

Latin chiefs

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add some tensions to the world economy again.”

Phil Suttle, chief economist at the Institute of International Finance, said: “If the inflation problem in China gets really bad, you have to expect the People’s Bank of China to be very aggressive, and that would not cause just a sharp slowdown in Chinese growth, but a pretty sharp decline in commodity prices. In that sense it could be quite significant for Latin America.”

Prospects for rising interest rates in the US also come at a critical time, and financial markets volatility could increase sharply. “One thing I have learned, looking at Latin America over 30 years, is never to underestimate the impact of high US rates,” said Suttle. “If you combine it with the China monetary policy shock, it could be significant and worth watching for,” he said.

De Gregorio nevertheless said most countries are well prepared to withstand the shock. “Overall, I think most emerging markets have done the job of having a strong fiscal position, a strong financial system, and well conducted monetary poli-

“One thing I have learned is never to underestimate the impact of high US rates”

—Phil Suttle

cies with enough flexibility,” he said.

“This is very different from a period in which countries had very large current account deficits, and sometimes there is no financing so they have to go through a strong adjustment.”

He added that any possible reversal of capital inflows to emerging markets “should imply a re-accommodation” where “macroeconomic policies should adjust, but it is not a reason to cause a big turmoil in emerging markets.”

But former IDB chief economist Guillermo Calvo noted that liquidity could dry up fast despite a country’s economic fundamentals. He cited the case of Chile – one of the region’s star performers – which suffered disproportionately after the collapse of Lehman Brothers in 2008. “That had nothing to do with Chile’s fundamentals,” he said. “It’s a small, open economy that’s linked to the rest of the world.”

The IIF forecasts that China will achieve a soft landing and avoid a severe adjustment, and that the US tightening will be modest and limited. Nevertheless, Latin American countries should move quickly to adopt flexible exchange rate policies, its chief economist said.

“The message for policy makers is ‘use exchange rate flexibility,’” Suttle argued. “At present, they should be using it to see some appreciation to counter inflationary pressures.

“But if and when global conditions turn, then allowing exchange rates to depreciate is the obvious thing. [In this respect] - both Canada and Australia represent [...] role models for most Latin American countries.”

THE final word

Inequality may have declined, but Latin America continues to be the most unequal region in the world

By Nora Lustig

In the past decade, income inequality has declined throughout Latin America while it has been growing in China, India, South Africa and most of the advanced countries.

Given that Latin America is the most unequal region in the world (with a Gini coefficient of around 0.52 for the region as a whole) – and that during the 1980s and 1990s inequality increased – this is great news.

Declining inequality in Latin America has been pervasive: of the 17 countries for which comparable data is available, inequality fell in 12 or 13, depending on the years. Between 2000 and 2008, the average decline in the Gini coefficient was close to 1 percent a year.

Inequality declined in countries which grew fast such as Chile and Peru and countries whose growth was modest, such as Brazil and Mexico; in countries with high inequality such as Brazil and in countries with comparatively low inequality such as Argentina; and, in countries governed by the left such as Argentina, Bolivia, Brazil and Chile; and in countries governed by non-leftist regimes such as Mexico and Peru.

In most countries, the decline in inequality continued during the global financial crisis in 2009.

Two leading factors account for the decline: the narrowing of the earnings gap between skilled and low-skilled workers and the increase of government transfers to the poor.

Educational upgrading – an increase in the average years of schooling and a decline in the years of schooling inequality – and the petering out of the unequating effects of skill-biased technical change and market liberalization in the 1990s, caused the skill premium to fall.

More competitive politics following democratization triggered a more equitable use of fiscal resources. Large scale conditional cash transfers targeted to the poor in the millions have blossomed in the region following the two pioneers Brazil’s Bolsa Familia and Mexico’s Oportunidades (earlier called Progresa).

Although inequality declined in countries governed by leftist and non-leftist regimes, the social democratic left countries of Brazil under president Lula da Silva and Chile under presidents Ricardo Lagos and Michelle Bachelet have been more redistributive than their non-left and left-populist counterparts. In the latter, expansive fiscal policies may become unsustainable if commodity prices fall.

In spite of the good news, there is no room for complacency. Latin America continues to be the most unequal region of the world. In a mostly middle-income region, millions



of inexcusably poor people still live side-by-side with some of the wealthiest on earth.

Sadly, one of the key equalizing forces – education – will soon lose its steam. The upgrading of education for lower income groups will sooner or later face difficult barriers, mainly due to supply constraints in post-basic education, the low quality of education at preceding levels and higher opportunity costs.

Moreover, despite the progress in making public policy more pro-poor, a large share of government spending continues to be either neutral or regressive, and in most countries the collection of taxes on personal income and wealth is very low. Even the most successful large-scale cash transfer programs such as Oportunidades leave millions of the extreme poor out by design or mistake.

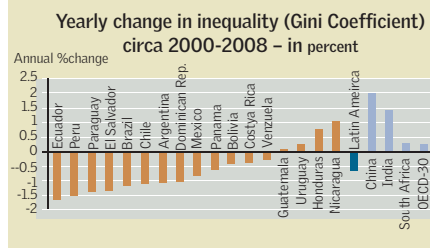
Nor do countries have adequate programmes to help the poor cope with, for example, rising food prices.

Improving the quality of public services for the poor – especially in education – expanding the supply of post-secondary education, closing the egregious coverage gaps in the safety net system and making public spending and taxes more progressive are key to continuing on the path towards more equitable societies.

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Source: Author's calculations based on data from SEDLAC (CEDLAS and The World Bank), August 2010 for Latin American countries; and OECD (2010) for China, India, South Africa and OECD-30. Data for Argentina and Uruguay is for urban areas only.