Inequality in Latin America and the Caribbean: Breaking with History?

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Structure of the Report

I. Motivation and Framework
II. Facts and features of inequality in LAC
III. The determinants of inequality
IV. Options for public action
V. Conclusions
I. **Motivation:**

*Latin America is unusually unequal…*

*Gini coefficient: distribution of household per capita income, regions of the world, 1990s*

*Source: Authors’ calculations based on UNU/WIDER-UNDP World Income; Inequality Database, Version 1.0, September 2000.*
I. **Motivation:**

...both in terms of outcomes and of opportunities...

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### Inequality of Observed Opportunities as a Share of Total Inequality: Brazil, 1996

<table>
<thead>
<tr>
<th>Cohort</th>
<th>Residual Inequality</th>
<th>Inequality of Observed Opportunities</th>
</tr>
</thead>
<tbody>
<tr>
<td>b1936_40</td>
<td>0.44</td>
<td>0.803</td>
</tr>
<tr>
<td>b1941_45</td>
<td>0.511</td>
<td>0.805</td>
</tr>
<tr>
<td>b1946_50</td>
<td>0.489</td>
<td>0.750</td>
</tr>
<tr>
<td>b1951_55</td>
<td>0.499</td>
<td>0.779</td>
</tr>
<tr>
<td>b1956_60</td>
<td>0.489</td>
<td>0.767</td>
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<tr>
<td>b1961_65</td>
<td>0.459</td>
<td>0.753</td>
</tr>
<tr>
<td>b1966_70</td>
<td>0.455</td>
<td>0.684</td>
</tr>
</tbody>
</table>

Residual inequality: 

Inequality of observed opportunities: 

Cohorts: b1936_40, b1941_45, b1946_50, b1951_55, b1956_60, b1961_65, b1966_70
I. Motivation

This inequality slows down development and poverty reduction...

Growth elasticities become less negative with inequality

\[ E_i = -2.2 + 0.05Gini + \varepsilon_i \]

\textit{p-value Gini: 0.09}
I. Motivation

... and is widely disliked.

Figure 1.2: Perceptions of fairness of the income distribution in Latin America

* Source: Latinbarometer (2001). Responses to the question: "Do you think that the income distribution is ... ?"
I. Framework

Inequalities in voice, assets, opportunities and outcomes reinforce one another.
II. Facts and Features of Inequality in Latin America:

Mexico, 2000: histogram of the household per capita income distribution, excluding the richest 1 percent

Source: Author’s calculations based on microdata from the ENIGH, 2000.
II. Facts and Features of Inequality in Latin America:

Inequality Convergence: The ‘Big Three’

Gini coefficients for equivalized household income per capita
II. Facts and Features of Inequality in Latin America:

Distribution of conditional probabilities of attending college for youths aged 19–21: Gini coefficients

<table>
<thead>
<tr>
<th>Country</th>
<th>Around 1990</th>
<th>Around 2000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
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<tr>
<td>Bolivia</td>
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<td>Peru</td>
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<td>Venezuela</td>
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<td>Panama</td>
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<td>Chile</td>
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<td>Mexico</td>
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<td>Uruguay</td>
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<td>Colombia</td>
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<td>Costa Rica</td>
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<td>El Salvador</td>
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<td>Ecuador</td>
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<td>Paraguay</td>
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<tr>
<td>Nicaragua</td>
<td></td>
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</tr>
<tr>
<td>Brazil</td>
<td></td>
<td></td>
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<tr>
<td>Honduras</td>
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</tr>
</tbody>
</table>
II. Facts and Features of Inequality in Latin America:

**Large inequalities by race/ethnicity/gender**

![Bar chart showing wages relative to wages of white males for Brazil, Guyana, Guatemala, and Bolivia.](image)

- **Brazil**
- **Guyana**
- **Guatemala**
- **Bolivia**

- **Non-white male**
- **White female**
- **Non-white female**
II. Facts and Features of Inequality in Latin America:

Within-group share of the Theil-L decomposition across both races and genders.

Memo: US actual for race is 0.98.
III. The determinants of inequality

History

- Factor endowments: abundant land and/or minerals. Best technologies intensive in unskilled labor.
- Extractive institutions: Most labor native or slave. No early large European migration to check authoritarian institutions.
  - By contrast, early attempts at autocracy in the US failed.
- Unequal structures were consolidated to serve local elites, through Independence.
III. The Determinants of Inequality

Socio-political mechanisms

LAC’s historical heritage has contemporary salience in:

- Social relations that perpetuate exclusionary behavior, via structures of economic, social and cultural capital, e.g.
  - Education and service provision
  - Market access and work
- A democracy that is both unconsolidated and limited:
  - Unconsolidated: threats of radical change lead to frequent coups (Argentina 1930, Venezuela 1948, Guatemala 1954, Brazil 1964, Chile 1973).
  - Limited: processes of party formation leads to vertical alliances between classes, with weak working class and poor horizontal alliances. Weak transformative capacity of the State (O’Donnell).
There is no single reason for excess inequality in LAC.

High levels of inequality are reproduced via the interaction between:

- Moderate levels of educational inequality
- High (and convex) market returns to education
- High levels of concentration of land and other assets
- Family formation: high correlation in incomes of parents.
- Regressive nature of important parts of public spending
III. Economic Determinants

Distribution of education

INCOME AND EDUCATION INEQUALITIES ACROSS COUNTRIES

Data Sources: World Development Indicators Database for Income Ginis and Thomas et. al. (2002) for Education Ginis
III. Economic Determinants
High market returns to schooling

RETURNS TO SCHOOLING AND INEQUALITY ACROSS COUNTRIES

Data Sources: World Development Indicators Database for Income Ginis and Fernandez et. al. (2001) for Skill Premium measured by Mincer Coefficients of Returns to Schooling.
III. Economic Determinants

Access to quality education is low and highly unequal.

<table>
<thead>
<tr>
<th></th>
<th>Distribution of mathematics test score</th>
<th>Distribution of reading test score</th>
</tr>
</thead>
<tbody>
<tr>
<td>OECD average</td>
<td><img src="graph1.png" alt="Graph" /></td>
<td><img src="graph2.png" alt="Graph" /></td>
</tr>
<tr>
<td>Brazil</td>
<td><img src="graph3.png" alt="Graph" /></td>
<td><img src="graph4.png" alt="Graph" /></td>
</tr>
<tr>
<td>Mexico</td>
<td><img src="graph5.png" alt="Graph" /></td>
<td><img src="graph6.png" alt="Graph" /></td>
</tr>
</tbody>
</table>

- 50% above 500
- 50% above 500
- 4.4% above 500
- 11% above 500
- 8.6% above 500
- 18% above 500
III. Economic Determinants

High Correlation in Education across Spouses

\[ \rho_1 = 0.68^* \]

\[ \rho_{ic} = 0.63^* \]

Data Sources: World Development Indicators Database for Income Ginis and Fernandez et. al. (2001) for Marital Sorting Pearson Correlation Coefficients. and Gasparini chapter 2 for Income Ginis.

NOTE: * significant at 5% level; ** significant at 10% level; Full circle - Income; Empty circle - Consumption
III. Economic Determinants
Ineffective State redistribution
IV. Can LAC break with history?

Options for Public Action

- Deepening democracy and social inclusion
- Institutions and markets
- Economic assets and services
- Taxes and transfers
IV. Options for Public Action

Deeper Democracy

- Reducing elite capture of the State:
  - Equity is only sustainable if all citizens are effectively enfranchised: i.e. if political power is spread out.

- New alliances that include those previously excluded:
  - “Participatory Budgeting” in Porto Alegre
  - “Popular Participation” as it worked in parts of Bolivia
  - Experiences across cities in Colombia (Bogotá, Pasto)
IV. Options for Public Action

Inclusive Institutions

✦ Deeper markets
  - “Pro-market” reforms of the nineties were neither curse not cure (CEPAL)
  - Economic integration *mediated* rising skill premium: need for a rapid educational response
  - Major challenge is deeper and broader markets (credit—including educational, housing credit-, property rights, infrastructure)

✦ Inclusive labor institutions
  - From protecting entrenched privileges to bargaining for efficiency and workers’ rights.
  - Major challenge—including the informal sector.
IV. Options for Public Action
Inclusive Institutions (continued)

✦ Better risk-management institutions.
  − At a macro/financial level:
    − Lower public debt/GDP ratios or higher export and tax ratios and better debt composition, to reduce fiscal vulnerability;
    − Institutions and rules for counter-cyclical fiscal policy, to avoid pro-cyclicality of social expenditures.
    − Stronger prudential regulation and more equitable financial crisis resolution frameworks, to avoid highly regressive financial crisis resolution.
  − And at a microeconomic level:
    − Comprehensive, truly universal social insurance systems.
    − Targeted and integrated social assistance mechanisms.
IV. Options for Public Action

Assets and Services: education

- A major drive for expansion of quality basic and secondary education.
- Focused action for most disadvantaged groups
  - Scholarships, vouchers
  - Bilingual/multicultural education
- Improving classroom practices (teachers incentives, school autonomy and accountability)
- Facilitating access to tertiary education
  - Overcoming credit and information constraints
  - Cost recovery and performance-based support to public Universities
  - Affirmative action for under-represented groups (Afros in Brazil)?
IV. Options for Public Action
Assets and Services: land reform

★ Why is tenancy so unusual in LAC?
★ Market-based land reform (Cédula da Terra, Brazil).
★ Indigenous rights.
★ The role of rural non-farm sectors.
★ An expanded role for land taxation.

Context is key:
Colombia, Bolivia, Brazil—options for redistribution
Mexico, Peru—little land to redistribute
Southern Cone—current property rights are legitimate
IV. Options for Public Action

Assets and Services: infrastructure

- More equitable distribution of access to water and sanitation, roads, electricity, telecommunications, crucial to distributional dynamics

- Privatization _can_ be pro-poor and bring real benefits (e.g. infant mortality in Argentina)
  - Coverage has tended to increase
  - But price effects are mixed. Autonomous/effective regulation is crucial to promote competition and avoid excessive market power
  - Need for transparent processes to reduce excessive public risk taking and corruption.
  - Potential use for democratizing access to shares. Few attempts.
IV. Options for Public Action

LAC can increase collections and improve tax incidence

Source: Stotsky and Wolden Mariam 2002 and IMF GFS database
IV. Options for Public Action

Social spending rising, but mostly on pensions.

Social spending increased in LAC in 1990s. Incidence of increases was generally progressive.

Source: ECLAC 2001
IV. Options for Public Action

Marginal incidence of expenditures is often progressive...when initial access is already high.

Example of health services.
IV. Options for Public Action

Incidence of public programs vary widely

Concentration coefficients for programs in Mexico.
IV. Options for Public Action

But, there is an apparent dilemma between targeting and coverage of the poor.

Source: WB staff estimates
IV. Options for Public Action

Conditional Transfers: a useful complement to expanded coverage

Conditional Cash Transfers really reach the poor.

Cumulative distribution of beneficiaries across national consumption deciles, in percent

<table>
<thead>
<tr>
<th>Decile</th>
<th>PRAF (Honduras)</th>
<th>RPS (Nicaragua)</th>
<th>Progresa (Mexico)</th>
<th>SUF (Chile)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>22.1</td>
<td>32.6</td>
<td>22</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>42.5</td>
<td>55</td>
<td>39.5</td>
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<tr>
<td>3</td>
<td>66.9</td>
<td>70.2</td>
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<td>4</td>
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<tr>
<td>5</td>
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<td>10</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

Sources: For Chile, MIDEPLAN 1998; for Honduras, Nicaragua, and Mexico, Morris and others 2002 (Table 4).
V. Main Conclusions

Reducing inequality requires:

- Deeper democracy: *real sharing of voice and power.*
- Deeper markets and more equitable institutions:
  - *For crisis avoidance and resolution*
  - *For better access to markets and to public services.*
- Broadening Asset Ownership: *education, health, land and infrastructure.*
- Reform elitist, truncated welfare state: *make taxes, expenditures and transfers more progressive.*