism towards the state's commitment to fairness and justice when dealing with all citizens (mainly that the rich receive preferential treatment) are causes for a fractured social contract between citizens and their governments (Saavedra and Tommasi 2007). Problems within the economic and social arenas are causes for the emergence of informal sectors within Latin America.

The absence of a "social safety net" as well as the people's perceptions that inadequate social protection systems (social security benefits and health insurance) are in place are two other major reasons for the informal sector's existence. Workers use cost-benefit analysis when deciding whether to work in the formal or informal sector. By working in the formal sector, an individual would contribute portions of his salary towards social security in order to receive benefits for himself and for his family. He would trust the government to adequately provide those benefits and protections if he became unemployed or unable to work for some time. Additionally, working in the formal sector prevents resentment among peers for being a "free-rider" or cheater of the system. Quite often in Latin America individuals decide against working in the formal sector. Why would an

individual who does not believe his government will adequately protect him choose to make payments towards social security? For this and among other reasons, millions of workers in Latin America choose to practice informal employment.

There is a widespread belief that if many other people are working in the informal sector, it might be easier for an individual to follow suit and work there too. Saavedra and Tommasi (2007) call this type of reasoning “multiplicity of equilibria.” Individuals conclude that if other people are not paying taxes and are not subjecting their businesses to state regulation and inspection, then the chance that they themselves will be prosecuted or sanctioned is less likely. There is a peer dynamic to informality that decreases the ethical constraints to violating the law. The greater the presence of informality among peers, the less harmful or immoral an individual might perceive his participation in the informal sector to be. If workers think they can either evade or bribe authorities who crack down on informal operations, they will employ such tactics to remain informal.

Cultural implications: Corruption and distrust

As Blake and Morris (2009) suggest, in Latin America corruption came long before democracy. Since the Spanish colonization of the region, paternalism, misuse of government revenues by politicians, and little adherence to the rule of law has afflicted Latin America. By denying justice, corruption is a direct threat to democracy. If politicians and institutions are perceived to be corrupt, the trust which citizens place in democracy is extinguished. Furthermore, there is an inverse relationship between corruption and democracy.

Latin America has some of the lowest levels of interpersonal trust in the world. Therefore, it is difficult for citizens to trust in institutions, democracy, and political leaders if trust amongst peers is scarce (Lagos 2001). In a 2005 Transparency International study done in 15 Latin American countries, police, the legislature, and political parties were identified as the most corrupt institutions according to citizens (Blake and Morris 2009). The ability to keep confidence in the rule of law is weakened when police are perceived to be corrupt or apathetic. The legitimacy of the state is then called into question, since law enforcement is a direct representative of the state for its citizens. What is the reason for the lack of trust throughout Latin America? It is often blamed on history and culture. Much of the distrust and corruption can be attributed to the Spanish imperial system and colonial legacy of exploiting indigenous resources and people (Buvinic et al., 2004). Latin America never had the chance to start off on the right foot, unlike the British colonies in Canada and the United States. The existence of hierarchical structures and social stratification has plagued Latin America for centuries (Lagos 2001).

A lack of trust by individuals in the judicial system is another factor contributing to the informal sector's existence. Individuals and firms in Latin America on average are far less trusting of their judicial systems than other regions of the world (Saavedra and Tommasi 2007). Many citizens do not believe that contractual and property disputes will be settled fairly. Judges are often perceived to be corrupt and in favor of the rich in legal matters. If the poor believe they will be victims of an unfair legal system, they will often choose not to comply with the law. Moreover, the informal sector could be considered a product of individuals' perception of the quality and fairness of the state's services.

As far as property rights are concerned, the barriers individuals must overcome in order to operate a business legally discourage many workers from making the necessary efforts to become formal. The Peruvian social scientist Hernando De Soto proved just how cumbersome it can be to clear bureaucratic road blocks. De Soto organized a team of researchers to register a fictitious small garments factory in Lima, Peru. De Soto's team encountered numerous obstacles as they attempted to make their firm formal or legal. Among the obstacles to be legally recognized was the team's requirement to obtain eleven different permits. The permit process lasted 289 days and would have cost the firm more than 30 times the monthly minimum wage in terms of fees and profits they could have made (De Soto 1989). Because of De Soto's ground-breaking work on informality, it is easy to understand why so many owners decide against formal sector employment in a mixed economy such as Peru. Many owners cannot afford to adhere to the high costs of formal employment. Excessive bureaucratic regulations and rules cause high rates of informal sector employment and are a hindrance to economic productivity.

The 2009 Index of Economic Freedom provides compelling data on countries. Among the 10 components of the index are property rights, freedom from corruption, and labor freedom. An overall score is given for each country after the 10 components are averaged together (an explanation of overall scores is given below the table). Chile is way ahead of Bolivia and Peru in the 2009 index (The Heritage Foundation 2009). The factors which constitute property rights include among other things: enforcement of contracts, protection of private property, and efficiency of the court system. These scores range from 10 (poor)

to 100 (best). The freedom from corruption component is based on a 10 point scale where a 10 signifies very little corruption and a 0 is very corrupt. Finally, labor freedom includes 6 factors including mandatory severance pay and rigidity of hours. The findings for Chile, Peru, and Bolivia are given in Table 1.

Table 1. 2009 Index of Economic Freedom Results

	Bolivia	Peru	Chile
Overall Score	53.6	64.6	78.3
Property Rights	20.0	40.0	90.0
Freedom From Corruption	29.0	35.0	70.0
Labor Freedom	41.9	48.7	75.0
World Ranking	130	57	11

Note: Overall scores denote the following: free countries 100-80, mostly free 79.9-70, moderately free 69.9-60, mostly unfree 59.9-50, and repressed countries 49.9-0. Results gathered from 2009 Index of Economic Freedom, The Heritage Foundation.

The indigenous, women, and exclusion

Social exclusion has been etched into Latin America's history (Buvinic et al., 2004).

Higher rates of poverty are usually found among populations which live on the margins of society including indigenous populations. According to research, indigenous populations experience high concentrations of low wages. Informal sector employment may be a result of discrimination. Occupational segregation which can be defined as discriminatory behavior in promotion and hiring is a determinant of low wages for excluded people such as indigenous populations. Bolivia and Peru have high percentages of indigenous

populations among Latin America countries. In these two countries, indigenous groups account for 60% of the population living below the poverty line. The indigenous populations in these two countries have higher rates of informal sector participation than the non-indigenous. In fact, in Bolivia more than 70% of indigenous people are employed informally compared to 59% of non-indigenous. In terms of decent working wages, more cumbersome than being indigenous, is being female and indigenous. In Bolivia and Peru, a significant share of working age indigenous women lack even a year of schooling. In fact, 39% of indigenous Bolivian women have no schooling, while that number is 10% for indigenous males. What must be done to change these shocking statistics? Measures must be taken to extinguish discriminatory practices in the workplace through more equal pay and by enacting merit-based promotions (Perry et al. 2006). Indigenous people must be reached out to by governments. Improved infrastructure such as better road access and communications need to be reaching those who live further away from the technological gird. The language barrier needs to be addressed as well. Many indigenous people in Bolivia and Peru may not speak Spanish at all. Quechua and Aymara are very commonly spoken languages among indigenous populations. There needs to be a commitment between government and the indigenous bodies that communication will not be impaired because of language barriers. Both parties need to do their part to learn the other's language. Last, the gender disparities must be resolved. Education needs to be accessible for impoverished indigenous populations, especially among women.

CHAPTER III

THE COSTS OF INFORMAL SECTOR EMPLOYMENT

Social ills and the informal sector

There are a number of disadvantages associated with employment in the informal sector. As stated earlier, for the vast majority of informal workers, social security benefits and health coverage is absent. In addition, these workers are usually less educated than formal workers. Much of the informal population of workers is female, and females in developing countries often lack the same access to the labor market as males. Therefore, informal work is often the only option for a poor female aspiring to earn an income. Women usually have a higher percentage of informal sector employment than men. In Latin America, 58% of women compared to 48% of men are employed in the informal sector (WIEGO 2008). These workers often encounter cumulative disadvantages and become trapped in a cycle of poverty. Individuals with less human capital often find themselves working in the informal sector. Since informal workers lack the human capital that most formal workers possess, informal workers earn far less than their formal sector counterparts. With less human capital, an individual's job opportunities are more limited, and the quality of life that is attainable is much lower than an individual with more human capital. In addition, access to credit in the informal sector is scarce.

In Table 2, I present statistics on birth rates, percentage of primary school education, and percentage of secondary school education for the countries of Bolivia, Peru, and Chile. It is more difficult for large families in developing countries to escape the cycle of poverty.

High fertility rates are one of several characteristics of lesser developed countries, for having a high number of children can be economically stressful for poor families.

Education levels attained by children are important when viewing levels of development. However, the education levels of parents are a component which may affect whether or not children stay in school (Dion 2007). There is a positive relationship between parents' income and the educational attainment of their children (Perry et al. 2006). In addition, large, poor families have a difficult time generating the necessary amount of income to provide food and other basic needs. Because of this, parents may force their children to start working at young ages in order to make money for the family. As stated above, with less human capital, an individual is limited in the number of employment opportunities from which to choose. The choices are often low-paying and informal jobs. Eventually these children with small amounts of human capital become adults and decide to start their own families, and the process of children being born into poverty is very likely to continue. For poor families, a juggling act takes place between educational investment and subsistence needs. It is common for families to invest in their children's education so long as it is cheap. Once the investments become costly, parents may discontinue their children's schooling. Other factors such as lack of academic performance by the children and the difficulty in attaining better quality education may also cause parents to cease investing in their children's educations. Alonso (2007) concludes the limited social mobility which translates into poverty reinforces the fact that poverty of one generation is highly predictive of the poverty of the following generation.

Table 2. Birth Rates and Educational Attainment

	Bolivia	Peru	Chile
Birth rate (births per 1,000 people)	22.3	19.7	14.8
% of students finishing primary education	87.9	94.2	95.8
% of students finishing secondary education	30.2	59.2	67.5

Birth rate source: CIA World Fact Book, 2009; Percentage completed of primary/secondary education source: IADB, 2008

Social ills are also a result of poverty in the informal sector. In many instances, informal workers live along the margins of a society. The phenomenon of “social exclusion” is common within informal circles (Gwynne and Kay 2004). Many of these individuals interpret the world to be a hostile and unfair place. A fatalistic view of life known as the “learned hopelessness syndrome” invades the lives of these informal workers. This is where an individual ceases to believe that his personal efforts have any effect on his situation. Therefore, an individual may become less productive when the incentive to work hard is absent.

A significant amount of the economically active population in Latin America has not gained access to formal and productive work. Approximately 50% of all workers in Peru fit into this category, and 25% of the population in the major cities throughout Latin America do not hold steady jobs or earn a regular income. Estimates also reveal that half of all urban firms in Bolivia are completely informal.

The well-being of a nation (not just the lives of individuals) is also at stake, when a large percentage of the population holds informal jobs. The identities of $NI = C + S$ and $NI = C + I$, where “NI” is national income, “C” is consumption, “S” is savings, and “I” is investment, explain that consumption plus savings or consumption plus investment equals the national income. The money required to finance investments is pulled from the national pool of savings. Investing in projects such as building schools, hospitals, and better and more efficient roads can improve the quality of life for a country’s citizens.

Remember that individuals and firms operating informally almost always evade taxes. If the government is unable to collect taxes from more than half of its population in the cases of Peru and Bolivia (see the table on page 13), there will be far less tax revenue collected in those countries. Furthermore, the amount of money that would go to the savings pool and ultimately be used for investments is severely diminished.

Next, apply the concept of consumption to the individual. Again it is clear why the informal sector is economically unproductive. Since many informal workers make such poor wages, they have less disposable income. Less consumption of goods and services results in slower economic growth.

Development and informal sector prevalence: A negative correlation

Countries with smaller shares of their population employed in the informal sector are more developed than countries with large shares of their population employed in the informal sector. One variable used to determine a country’s economic growth is the GDP per capita

or per capita income. Factors used to measure the levels of human development of a country, which are also telling in the level of economic development include: literacy rates, life expectancy, and infant mortality rates. For a look at how Chile compares to Bolivia and Peru, see Tables 3 and 4.

Table 3. GDP per Capita and Human Development Determinants

	Bolivia	Peru	Chile
GDP per capita (adjusted to PPP)	\$4500	\$8400	\$14,900
Adult literacy rate (%)	89.8	88.7	96.4
Life expectancy at birth (years)	65	71	78
Infant mortality rate (per 1,000)	44.6	28.6	7.7

GDP and infant mortality rate source: CIA World Fact Book, 2009; Adult literacy rate and life expectancy at birth source: UNDP Human Development Report, 2006.

Table 4. Urban Population Employed in Informal Sectors of the Labor Market

	Bolivia	Peru	Chile
% of Working population employed informally	62.5	64.6	30.7
% of Male workers informally employed	56.4	58.1	25.6
% of Female workers informally employed	70.6	72.5	38.2

Data collected on informal sector employment is most recent available data for each country, Bolivia (2007), Peru (2003), and Chile (2006). Source: ECLAC (Economic Commission for Latin America and the Caribbean) CEPALSTAT.

How can these three neighboring South American countries differ so greatly in human and economic development? Has Chile separated itself from the rest of the pack in Latin America? Greater human development through solid institutional reform will naturally decrease the percentage of workers in the informal sector. When more workers are incorporated into formal, legalized, and regulated employment, better conditions for economic productivity will prevail. According to Madoery (2008), a group of phenomena which take place at the local level such as innovation, creativity and the ability to enterprise are linked together in the process of development. A commitment by both individuals and the state is necessary for growth and productivity to take place.

CHAPTER IV

THE CASE OF CHILE

Chile by the numbers: World rankings

When it comes to poverty reduction, Chile is one of the leaders in Latin America. In 1990, when the Pinochet regime came to an end, 38% of Chileans were living below the poverty line. Statistics compiled by the Caracterización Socioeconómica Nacional (CASEN) reveal that by 2006 that number had been lowered to 13% (Isabel 2007). In the 2008 Human Development Report, Chile was ranked 40th out of the 179 countries studied; Chile was ahead of European countries such as Slovakia and Estonia. The human poverty index (HPI) compiles the development indicators of: likelihood of living a long and healthy life, access to education, and a decent standard of living. Chile had the 8th best HPI ratio out of the 135 developing countries measured; Peru and Bolivia were ranked 49th and 56th (UNDP 2008). The 2009 Index of Economic Freedom ranks Chile at #11, ahead of countries such as the Netherlands, Iceland, Finland, and Japan (The Heritage Foundation 2009). In order to understand how Chile has separated itself from its Latin American neighbors, it is necessary to review some 20th century Chilean history.

Salvador Allende and Augusto Pinochet

Chile, a country with a long and enduring democratic legacy, applied the import substitution industrialization model (ISI) as a development strategy like other Latin American economies during the mid-20th century (Torche 2005). As social problems and inequality among Chileans increased, redistributive reforms in education and agriculture

were implemented in the 1960s and early 1970s. Salvador Allende, the first democratically-elected Socialist president in history, brought leftist politics to Chile. His vision of a socialist Chile required significant state control of enterprises as he nationalized large industries such as copper mining and banking and implemented new government programs that would provide peasants and commoners with work in factories and on farms (Stillerman 2006).

Military and political opposition from within Chile as well as external forces fearing a new communist regime in the hemisphere disrupted Allende's plan for a peaceful socialist revolution. Chile found itself in a state of political and economic disarray as Allende's reforms were met with strong opposition by much of the population.

On September 11, 1973 the Chilean armed forces successfully overthrew President Allende, storming the presidential palace, La Moneda with air force bombers and army tanks. Within La Moneda, Salvador Allende took his own life rather than being captured and probably executed. The military junta, led by General Augusto Pinochet commander of the Chilean army, suspended the constitution and embarked on a witch hunt of any leftist opposition. Gen. Pinochet aimed to extinguish Allende sympathizers and to forcefully grab hold of a feeble economy through authoritative measures.

After the junta struggled to see improvements in the debilitated economy, they turned to a group of Chilean economists known as the Chicago Boys. Originally economists at the Catholic University of Chile, the Chicago Boys were sent to the University of Chicago as

exchange students in the early 1970s. While studying under Milton Friedman and Arnold Harberger at Chicago, the group came to embrace the free-market ideals of minimal government interference in markets and distrust for state planning. The Chicago Boys returned to Chile, and they met weekly to discuss economic policies they believed could fix the ailing Chilean economy under Salvador Allende (WGBH-Boston Video 2003).

When Gen. Pinochet turned to the Chicago Boys to resurrect the economy, free market reforms swept Chile and changed the country forever. Around 500 state-owned businesses were privatized, government budgets were diminished, exports increased, and price controls were eradicated. Chile was on its way to becoming the world's poster child of free-market economics. Unlike the Allende administration's emphasis on a collective society, Pinochet's regime celebrated neo-liberal ideology which extolled achievements of the individual. Because of the economic reforms, the Chilean society transformed from collectivism to consumerism (Silva 2004). Since the military takeover in 1973, Chile had privatized enterprises, liberalized trade, and transformed its economy from a state-intervening closed model to arguably the most open economy in the world (Torche 2005).

The Chilean economy took off, but the transformation did not come free of great human costs. The gap between poor and rich was greatly increased during the Pinochet regime. While it had become a consumer society, Chile had also become socially stratified as inequalities among the population were widespread (Silva 2004). Income inequality in Chile is in fact still a social ill today. According to Torche, (2005) Chile is the 10th most unequal country in the world. The ratio between the wealthiest 10% and the wealthiest

20% is twice as large in Chile as it is in the United States and the United Kingdom. There is a high concentration of wealth, as 42% of the income is possessed by the top 10%.

While there is less inequality throughout the rest of the Chilean class structure, it should be noted that Chile's economic growth over the years through free market reforms has led to the problem of inequality.

In addition to inequality resulting from neo-liberalism, the Pinochet regime was a repressive and authoritarian force. It is estimated that between two and three-thousand people were either killed or disappeared during the Pinochet years. Thousands of human rights violations were committed, and a "red-scare" swept the nation as Pinochet's military and police forces harassed, detained, tortured, and killed suspected "dangerous" leftists. Liberal priests, artists, musicians, intellectuals, and students among others were victims of the atrocities under Gen. Pinochet's regime.

Post-Pinochet Chile: Restoration of democracy and institutions

The free-market economics model adopted during the Pinochet regime has remained in place since his departure from office in 1990. Unlike Pinochet, under whom the percentage of citizens living below the poverty line was just below 40%, the subsequent administrations have made investments in human capital a priority (Valenzuela 2007). Significant improvements in the accessibility of education and health care have greatly reduced unemployment and poverty in Chile. However, human and physical capital is not alone sufficient for the process of development to occur. Alonso (2007) notes:

The accumulation of physical and human capital as well as technological progress are held as primary factors (in explaining the process of development), but alone they are not able to explain the achievement of the process in its international environment that is very unequal at its core.

Political parties from the left, center, and right were free once again to voice opposition, when Gen. Pinochet's regime came to an end in 1990. The various parties of the Concertación, a coalition of center-left political parties including the Party for Democracy, Christian Democrat, and Socialist Party, have brought back that which was eradicated during General Pinochet's 16 year reign- legitimate democracy (Valenzuela 2007). The Concertación, which has won every presidential election since democracy was restored in 1990, is currently led by Michelle Bachelet. If there exists today a world leader committed to the transparency and accountability of government, it is President Bachelet. It should be noted that Ms. Bachelet and her parents were detained by the Pinochet regime in 1975. Ms. Bachelet said the following words when addressing the UN General Assembly on September 20, 2006:

I come from a country where today the rule of law prevails, where the rights of every persons are respected and promoted. A democracy that is experiencing economic growth and that in the past 16 years has helped millions of Chileans out of poverty...we wish to reaffirm our commitment to international law and institutions. Only through them shall we be able to build this fairer and more integrated world of which we dream, where large and small coexist in peace and harmony.

Mrs. Bachelet's proclamation that institutions play a crucial role in fostering a sound environment favorable to democracy has been widely hailed throughout the world.

Institutions have been emphasized throughout history. Alonso (2007) agrees:

Intertwined with the English liberal philosophy of Locke, Smith, and Stuart Mill, who contribute a significant amount to the economic doctrine, is the contention that liberal order and property rights are instrumental to progressiveness.

Perhaps nobody has illustrated the importance of institutions better than Douglas North, recipient of the Nobel Prize in economics. The incentive structure of a society is reinforced by its institutions. Thus, economic performance is determined by that society's political and economic institutions (North 1994). In other words, institutions- laws, social norms, and codes of conduct- are the "rules of the game" that the "players" such as politicians, firms, and citizens must follow. The enforcement of rules and laws which punish violators is of the utmost importance. In a society where there is no institutional framework in place to punish unlawful behavior, criminal behavior will be accepted and even rewarded. On the other hand, in a society where institutions reward productive and law-abiding behavior, legitimate businesses will operate and thrive. Leaders from the high ranking officials in government to the common low wage workers must all be held equally accountable under the law.

Social and economic policy

While in office, Ms. Bachelet has maintained a dual mentality when implementing social and economic policies. That is to say the administration has embraced the free market system, while creating programs dedicated to helping the poor. A "social safety net" has been in place since democracy was restored. One example of a government program that assists poor families in Chile is Chile Solidario, a conditional cash transfer program (CCT). Through this program and similar programs in Brazil (Bolsa Familia) and Mexico

(Progresa), poor families are rewarded with small monthly stipends for ensuring their children maintain high attendance rates at school. The families also meet with social workers who assist them in finding jobs (Epstein 2008). Abiding by the CCT's guidelines provides families with financial assistance and strengthens the human capital of younger generations. Greater national savings and investment has been an effective solution to the problem of poverty. Chile's gross domestic savings and investment rates were among the highest in Latin America in the late 1990s (Valenzuela 1997).

CHAPTER V

CONCLUSION

After examining the social problems and limited productivity associated with informal sector employment, analyzing the factors that lead to the creation of the informal sector in a country, and understanding that there is a negative correlation between informal sector employment and economic development, it is clear the Chile has established itself as a country for less developed Latin American countries to follow. Chile outperforms other Latin American countries in adult literacy, life expectancy, GDP per capita, and has lower infant mortality rates. In addition, Chile has a lower percentage of its working population employed in the informal sector.

Both physical and human capital aid the development process. Higher rates of national savings allows for the creation of new hospitals, schools, roads, and other projects, providing a better quality of life for the citizens of a country. Improved roads will increase efficient transportation for citizens that live in areas further away from the cities.

Education is probably the single most important aspect in escaping the poverty trap.

Conditional cash transfer programs (CCTs) are excellent resources for poorer families to receive small stipends to cover living expenses, so long as the children of these families are staying in school. Job training through the CCTs is also an efficient form of assistance to poorer individuals seeking employment. Nonetheless, it must be restated that human and physical capital is necessary but not alone sufficient for the development process to take place. Governments need to take more serious measures to combat workplace

discrimination. Promotions need to be unbiased and merit-based. Indigenous populations and women must receive fairer treatment in the labor market. Social exclusion must be addressed by countries which have high indigenous and informal sector populations such as Bolivia and Peru. Where development has begun to take place, human and physical capital can be facilitators for further development.

Institutions are most responsible for creating a sound environment favorable to economic development and growth. The rule of law, democracy, and a respect for human rights among other institutions provides the legal framework and codes of conduct that citizens must follow. Where solid political and economic institutions exist, economic performance and a system of incentives are reinforced (North 1994). Thus, through incentives, individuals are rewarded for their productivity. The state plays a part in economic development to be sure. As we have seen, governments that provide social safety nets such as CCTs are instrumental to assisting the poorest citizens. The “dual mentality” embraced by Chile has shown itself effective. The state’s role and individual efforts walk side by side as economic growth and development continue.

Countries with large populations employed in the informal sector must start by lifting excessive rules and regulations that are a direct cause for informal sector employment. Where rules and regulations burden a country, corruption is bound to exist. If citizens cannot abide by the rules and regulations (such as those which De Soto’s team encountered in Peru) in order to open up formal businesses, they will do one of two things: pay bribes to local authorities or operate informally and hope that they are not caught. While those

who collect the property payments and fees that precede formal employment benefit, the vast majority of the citizens who cannot pay them (in the case of Peru, 64%) decide to work in the informal sector. A commitment to fairness from national leaders is necessary. Corruption must be taken seriously by Latin American governments. The judiciary, law enforcement, and politicians must come to a consensus and end corrupt dealings. Bribery must stop, and complacency towards dishonesty has to end. Without accountability from the state, the people will never comply with the law. The centuries old tradition of cheating will ravage the region for more centuries if action is not taken. The development process will be static as long as corruption pervades Latin societies. When institutions are established that form a framework favorable to economic productivity, the development process will begin. Once development takes place, the informal sector will gradually diminish.

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