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Firms and inequality in Latin America

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WORKING PAPER N° IDB-WP-01587

Firms and Inequality in Latin America

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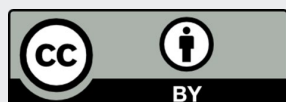
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Firms and inequality in Latin America

Marcela Eslava, Marcela Meléndez, Gabriel Ulysea, Nicolás Urdaneta and Ignacio Flores.¹

JEL Codes: E2; J21; O54

Abstract

The relationship between firms and inequality has been a focus of recent attention globally. This chapter summarizes basic facts about this relationship for Latin America. Unlike advanced economies where superstar firm growth has prompted concerns over disproportionate income growth at the top, the facts we summarize illustrate that the main concern for Latin America is the extreme prevalence of tiny businesses whose workers and owners tend to populate the bottom income segments. The empirical likelihood that these businesses improve their productivity and grow to hire more workers and pay better wages is also very low. The region displays a deficit of employment generation in SMEs, by contrast to both microbusinesses (including self-employment) and large corporations. While the former tend to remunerate both workers and owners with very low incomes, the latter pay high wages but also exhibit low labor shares.

Introduction

The relationship between firms and inequality has been a focus of recent attention globally. In recent decades, rapid growth by superstar firms has led them to seize an increasingly large share of their respective markets, with gains concentrated in their shareholders. As a result, at least in the developed world, the fraction of income and wealth in the hands of the richest individuals has grown since 1990, while the labor share of national income has

¹ The authors thank Laura Tenjo for her excellent assistance in generating some of the figures in this chapter.

shrunk, and average market power has increased.² The role of firm size and firm growth in inequality has thus become a focus of attention.

Business size/growth is also crucial to understanding inequality in Latin America, as illustrated by a series of recent studies. First, Latin American economies are unique in exhibiting extremely skewed market structures when business size is measured by the number of workers. Most of the employment creation in the region is concentrated in businesses with at most ten employees, with close to half of workers in that segment actually self-employed without employees (i.e., in one-person businesses). This stands in sharp contrast with more advanced economies across the world. While in the region close to 70% of workers are in these business size categories, the figure falls to less than 30% for high income economies, where most of the employment occurs at firms of 10 or more employees (Eslava et al, 2023).

Second, business size matters for inequality in the region. There is a close correlation between personal earnings and the size of the business where the person works, in Latin America much more than in more prosperous regions. For instance, only 3% of workers with earnings in the bottom decile work in businesses with more than ten employees. In contrast, this category absorbs 55% of the workers in the top earnings decile. (Eslava et al, 2023)

Understanding the relationship between business size/growth and inequality is thus also crucial in the region. This chapter lays out the basic facts about this relationship. Eslava et al. (2023) use information from household and employment surveys to illustrate the entire distribution of workers in Latin America across business sizes, including self-employed activities without employees. This type of data allows a comprehensive look at productive activities (all employment-generating activities), including those occurring in businesses not covered by firm-level information. Such a comprehensive view is crucial precisely because of the fraction of activity corresponding to this type of business in the region. At the same time, it comes at the cost that only the employment-weighted business size distribution can be characterized. After a broad look at Eslava et al.'s findings regarding the employment-weighted business size distribution in section 2.1, we move to firm-level data sources in section 2.2. Firm data allow us to provide a more thorough description of business size structure and growth across firms-size categories, though only for the employment at firms covered by these sources, leaving out the self-employed without employees and, in many cases, employment at the smallest units. Section 3 then characterizes the relationship

² See Autor et al. (2020); Karabarbounis and Neiman (2014); Kavoussi (2019); De Loecker, Eeckhout, and Unger (2020).

between business size and inequality in Latin America, both from sources that use household surveys and others based on firm data.

2. Latin America's skewed business size distribution

2.1. The economy-wide business size distribution

This subsection summarizes findings on the economy-wide business size distribution (employment-weighted) from Eslava et al. (2023) based on employment/household surveys. As highlighted in the introduction, the most outstanding feature of the employment-weighted average business-size distribution in Latin America is the vastly predominant weight of tiny businesses. The fraction of workers who work independently without employees, or in a business with at most ten employees, i.e., a microenterprise is only around 20% in the US and Japan, close to 30% in the richer economies of the European Union and rich economies of Asia, and 40% in European economies with per capita GDP below the continent's mean. Meanwhile, these business arrangements account for almost 70% of employment.

Within microenterprises with at most ten workers, the most outstanding measurable differences with comparator economies emerge in the smallest sizes. Businesses with up to 5 workers carry a weight of almost 30% in these LATAM economies and a much lower weight in all comparators. For the US, Japan, and Australia, the figure is closer to 10%. The larger size category is likely more skewed toward the right-hand side of the distribution in the richer economies, as suggested by the size bins in household surveys. Only three of the Latin American countries in Eslava et al.'s (2023) sample report the 500+ employees' category, and most consider 200+ employee businesses to be large, signaling there may also be substantial differences in the worker distribution across firm sizes at the very top.

The distribution of employment across business sizes is reminiscent of the idea that LATAM displays a missing middle, where a robust segment of SMEs has not materialized. In particular, they find that Latin American economies display *lower* fractions of workers in businesses between 10 and 50 employees than their level of development would predict, and that this occurs because there is more self employment than in economies with similar levels of GDP per capita. Also, the employment distribution is U-shaped across business sizes, with more mass for businesses below 10 and above 50 or above 100 employees than in the intermediate categories. It is also the case that the largest firm size bins are much thinner in Latin America compared to advanced economies. For example, firms over 50 employees absorb 20% of employment in the region, vs. 60% in the U.S. and over 40% in the European Union. Yet, the absence of a more robust middle is particularly surprising,

because it does not support the notion that the smaller business size in LATAM is *solely* a manifestation of individual businesses displaying lower productivity, or a feature that will disappear spontaneously with economic growth. Instead, it suggests that barriers in the business environment are particularly tolling for the emergence of an SME segment capable of both absorbing significant labor and bringing meaningful competition to the product and labor markets.

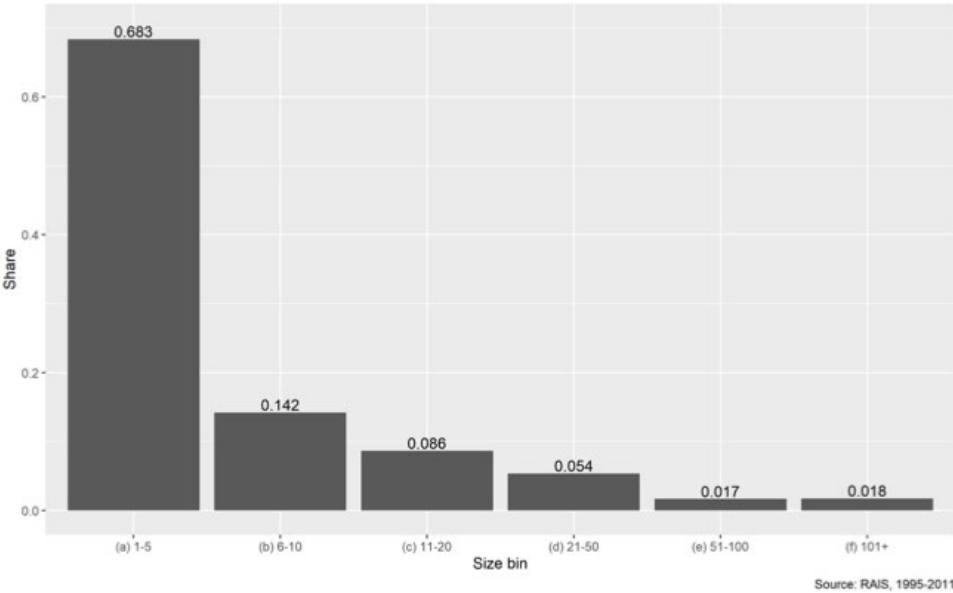
2.2. The business size distribution from firm-level statistics

The numbers presented thus far are based on employment or household surveys for a series of countries. These have the advantage of covering all the employment-generating economic activity in each country and being relatively easy to compare across countries. At the same time, they lack additional information on the businesses where workers generate their income. We, thus, now move to findings from firm-level data sources for specific countries. Based on these sources, we discuss findings related to the unweighted firm size distribution in Latin American countries and the patterns of firm growth behind the stationary distribution.

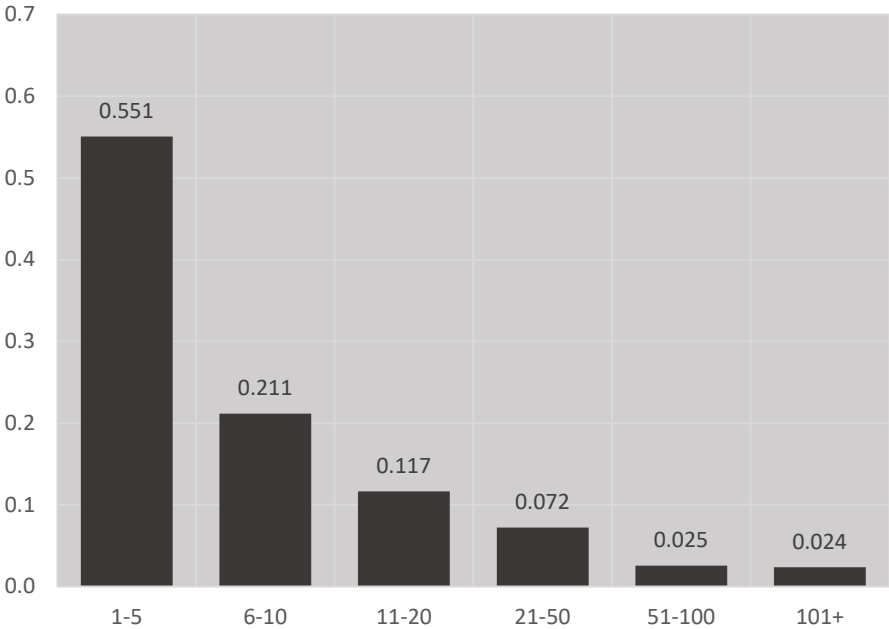
Firm-level data sources differ across countries in terms of their coverage. We discuss findings from Blundell et al. (2022) using the Economic Census in Mexico, the RAIS employer-employee matched data for Brazil, and secondary sources that use Annual Manufacturing Surveys for other countries. The most comprehensive of these databases is the Mexican Economic Census, which covers all productive units with an identified location, fixed or not, registered or not in administrative data sources. Even this very comprehensive dataset, however, misses a large proportion of economic activity, as evidenced by the fact that the number of workers captured in the Census is around 50% of the total number of workers in the economy (Busso et al., 2012).

We start by showing the firm size distribution in the formal sector for both Mexico and Brazil in Figure 1. It confirms that the vast prevalence of small businesses indicated by the evidence from worker-level data discussed in the previous sections is confirmed even if one focuses on formal sector data only. As Panel (a) shows, more than 85% of all formal businesses in Brazil have at most 10 (formal) employees, while Panel (b) shows that this fraction is a bit smaller in Mexico, with 76.2% of all formal firms. In Figure 2, we further explore the unique feature of the Mexican Census, which also covers informal firms, and we contrast the firm size distribution in both sectors. As expected, informal firms are even more concentrated in small-size bins, with around 93% of informal businesses being smaller than ten employees. Perhaps more interesting is that the data shows a non-negligible mass of informal firms even at large-size bins, with more than 6 thousand informal firms declaring more than 101 employees.

Figure 1. Formal firms' size distribution



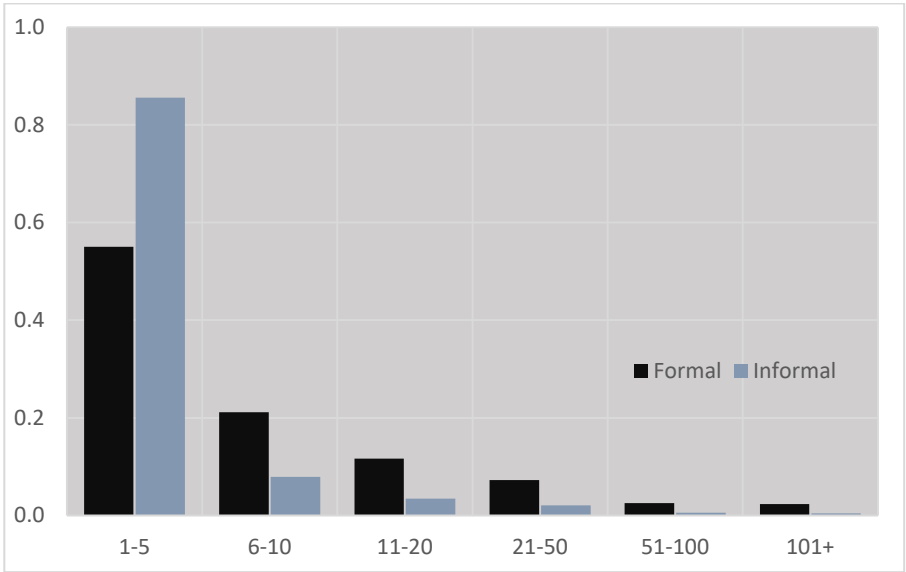
Panel (a): Brazil



Panel (b): Mexico

Source: Blundell et al. (2022)

Figure 2. Formal vs. Informal firm size distribution in Mexico

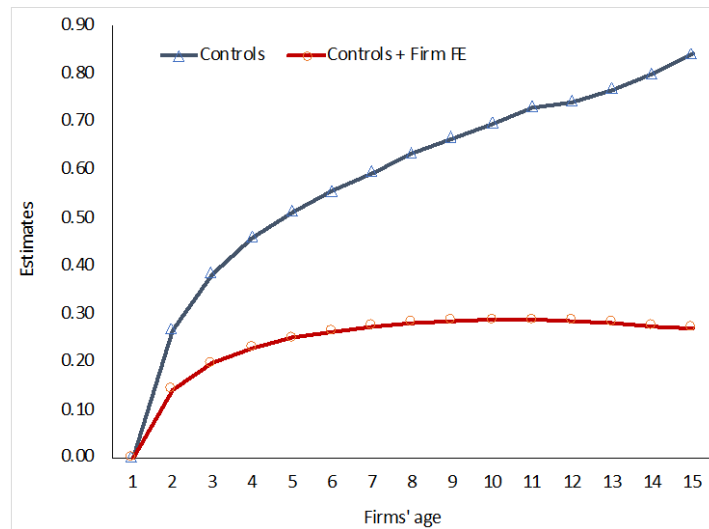


Source: Blundell et al. (2022)

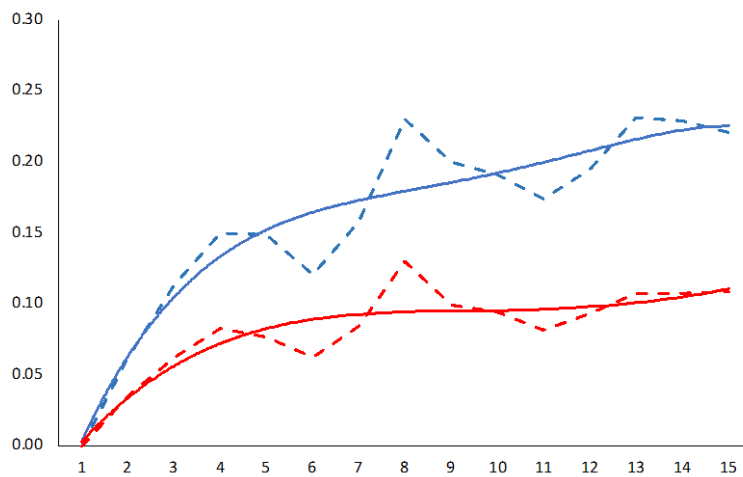
2.3. Firm dynamics

So far, we have provided a completely static picture, focusing on the stock of firms and jobs in the economy. However, an equally important dimension is the dynamics of firms’ outcomes, and in particular firm growth (or its lack thereof). Of course, the fact that most firms are concentrated in small-size bins is suggestive that firm growth must be slow on average. Figure 3 shows the estimates of age dummies’ coefficients in a regression with the logarithm of firm size (measured as the number of employees) as the dependent variable and additional controls for firm characteristics (such as location and industry) and firms’ fixed effects, from Blundell et al. (2022). The figure shows that firms in Brazil and Mexico – Panels (a) and (b), respectively – experience some growth over their life cycle. However, once firms’ fixed effects are controlled for, the growth profile is quite flat after age 4.

Figure 3. Formal firms' growth – Brazil and Mexico



Panel (a): Brazil



Panel (b): Mexico

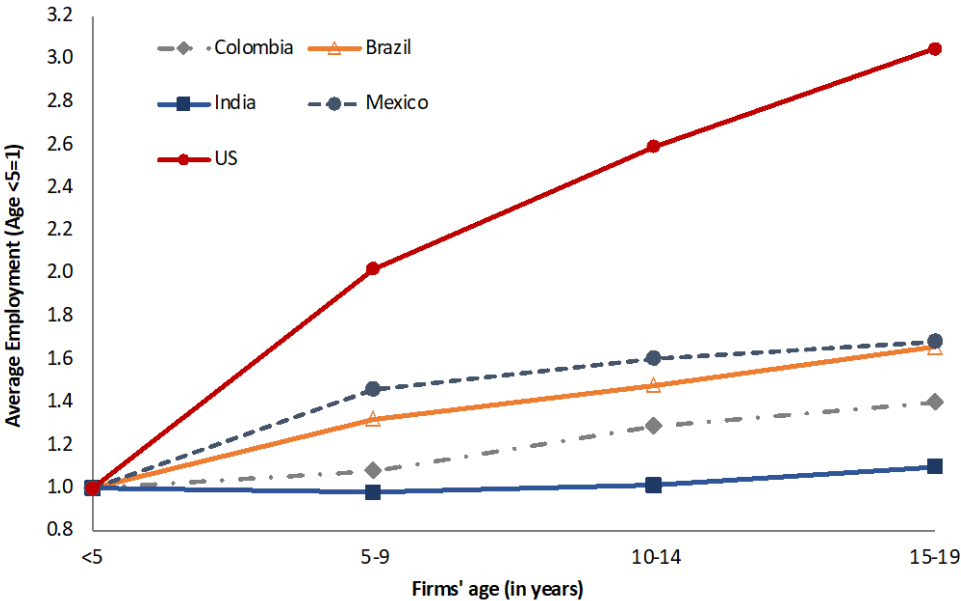
Source: Blundell et al. (2022)

To put the results displayed in Figure 3 in perspective, we compare firms' growth in Mexico, Brazil, and Colombia with that observed in India and the US. The latter is the benchmark against which we assess all countries, while India provides an important reference point within low- and middle-income countries. To do that, we combine the results from Hsieh and Klenow (2014) on India and the US with the data for Brazil from Blundell et al. (2022) and results from Eslava et al. (2022) on Colombia. Figure 4 shows that firms in the three Latin American countries grow much less than those in the US, with Colombian firms

displaying the flattest growth profile among them. Colombian plants aged 5-9 years are only 8% larger than those aged 0-4, while their comparable number for the US is around 100%. The growth profile of Indian firms, however, displays a much more drastic shape, with firms displaying, on average, zero (and at points negative) growth over their life cycle.

Eslava et al. (2022) also present entry and exit rates and transition rates to over ten employees from less than 10 (and vice versa) for manufacturing plants in Colombia vs. the US. They use actual data on some of these rates and calibrate others to match the steady-state size distributions. Their data comes from the Business Dynamics Statistics for the US, from the Colombian 2005 Census for the steady state distribution of manufacturing establishments and from the Annual Manufacturing Survey for some transitions for plants over 10 employees, simulating the unobserved rates as the transitions necessary to fit the steady state distributions. They find that all these rates are substantially larger in the US compared to Colombia, in most cases by factors in the vicinity of 8-9. Exceptions are the exit rate of establishments under ten employees, which they estimate to be almost 13 times larger in the US than Colombia, and the transition (contraction) from over 10 to less than ten employees, which in their calibrations is similar between the two countries. In other words, the manufacturing sector in Colombia exhibits much less entry and much poorer growth of plants. Particularly interesting is the category of tiny plants under 10 employees (micro-establishments). Not only there is significantly less entry of these type of plants than in the US, and less likelihood that they grow sufficiently to outgrow the micro category, but once a micro establishment emerges it is very unlikely that it exits.

Figure 4. Firms' growth profile



Source: Blundell et al. (2022); Eslava et al. (2022); Hsieh and Klenow (2014).

3. Business size and inequality in Latin America

3.1. Earnings vs. business size for the universe of workers

Business size is crucially linked to earnings inequality, not only in developed economies, as emphasized by recent literature, but also in Latin America. Indeed, within the formal sector, Alvarez et al. (2018) have shown that the reduction of between-firm inequality explains most of the decline in wage inequality observed in Brazil in the past two decades, which is the mirror image of the trends observed in developed economies such as the US and Germany. They argue that changes in observable workers' and firms' characteristics contributed little to these patterns. Instead, the observed decline is due to a compression of returns to these characteristics, including firm size and, in particular, a decline in the wage premium associated with firm productivity.

Beyond the formal sector, the link between firm size and inequality in LAC is largely driven by a correspondence between working own-account or in microbusinesses and having very low earnings. The top panel of Table 1 shows tabulations of how workers in different quintiles of earnings in the region are distributed, depending on whether they work on their own or are associated with businesses with under five employees or to larger businesses. These calculations are based on ECLAC's database of household surveys for Brazil, Chile, Colombia, Costa Rica, Mexico, Peru, and Uruguay. The percentages of self-employed workers and those in businesses under five employees markedly decrease between the lowest and highest earnings quintiles. In contrast, the percentage of workers in businesses with five employees or more is much higher among workers with high earnings. As a reference point, because poverty in most countries in the region hovers in the 30%-40% range, most workers in the bottom two quintiles likely belong to households under whose incomes fall below the poverty line.

Table 1. Share of workers by size of employer and quintile of personal earnings: Latin America

Panel A: ECLAC dataset							
	Q1	Q2	Q3	Q4	Q5	P95	Total
Self-employed without employees	58	27	19	22	21	17	29
≤ 5 employee	26	28	23	15	6	3	19
6+ employee	10	41	54	58	60	58	45
≤ 5 owner	6	4	3	4	8	10	5
6+ owner	1	0	0	1	5	11	1
Panel B: ECLAC dataset with WID Tax Records Adjustments							
	Q1	Q2	Q3	Q4	Q5	P95	Total
Self-employed without employees	56	25	20	19	19	13	27
≤ 5 employee	26	27	19	12	5	2	18
6+ employee	12	45	58	64	63	61	49
≤ 5 owner	5	3	3	4	7	9	4
6+ owner	1	0	0	1	7	16	2

Note: Latin America corresponds to the weighted average across the countries Brazil, Chile, Colombia, Costa Rica, Mexico, Peru, and Uruguay. 2019 data for all countries but Colombia(2018)

The bottom panel of Table 1 shows that this regularity remains true, and in fact is even starker, if individual incomes are corrected using tax registries to account for the fact that high income levels may be underestimated in household surveys. For this purpose, we rely on World Inequality Database (WID) efforts to correct the weight of individuals with high income, based on tax records.³

In some dimensions, business size is even more closely linked to the distribution of personal earnings in Latin America than in other regions. Although across the world, the probability of being a worker or owner of a firm with more than ten workers is higher for those at the top of the earnings distribution than at the bottom, Latin America is particular in three dimensions (Eslava et al., 2023, comparing to high-income economies and even India). First, the share of workers in this category in the bottom deciles is much smaller, in fact negligible, in LATAM: 3% in Latam’s first decile compared to 62% in the U.S. and 40% in EU higher income countries. Second, contrary to elsewhere, self-employment absorbs more workers than microenterprises. Third, in Latin America, the likelihood of working in a firm with more

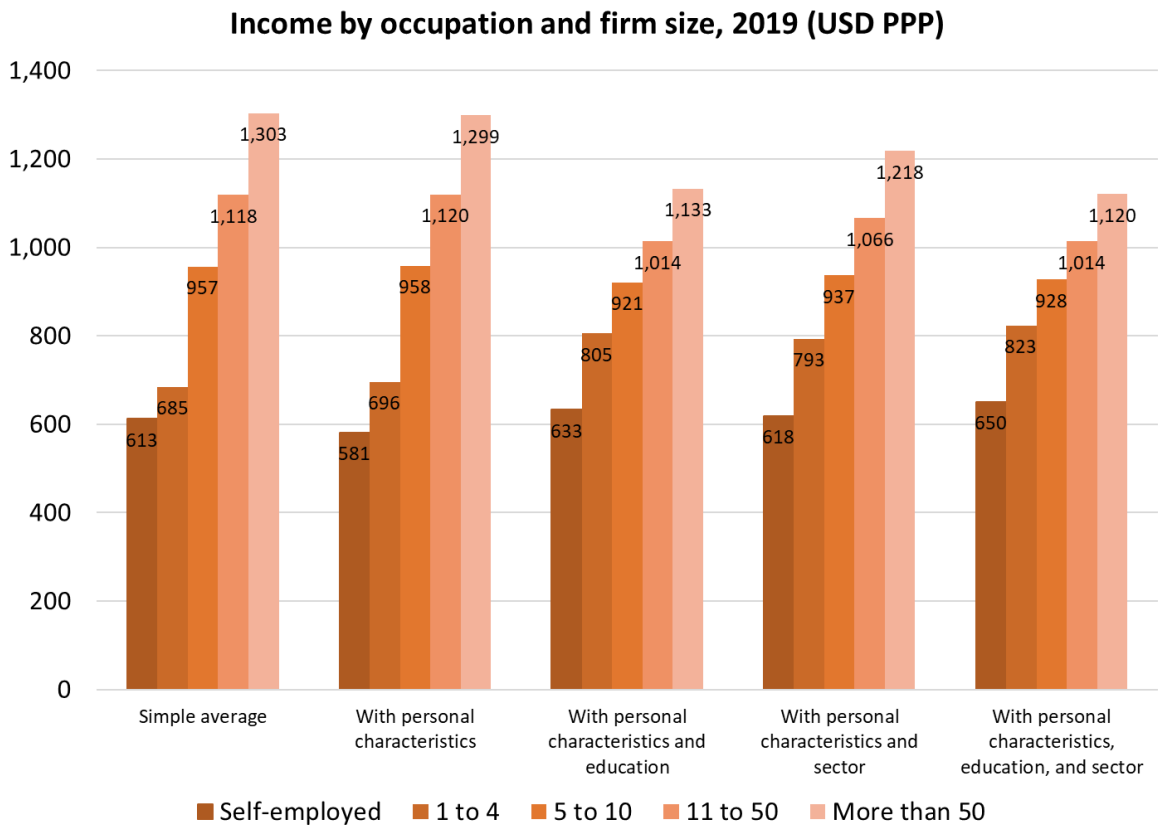
³ Beyond this adjustment, WID calculations for LATAM also scale values of earnings and capital income to match National Accounts aggregates. To minimize manipulation, and because our purpose is to correct the weights of high-earnings individuals, likely under-represented in the household surveys, we do not undertake these two additional steps. For further details, see De Rosa et al (2022).

than ten employees increases more slowly along the income distribution than in other regions.

Eslava et al (2023) also find that the likelihood of being a business owner with employees is much higher for individuals with high earnings, and this is true in both Latin America and benchmark economies. For instance, the probability of being an employer is four to five times higher in the top decile of earnings compared to the bottom decile (21% vs. 5% in Latin America and 10% vs. 2% in the US). At the same time, the likelihood of being an employer is twice as high in Latin America compared to the US for any decile of the income distribution (i.e., the prevalence of ownership is even higher when including business owners without employees, which is around five times higher in the region than in the US, again in any segment of the income distribution). The typical businessperson in Latin America is self-employed without employees and has earnings in the bottom tail of the distribution.

Workers' earnings are more related to the size of the business to which the worker is associated than to the workers' characteristics. Figure 5 displays the results from Eslava et al. (2023) that illustrate this. The first set of bars presents the average earnings (in PPP dollars of 2019) for people working at businesses of different sizes. Subsequent sets repeat the exercise but only compare individuals with given characteristics. Individuals whose income is generated at a firm with 50 or more employees (workers or owners) earn, on average, 691 dollars (PPP) more than those self-employed without workers and 618 dollars more than those working at a business with 1-4 workers. There is little change in these gaps when only people who share age, gender, years of education, or sector in which they work are compared. The main change occurs when controlling for education, which reduces the estimated earnings gap between individuals at a firm of 50+ employees and others in smaller businesses, but the gaps remain sizable. For instance, the gap with self-employed workers shrinks from \$691 to \$501, and that with workers in businesses, up to 4 workers, falls from \$618 to \$328.

Figure 5. Worker earnings and firm-personal characteristics

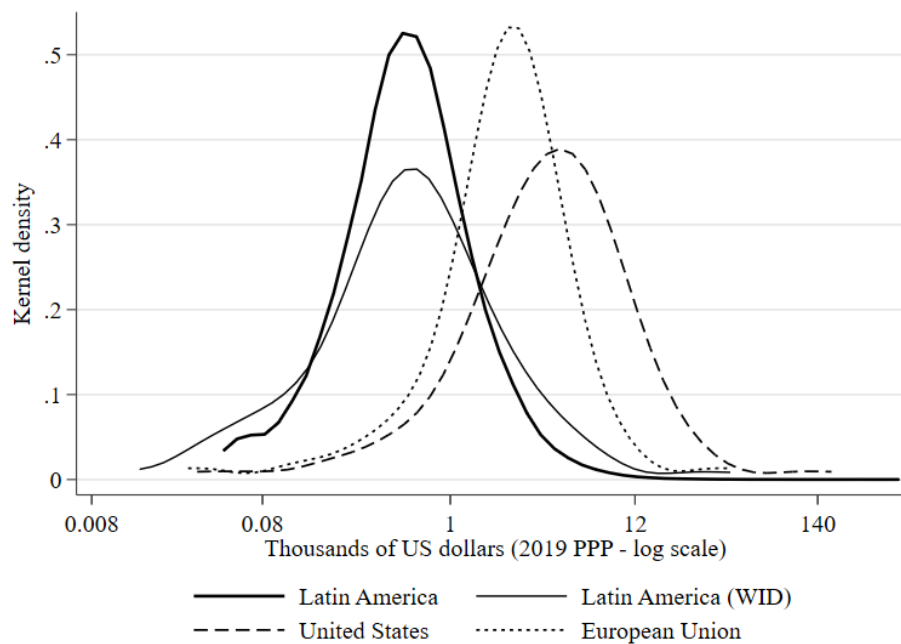


Source: Eslava et al (2023).

Not surprisingly, given the results summarized in this subsection, the overall income distribution mimics the business size distribution in Latin America and, particularly, the thick bottom tail of the (employment-weighted) distribution of business sizes. Figure 6 shows that the region has a much thicker tail at the bottom compared to the United States and the EU.⁴ This highlights how important is the dominance of self-employment and micro-entrepreneurship to understand the high prevalence of poverty, the huge income distances between the lower and upper half of the income distribution, and, more generally, income inequality.

⁴ The figure presents two versions of the region’s income distribution using National household surveys, adjusted and unadjusted using administrative tax records.

Figure 6. Income distribution



Source: Eslava et al (2021). Pre-tax national income data from World Inequality Database (WID) 2020 for the US, EU (Blanchet et al., 2020), and Latin America (De Rosa et al., 2021), own calculations. Weighted average between Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, the Dominican Republic, Mexico, Paraguay, Peru, and Uruguay from national household surveys for Latin America.

Note: For WID: Income by percentiles for adults over 20 years old with equal splits among household adults, excluding data below the 5th percentile where income is zero. For UNDP: personal income for adults over 20 years old. WID incomes for Latin America are adjusted to pre-tax values using administrative tax records to estimate effective tax rates at each income percentile (see De Rosa et al. 2020 for more detail) and using National Accounts.

Of course, the importance for inequality of business size and, more generally, of the characteristics of the businesses where people earn their income are widely recognized. But the dominant role of tiny businesses and self-employment for this relationship, through the weight of these types of businesses in creating low-income employment, is peculiar to LATAM. Our emphasis this far on studies that cover the entire occupied population in the different countries seeks to highlight how crucial this issue is for understanding inequality and its relationship to markets in the region.

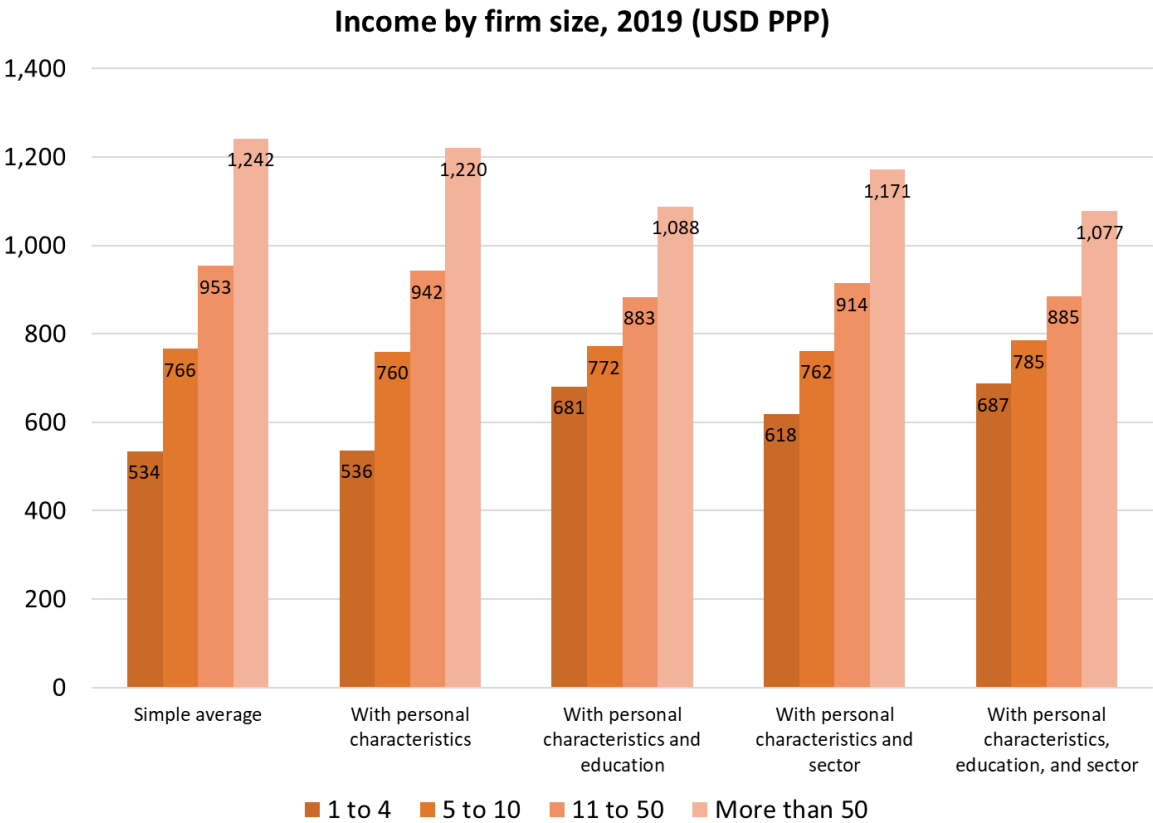
At the same time, because it stresses the problem of masses of workers who concurrently earn low incomes and work at tiny businesses, and because it uses data less fit for zooming into the incomes of the richest among the rich, this emphasis obscures the fact that market concentration at the top end of the business distribution is also present in the region and

has important implications for the income distribution. We thus move now to research that is able to look in greater detail at the top part of the business size distribution. This requires the use of firm level data that portray detailed firm characteristics. Unfortunately, it misses self-employment without employees by construction, and is also frequently misses employees in microenterprises.

3.2. The wages of salaried workers and characteristics of the employer firm

We start by illustrating how the patterns of Figure 5 change when using solely data on workers who are most typically captured by firm data: salaried employees – that is, excluding self-employed business owners with and without employees. Figure 7 recreates the exercise from Eslava et al (2023) presented in Figure 5, for a sample that includes only salaried employees. The differentials in average worker earnings across business sizes persist. Employees whose income is generated at a firm with 50 or more employees earn, on average, 708 dollars (PPP) more than those working at a firm with 1-4 workers. Again, schooling proves to be the personal characteristic that weighs more as a factor in these gaps. However, it fails to explain them entirely, and the business size remains a key explanatory factor. When accounting for education and personal characteristics, the gap with workers in businesses up to 4 workers falls from \$708 to \$407. We come back to this point further ahead looking at matched employer-employee data from Brazil and Mexico.

Figure 7. Employees' earnings and firm-personal characteristics



Source: Eslava et al (2023).

To discuss further the relationship between firms' characteristics and workers' earnings, we rely on the results from Blundell et al. (2022), which use the matched employer-employee data from Brazil (RAIS) and firm-level data from the Economic Census in Mexico. The former makes it possible to run worker-level wage regressions controlling for firms' characteristics, at the cost of being restricted to formal workers and firms. The Mexican data is at the firm level, and therefore one can only investigate the relationship between firms' average wage and their size. Nevertheless, it has the advantage of having information on both formal and informal firms. We believe that the results from both data sets provide a comprehensive picture.

We start with the worker-level regressions using Brazilian data. As Table 2 shows, there is a substantial size wage premium in Brazil, even after controlling for worker fixed effects (column 5). The authors also examine these results allowing for a non-linear relationship

between firm size and wages. Doing that shows that workers in firms with 6-10 employees earn, on average, 20.3% higher wages than those in firms with up to 5 employees. This wage premium increases to 70.5% for workers in the largest firms with at least 100 employees.

The firm-level regressions using Mexican data show the same patterns, albeit less strong (Table 3). Interestingly, controlling for the formality status reduces the point estimate but not dramatically, which suggests that the size wage premium also exists within informal sector firms. Indeed, when the authors run these regressions separately for formal and informal firms, results are similar across sectors, with a slightly higher point estimate for formal firms.

Table 2. Worker level regressions from Brazil

Dep. Var: Log(Wage)	(2)	(3)	(4)	(5)
Log Firm Size	0.221*** (0.0002)	0.201*** (0.0002)	0.167*** (0.0003)	0.143*** (0.0003)
Observations	12,472,959	12,472,959	9,543,672	12,472,959
Adjusted R-squared	0.297	0.342	0.315	0.172
Experience in the formal sector	No	Yes	No	No
Exporter Dummy	No	No	Yes	No
Individual Fixed Effect	No	No	No	Yes

Robust standard errors in parentheses
 *** p<0.01, ** p<0.05, * p<0.1

Source: Blundell et al. (2022)

Table 3. Firm-level regressions from Mexico

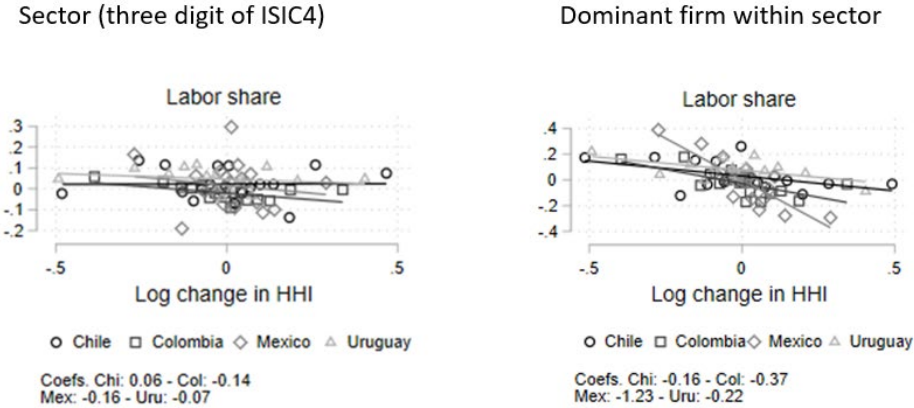
Dep. Var.: log(wage)	(1)	(2)	(3)	(4)	(5)
Log(Size)	0.192*** (0.0006)	0.140*** (0.0006)	0.130*** (0.0006)	0.0867*** (0.0007)	0.0745*** (0.0009)
Fixed effect:					
Industry		X	X	X	X
Municipality			X	X	X
Formality				X	X
Skills					X
Obs.	1,661,490	1,661,485	1,661,485	1,661,485	1,661,485
R2	0.064	0.163	0.173	0.190	0.192

Source: Blundell et al. (2022)

This first set of results thus indicates that the inequality in firm size documented in the previous section can have first-order effects on wage inequality, even if conditioning on formal firms and workers. Moreover, given that most workers (even in the formal sector) are concentrated in very small firms, the results reinforce the importance of firm size distribution and firm growth (or lack thereof) for understanding wage inequality in developing countries.

Although larger firms in LATAM do pay higher wages, they also exhibit lower labor shares. Related, labor shares are higher where markets are less concentrated. Figure 8 from Eslava et al (2021) illustrates this. Across sectors, the aggregate labor share tends to decrease with increases in the sales Herfindahl Index.

Figure 8. Changes in revenue concentration vs the share of revenue that goes to workers



Source: Eslava et al (2021)

Figure 8 was produced by the authors with the support of country experts who work with manufacturing sector surveys conducted by the official statistical bureaus of Chile, Colombia, Mexico, and Uruguay. The analysis covers all manufacturing establishments with ten workers or more in these countries. The figure presents a scatter plot, at the level of the three-digit sector of the ISIC-4 classification, of over-time changes in the Herfindahl index for revenues vs. over-time changes in the share of revenue that goes to workers in the firms. The vertical axis corresponds to the sector’s aggregate labor share in the left panel and the dominant firm's labor share in the right panel. As mentioned, the figure shows that increases in product market power tend to be associated with decreases in the labor share of income in these countries’ manufacturing sectors, and this is particularly strong for the dominant establishment in the sector.

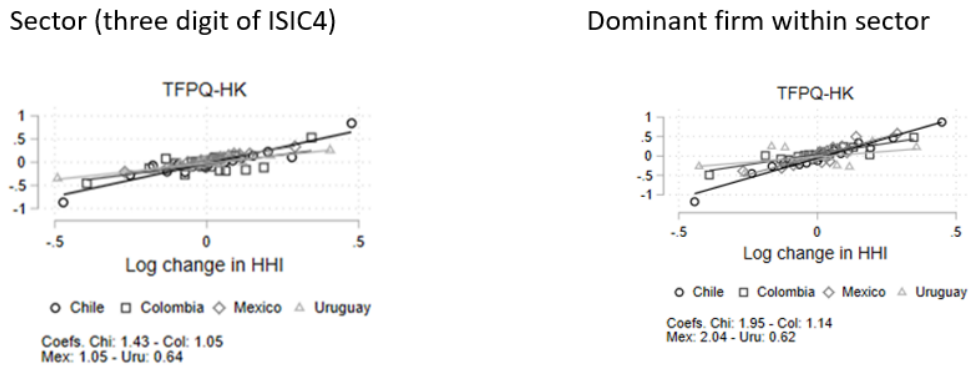
This is in the context of a region where the economy-wide labor share in total value added has been (and remains) lower than that of advanced economies, despite the use of labor intensive technologies. LATAM is also a region where firm ownership is much more concentrated than in high income economies, in particular because of the prevalence of family ownership (Eslava et al, 2021).

Market concentration becomes particularly worrisome in this context because it makes the exercise of market power more likely linked to political and social power. But, while there is indeed evidence for the region of the influence on the generation of business revenues of such non-market forces (e.g., Benn-Schneider, 2021) and other distortions (Hsieh and Klenow, 2014; Eslava, Haltiwanger and Urdaneta, 2022), increase in market concentration is also undeniably linked to increases in actual productivity by the dominant firm. This is illustrated in Figure 9 from Eslava et al. (2021), where the variable in the vertical axis is TFPQ as measured by Hsieh and Klenow (2014), that is, a distortion-free productivity measure.⁵ It is also confirmed by findings from the misallocation literature for Latin American countries showing that, although the link between actual productivity and firm size is weaker than in the US due to the presence of distortions, it is still upward-sloping. Likely because of this positive relationship with productivity, the relationship between increases in market power and average firm wage is also positive in general (Figure 10, where Uruguay is an exception⁶), indicating that firms do share part of the gains from increased market shares with their workers, although they share them less than proportionally (Figure 8).

⁵ Although the term TFPQ was initially meant as a measure of physical productivity in production, Hsieh and Klenow's measure of TFPQ incorporates not only physical productivity but also quality/taste. It is clean, in any case, from distortions external to these two firm attributes.

⁶ Gandelman and Casacuberta (2022), however, show that in more recent years strong labor unions have guaranteed more pro-worker rent sharing in Uruguay.

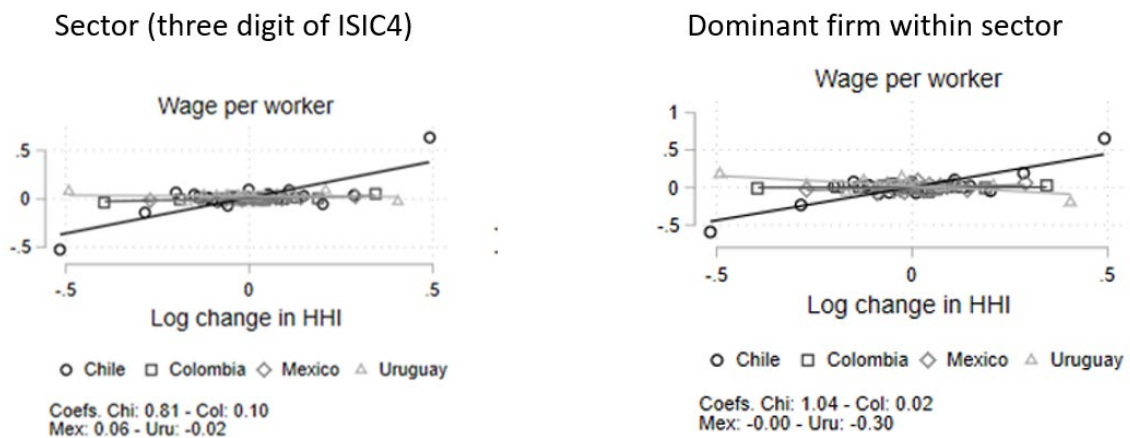
Figure 9. Changes in revenue concentration vs. productivity



Source: Eslava et al (2021)

Thus, as is also the case in advanced economies, the influence of market concentration is not black or white, but a shade of grey resulting from the combination of “good” and “bad” effects: lower labor shares, but also higher wages, productivity and innovation and not necessarily higher (quality-adjusted) price in markets with greater concentration (Ganapati, 2020;)

Figure 10. Changes in revenue concentration vs. average wages



Source: Eslava et al (2021)

4. In sum

Market structure in Latin America is a factor of high inequality, low productivity, and poor economic growth. Market concentration at the top of the business size distribution is as much a concern as in the developed world. But it is not so much because of a marked trend toward higher concentration and market power as for historically high levels of both and more widespread family ownership resulting in rents concentrated in the hands of a few.

However, more specific to the region and a most prominent concern, Latin America has a disproportionately large share of the workforce employed in firms of less than five workers or self-employed (without employees). Evidence from household surveys and firm-level data shows that earnings are explained more by the type of businesses where people work than by their personal characteristics, including their schooling level. A missing segment of medium and large high-productivity businesses capable of absorbing the workforce and containing market power at the top is a major region-specific concern for welfare.

Most Latin Americans are in low-productivity informal working arrangements. The administrative records used in developed economies to characterize inequality and business performance would, for this reason, yield a thoroughly incomplete picture, ignoring precisely the massive left tail of both distributions for which the region stands out.

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