**How Committed to Equity are Latin American Governments?**

**The Impact of Social Spending and Taxes on Inequality and Poverty in Latin America: Argentina, Bolivia, Brazil, Mexico, Peru and Uruguay**

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Latin America's distribution of income and wealth has long been the most unequal in the world—but poverty and inequality have been falling consistently since 2000 in most countries of the region. What has changed in Latin America? Are the region's governments more committed to equality than in the past? Have their tax and spending policies improved? Which governments are the most committed? Which the least? What policies and programs have been the most effective in redistributing income? Are they sustainable? What is holding Latin America back from achieving even faster gains? What more—or less—should governments be doing?

The Commitment to Equity project (CEQ) is working to answer these and many other related questions. A joint effort by Tulane University (Nora Lustig) and the Inter-American Dialogue (Peter Hakim), the CEQ has been designed to measure the impact of taxes and government spending on inequality and poverty in every country of Latin America. The CEQ's analytic tools include standard fiscal incidence analysis and a specially designed diagnostic questionnaire.

CEQ is among the first frameworks to comprehensively assess the tax and benefits system in developing countries and to make the assessment comparable across countries and over time. Studies have now been completed for seven countries—Argentina, Bolivia, Brazil, Mexico, Paraguay, Peru, and Uruguay—and the results are available on the CEQ website, http://www.commitmentoequity.org

These results offer a valuable assessment of how committed each of these Latin American governments are to raising the incomes and improving the living standards of their poorest citizens. Early conclusions point to a wide variation among countries as regards their policy choices, and the impact those choices have on income redistribution and poverty reduction:

- Inequality and Poverty Reduction. Taxes and transfers reduce inequality and poverty by nontrivial amounts in Argentina, Brazil, and Uruguay, but less so in Mexico, and relatively little in Bolivia and Peru. This can be observed in Figures 1 and 2, which trace the "evolution" of inequality and poverty, respectively, from market income (pre-taxes and transfers), to net market income (market minus direct taxes), to disposable income (net market plus cash transfers), to post-fiscal income (disposable minus indirect taxes and plus indirect subsidies), to final income (post-fiscal income plus in-kind transfers—i.e., public spending on education and health--). [1]

Figure 1 - Gini Coefficient for Each Income Concept: Argentina, Bolivia, Brazil, Mexico,
Peru and Uruguay.

[1] The Argentina study only analyzed the impact of social spending and is therefore not strictly comparable.

Figure 2 – Extreme Poverty Headcount Ratio for Each Income Concept: Argentina, Bolivia, Brazil, Mexico, Peru and Uruguay.

- Direct Personal Income Taxes. Personal income tax varies from around five percent of GDP in Uruguay to nearly zero in Bolivia. In all countries in which direct taxes exist, they are progressive, but because direct taxes are a small percentage of GDP, almost everywhere their redistributive impact is small.

- Direct Cash Transfers. Cash transfers have reduced extreme poverty by more than 60 percent in Uruguay and Argentina, but only by seven percent in Peru, which spends too little on cash transfers to achieve much poverty reduction. Bolivia spends five times more than Peru (as a share of GDP), but because funds are not targeted to the poor, the amount of redistribution and poverty reduction has been limited. For Bolivia these programs' impact in terms of redistribution and poverty reduction is only slightly higher than Peru's.

- Indirect Taxes. In Brazil and Bolivia, indirect taxes wipe out most of the effect of direct transfers, and poverty is almost the same after as before taxes and cash transfers.·In contrast, in Mexico poverty after indirect taxes is lower because the poor pay little in the form of indirect taxes due to exemptions and informality.

- In-kind Transfers. Public spending on education and health is significantly more equalizing than cash transfers in all of the countries (Figure 3). When one adds the effect of transfers in-kind (access to free or quasi-free services in education and health), inequality declines by 24.5 percent, 23.7 percent, and 20.2 percent in Argentina, Brazil, and Uruguay, respectively, and by 14.4 percent, 12.4 percent, and 8.1 percent in Mexico, Bolivia and Peru, respectively. Argentina achieves this effect thanks to the size as well as to the redistributive effectiveness (measured as the percentage change in inequality, divided by social spending as a percent of GDP) of its social spending on education and health. Despite spending considerably less than Bolivia and not much more than Mexico, Uruguay is highly effective at reducing inequality (second highest after Argentina). Brazil has a lower level of effectiveness than Argentina and Uruguay. Mexico's effectiveness is similar to Brazil's but because Brazil spends much more on education and health, the impact on after in-kind transfers inequality is higher for Brazil. Peru and Bolivia are the least effective in reducing after in-kind transfers inequality because spending on education and health is less progressive, especially in Bolivia, than in the other countries.

- Unpleasant Facts. The largely positive redistributive picture of Argentina, Brazil and Uruguay hides some unpleasant facts. For instance, about 16 percent of Brazilian social spending goes to tertiary education, mostly benefitting the five percent of the population with incomes above US$50 (in purchasing power parity) per day. Uruguay, too, allocates subsidies to upper income students. In Argentina, progressive cash transfers are substantially less than indirect (and regressive) subsidies to agricultural producers, airlines and other transportation sectors, manufacturing industries, and energy companies. Argentina's sharp rise of public spending during the 2000s has been increasingly financed by distortionary taxes and unorthodox and unsustainable revenue-raising mechanisms.

Figure 3. Reduction in inequality with respect to Market Income Gini, Social Spending (as a % of GDP), and Redistributive Effectiveness of Social Spending

In sum, redistribution and poverty reduction through fiscal policy is nontrivial especially in Argentina, Brazil and Uruguay. Cash transfers are an important contributing factor. Large scale Conditional Cash Transfers such as Bolsa Familia in Brazil and Oportunidades in Mexico are making a difference. Noncontributory pensions in Argentina and Uruguay have significant poverty-reducing effects as well. In all six countries, in-kind transfers redistribute more than cash transfers. Public spending on education and health significantly reduces inequality when the income concept includes the monetized value of these government services. Direct taxes are progressive, but their impact on inequality is small because of their low share in total revenues. Indirect taxes offset the poverty-reducing effects of cash transfers in Bolivia and Brazil. In Mexico and Peru the poverty-increasing effect of indirect taxes is tempered because: food and other basic goods are exempted, the significant scale of informality (e.g., consumers are able to avoid indirect taxes) and, in the case of Mexico, fuel subsidies (which have been phased-out).

Of the three most redistributive countries, Brazil would significantly improve its redistributive effectiveness if cash transfers were more targeted and the rich's tertiary education was not so heavily subsidized. The latter is also true for Uruguay. In the case of Argentina, the fiscal sustainability of its redistributive model is seriously in question. Of the two least redistributive countries, Peru reduces inequality and poverty very little because of its low social spending (as a share of GDP). Although Mexico's total government spending is similar to Peru's, it allocates considerably more of the budget to social spending and, hence, it achieves more redistribution and poverty reduction than Peru. Bolivia's social spending is higher than Mexico's and Uruguay's (a high redistribution country) but because Bolivia's cash transfer programs are not specifically targeted to the poor, redistribution is small in scale.

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