

# The Dynamics of Income Redistribution in Latin America

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Declining Inequality in Latin America: Are the Good Times Over?

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Brown University

# **Inequality in LA and the Rest**

# **Inequality in Latin America is high...**

## **...but has been declining since around 2000**

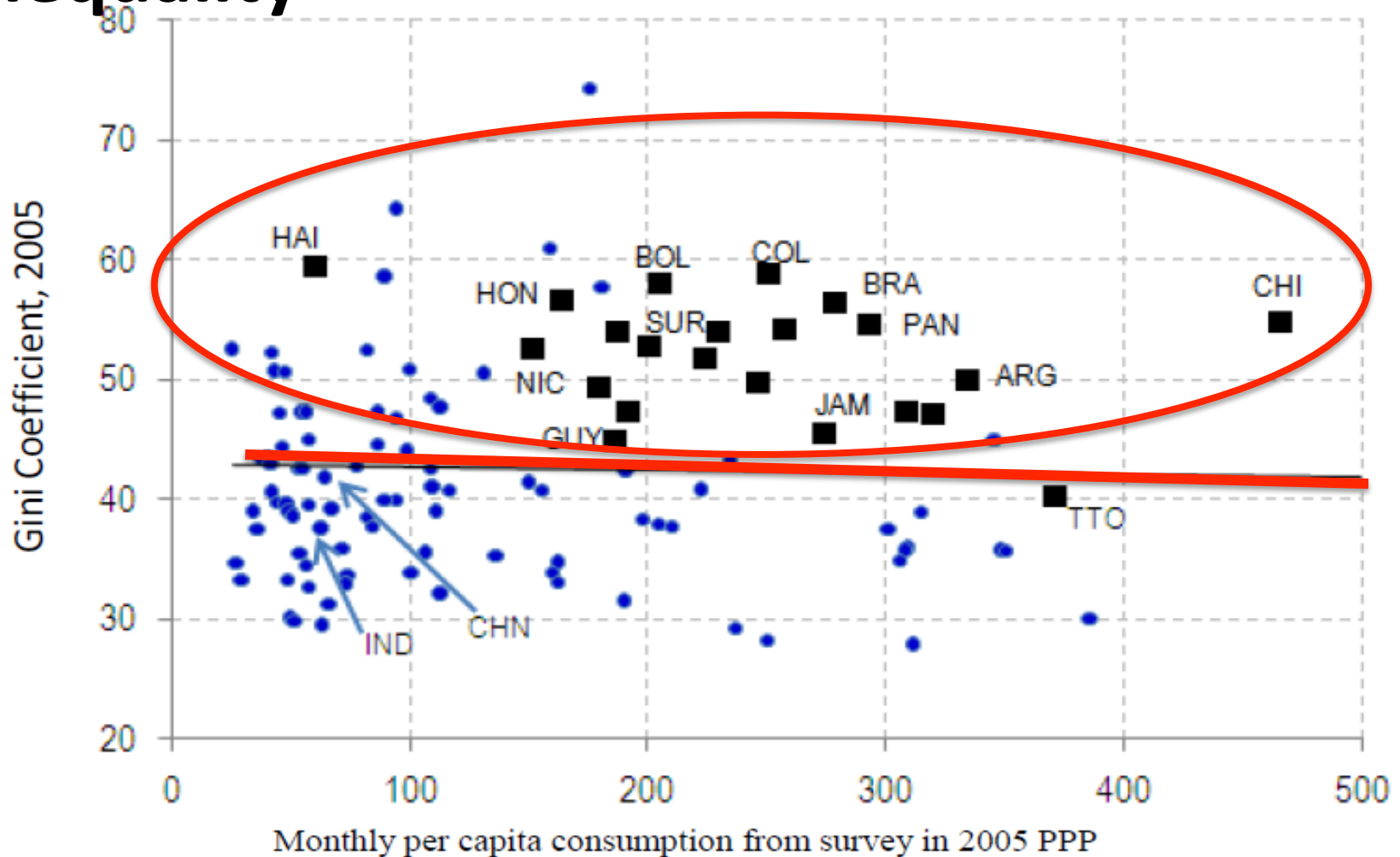
- Decline is pervasive and significant
- Larger than the rise in inequality in 1990s
- The region with the most significant decline
- Important contribution to the decline in poverty and the rise of the middle-class

# **Inequality in Latin America is high...**

## **...but has been declining since around 2000**

- In countries with high growth (Chile & Peru) & low growth (Brazil & Mexico)
- In countries with left (Arg, Bol, Bra, ELS, Ecu, Nic & Par) and nonleft ( Mex & Peru) governments
- In commodity exporters (Arg, Bol, Bra, Ecu, Per) and commodity importers (El Salvador & Mex)
- In countries with rising (Arg & Bra) and stagnant (Mex) minimum wages

# Latin America, a region with 'excess' inequality



# Average Inequality By Region (5 year Averages) 2000-2010

<u>Region<sup>b</sup></u>	<u>Gini Coefficient<sup>a</sup></u>		
	2000	2005	2010
<i>World</i> .....	0.390	0.385	0.380
Advanced Economies.....	0.298	0.302	0.304
East Asia and the Pacific.....	0.38	0.391	0.389
Eastern Europe and Central Asia	0.331	0.329	0.333
Latin America and the Caribbean ↓	0.551	0.532	0.502
Middle East and North Africa	Not Enough Data		
South Asia..... ↓	0.354	0.351	0.328
Sub-Saharan Africa.....	0.445	0.434	0.44

# Change in Gini by Country, 2000-2010

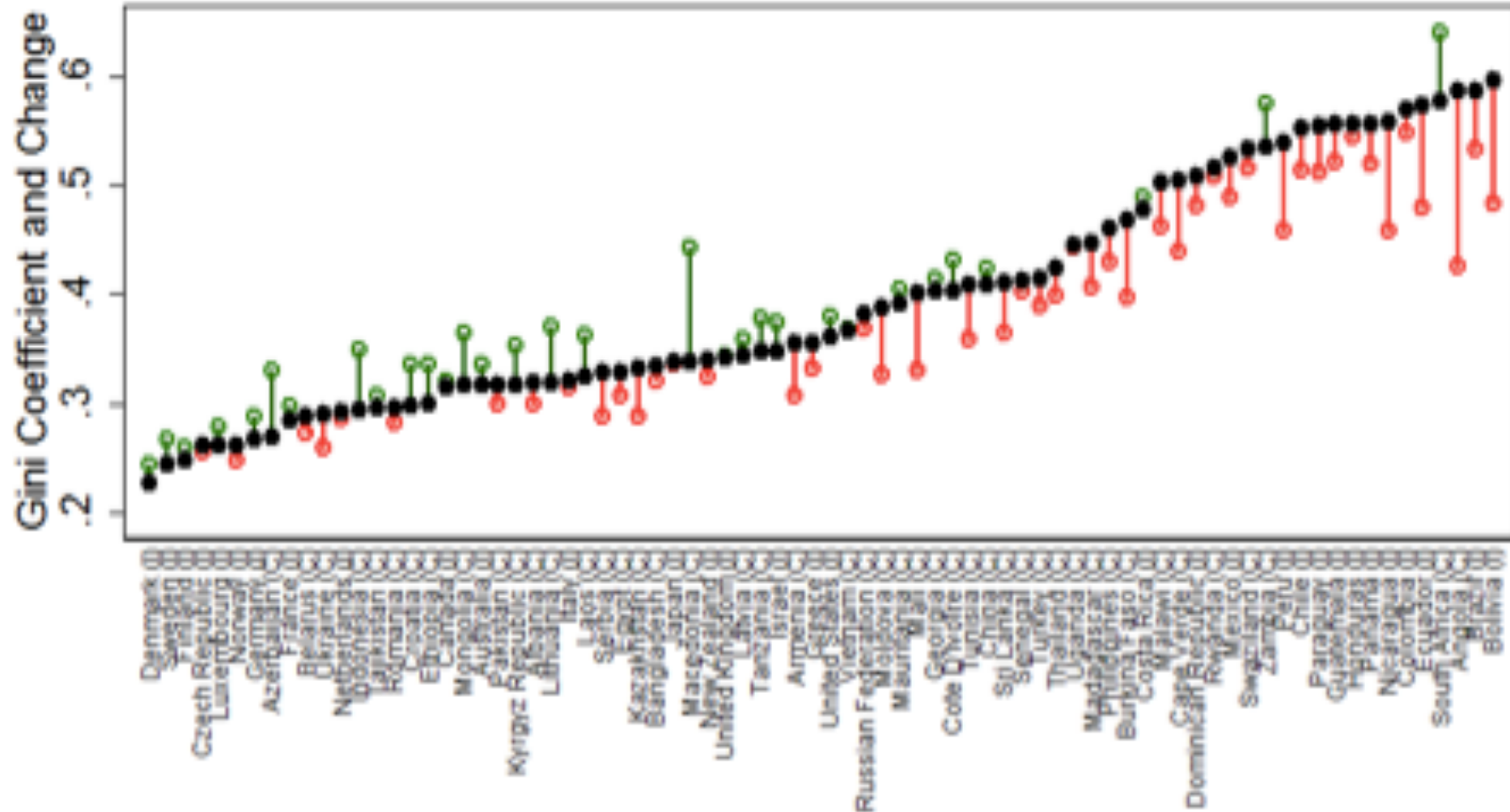
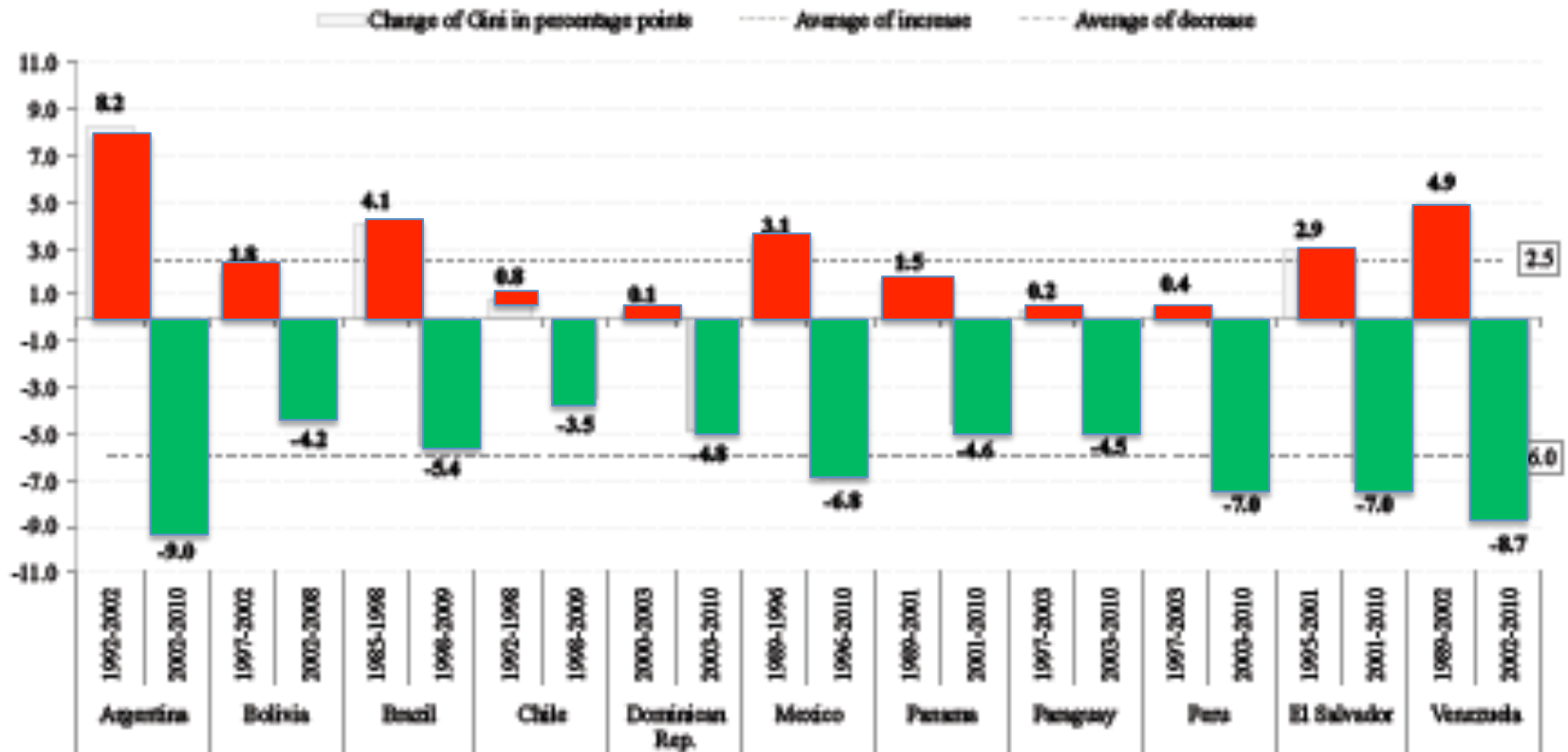


Figure 2 – The Rise and Fall in Inequality  
 (Changes in the Gini coefficients in percentage points)



Source: Authors' calculations based on data from SEDLAC (CEDLAS and The World Bank), March 2012 (<http://sedlac.econo.unlp.edu.ar/eng/>)

The decline of income inequality in the 2000s (-6.0%) has been higher than the rise in the 1990s (2.5%)

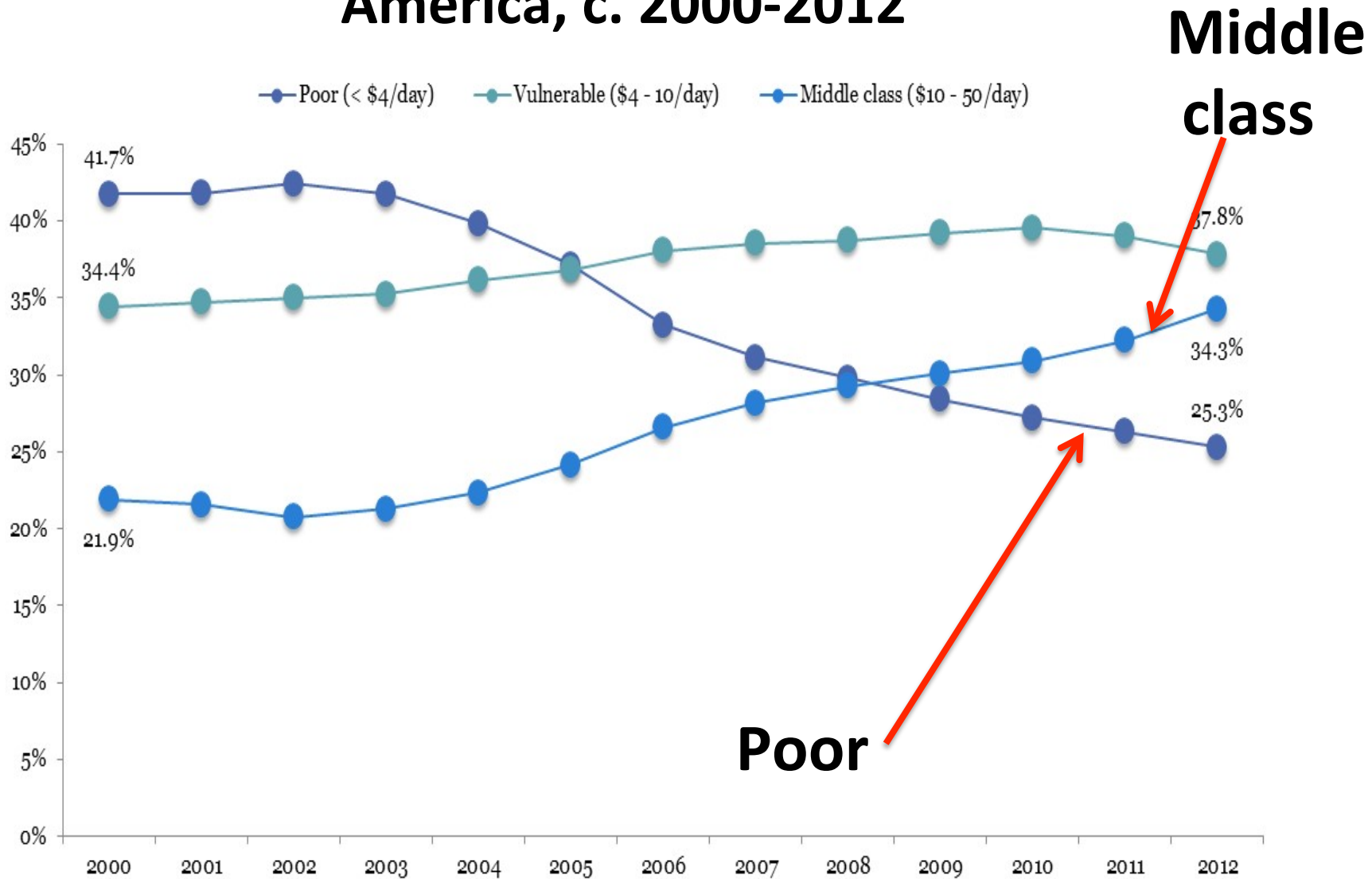


# Evolution of Poverty and the Size of the Middle Class in the 2000s

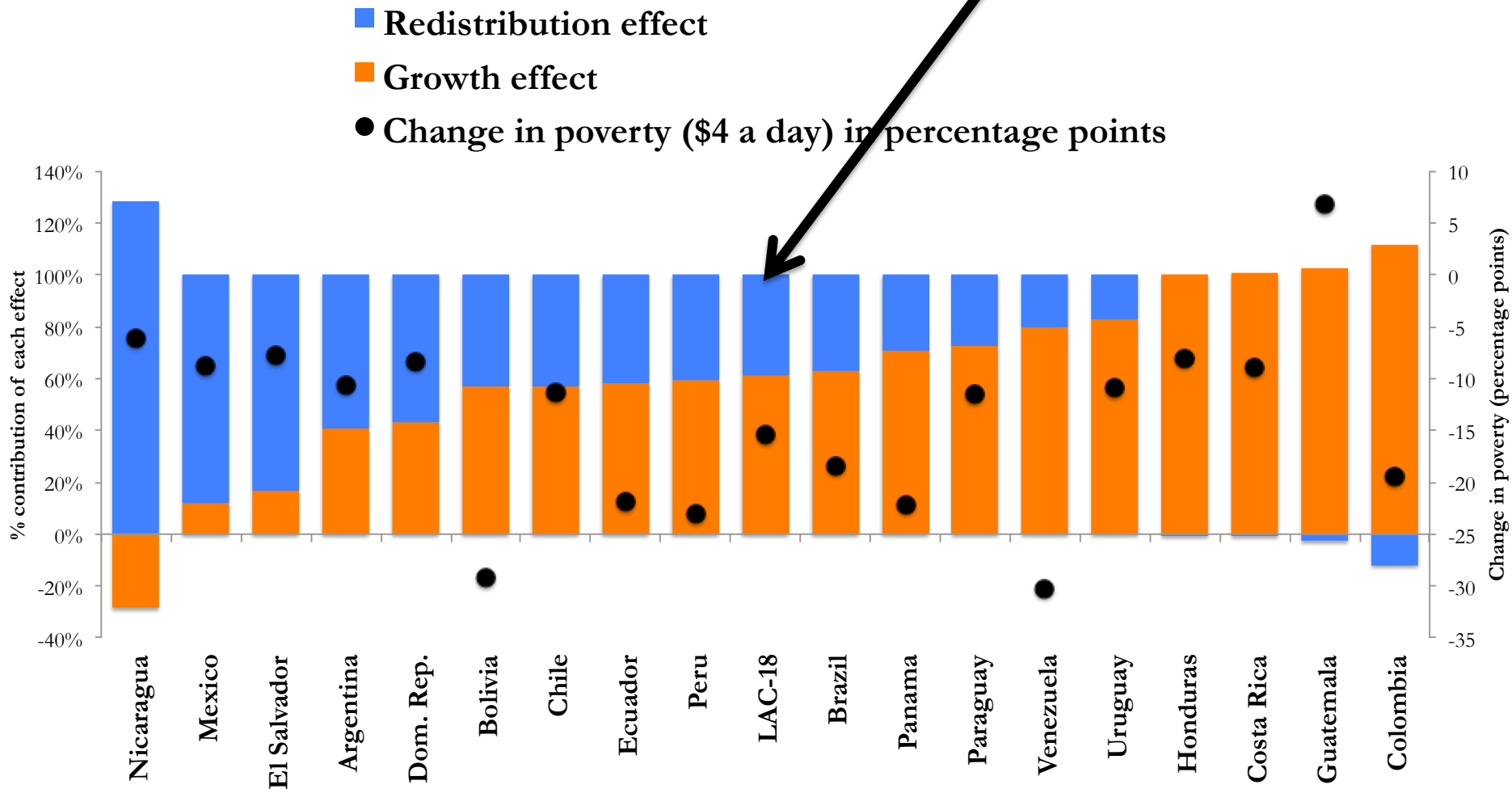
In the 2000s, economic growth and declining inequality led to

- significant poverty reduction: proportion of poor declined from 42 to 25 percent (poverty line US\$4 ppp/day)
- a robust expansion of the middle-class: proportion of middle class population rose from 22 to 34 percent

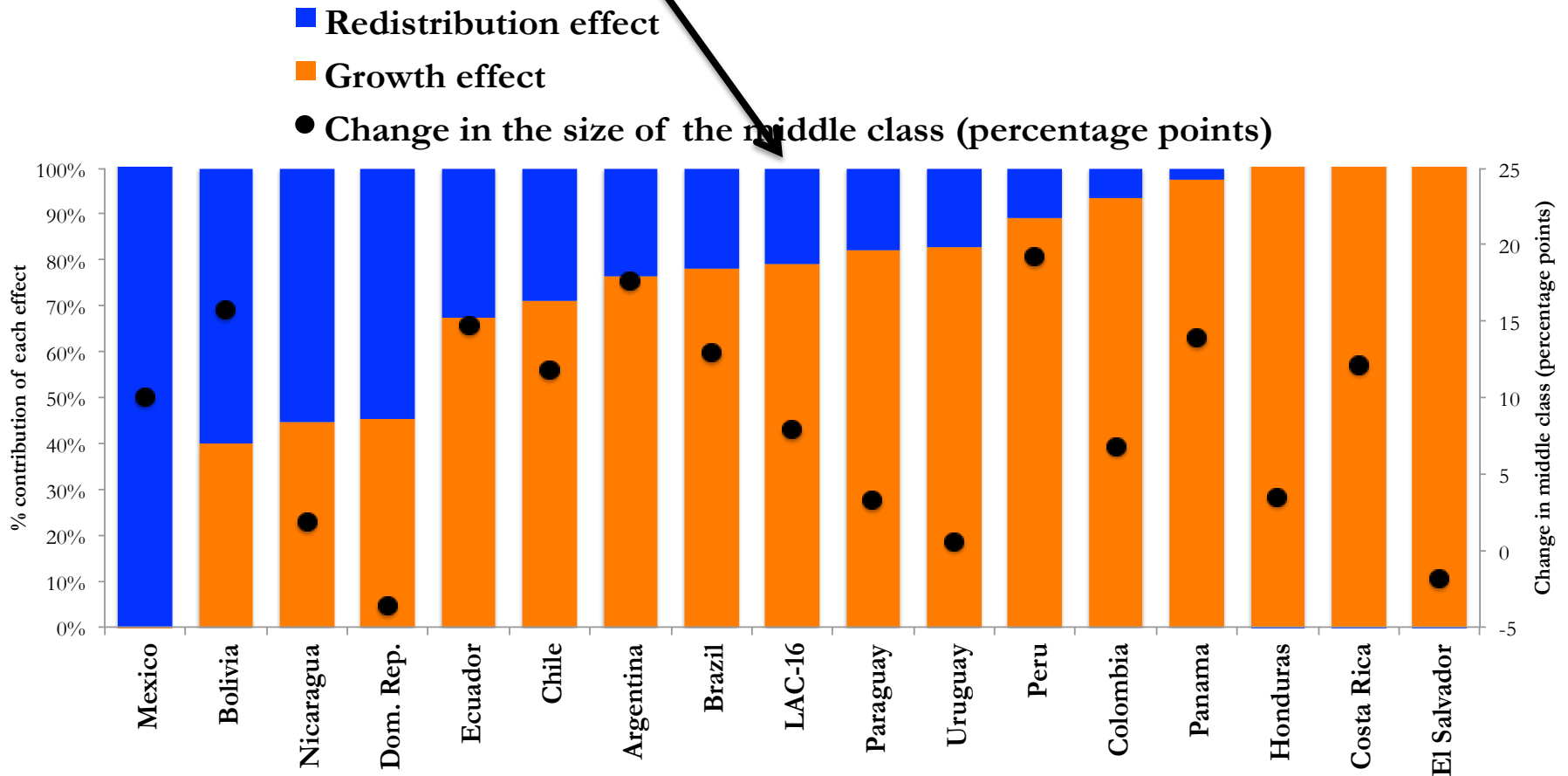
# Percentage of population by income groups Latin America, c. 2000-2012



# Poverty reduction: growth contributed with 61 percent and inequality reduction with 39 percent, on average



# Expansion of the middle-class: growth contributed with about 79 percent and inequality reduction with 21 percent, on average



**Why did inequality decline?**

# Determinants of the decline in inequality

- Decline in inequality of labor income
- Larger and more progressive government transfers
- Expansion of private transfers: remittances

# Determinants of the decline in inequality



# Schooling and Inequality in Latin America

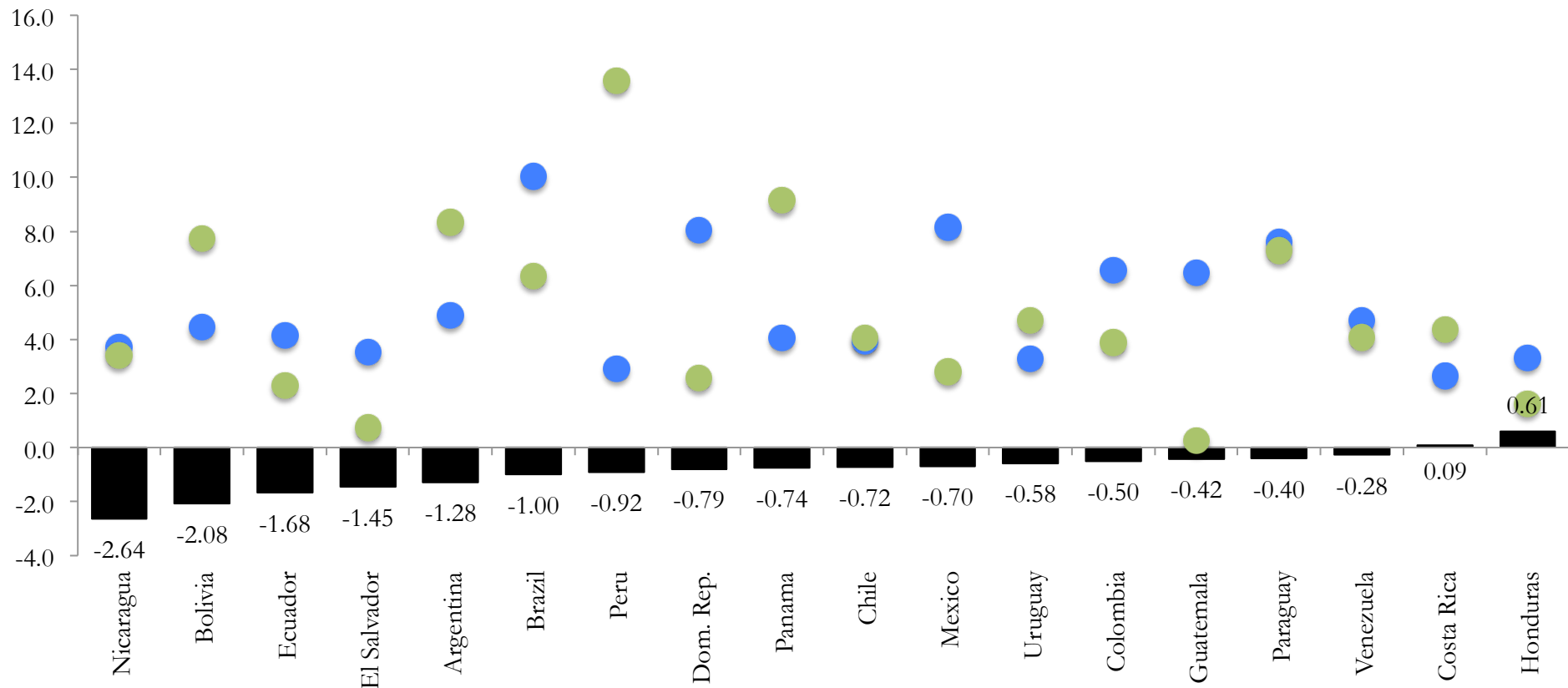
- Between 2000 and 2012, income inequality fell in 16 out of 18 countries in Latin America
- About 60% of the reduction in the Gini coefficient is explained by a reduction in labor income inequality
- Improvements in educational attainment, measured by the schooling composition of the labor force, is the main driver of the reduction in earnings inequality



# Gini coefficient and educational attainment; circa 2000-2012

## *Educational attainment for total population aged 25-65*

- Annual % change in the Gini coefficient
- Change in share of labor force with secondary education (in percentage points)
- Change in share of labor force with tertiary education (in percentage points)



*Source:* Own calculations, based on data from SEDLAC (CEDLAS, and The World Bank), December 2014.

*Notes:* The average change in the Gini for each country is calculated as the percentage change between the end year and the initial year, divided by the number of years. **The change in educational attainment is calculated as the absolute change between the shares in the end and initial years.**

According to years of schooling, the education groups are calculated as follows: secondary education (between 9 and 13 years of schooling) and tertiary education (more than 13 years of schooling).

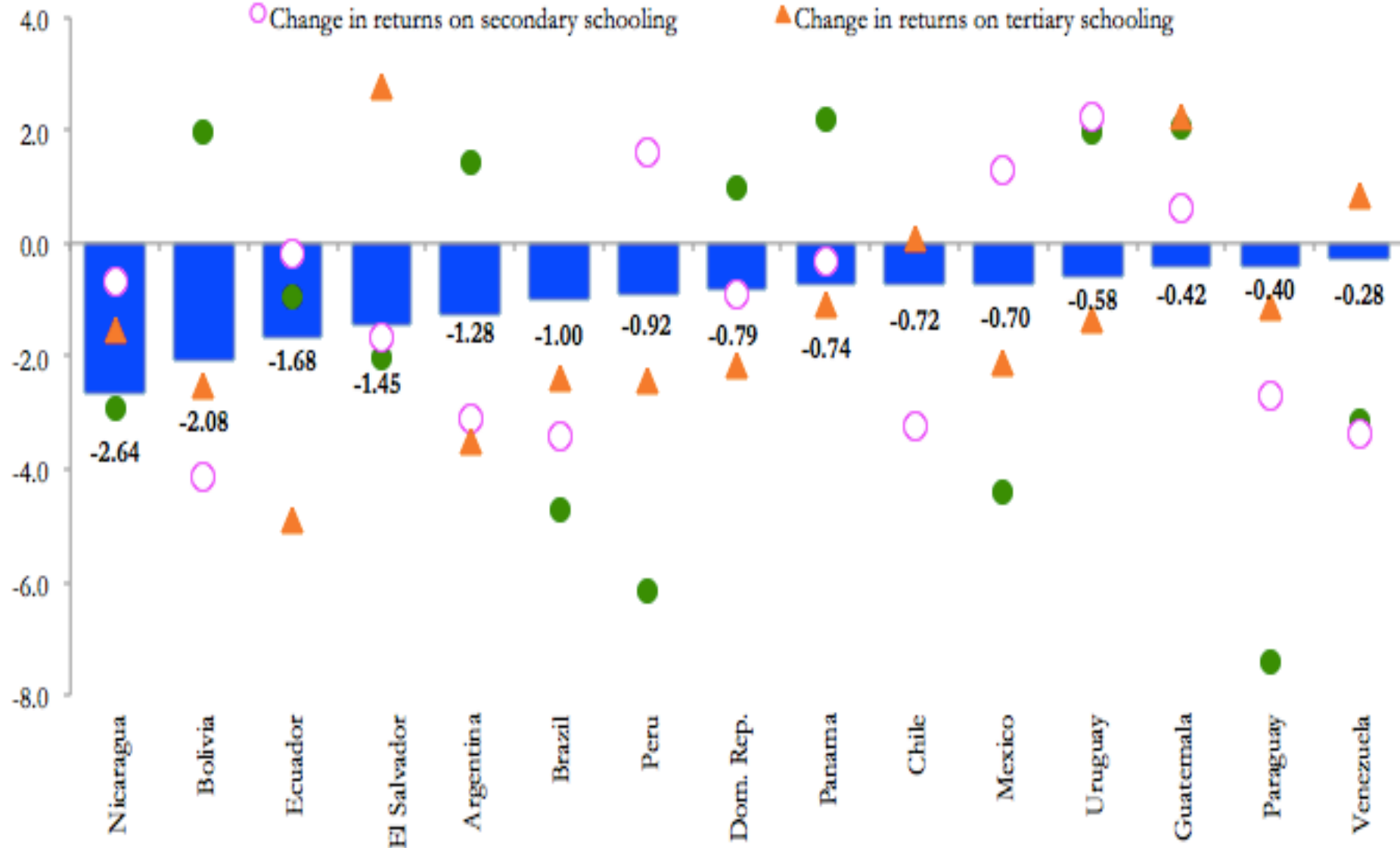
Chart Area

■ Changes in Gini

● Change in returns on primary schooling

○ Change in returns on secondary schooling

▲ Change in returns on tertiary schooling



# Determinants of declining inequality in labor earnings:

Decline in returns to post secondary education (aka. skill premium)

➤ Supply of skilled labor outpaced its demand

➤ Expanding access to education probably the single most important policy behind the declining trend in inequality

# Determinants of declining inequality in labor earnings:

## Reinforcing factors

- Labor market institutions: minimum wages
  - Rise of leftist parties?
- Declining “quality” in new generation of workers with tertiary degree: Brazil?
- Skill obsolescence and skilled labor saving technical change: Mexico?

## Countervailing forces

- Assortative matching?

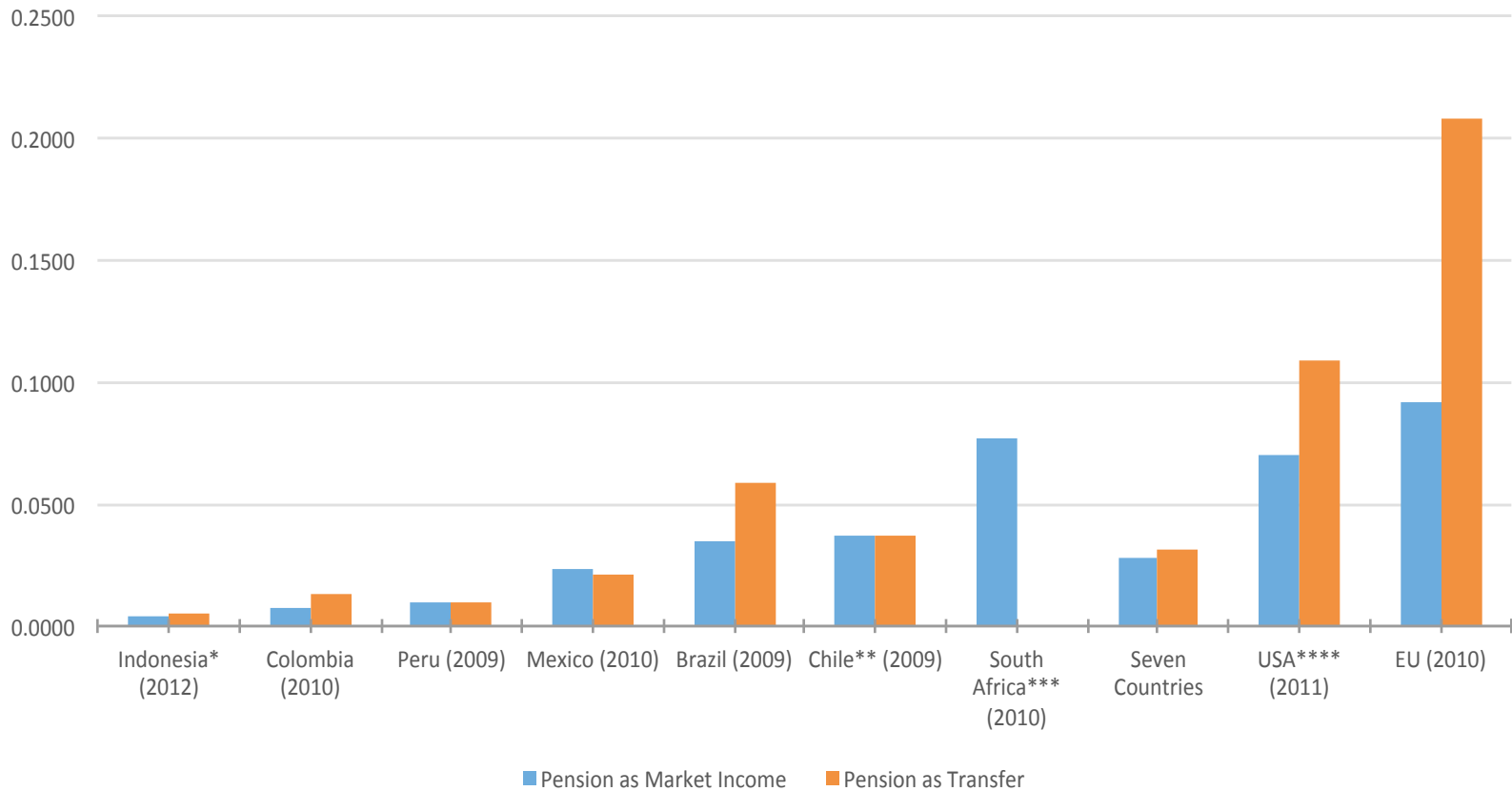
# Determinants of more progressive transfers

- Mainly two types:
  - Conditional cash transfers targeted to the poor
  - Noncontributory old-age pensions

- Technological innovation in social policy: cash transfers replaced general subsidies

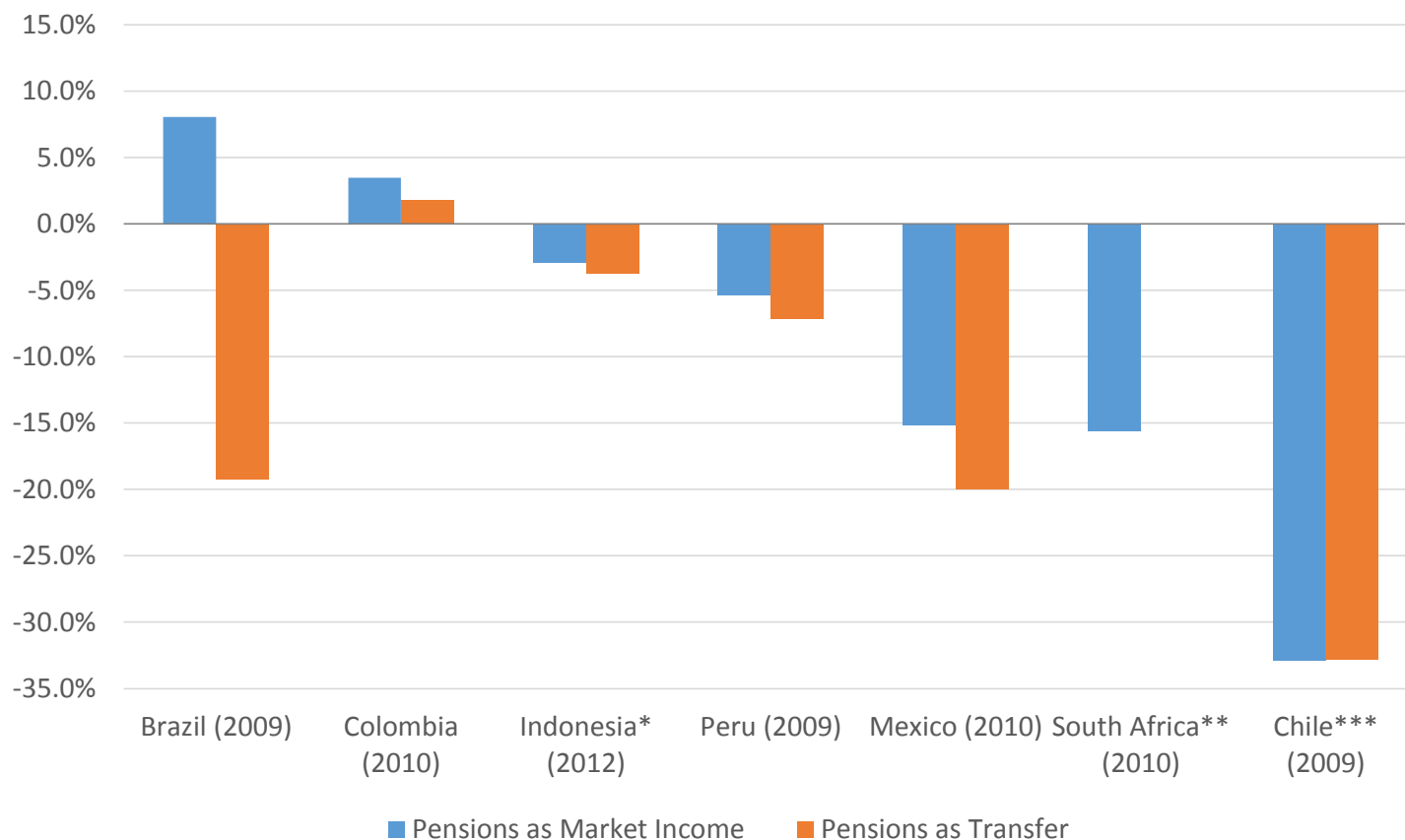
- Politics:
  - Democratization & inclusion of previously excluded sectors
  - Rise of the left & electoral competition

# Redistributive Effect: Brazil, Chile, Colombia, Indonesia, Mexico, Peru, South Africa, EU and the United States (circa 2010)



Source: Lustig, Nora. 2015b.

# Fiscal Policy and Poverty Reduction: net direct and indirect taxes (circa 2010)



Source: Lustig, Nora. 2015b.

# Caveat: Story does not include top incomes (Piketty's capital owners)

- Merrill Lynch's 4,400 individuals (roughly 0.001% of total population) with a net worth of US\$30 million or more with an average wealth of US\$500 million
    - Approximately **US\$600,000/month**
  - Forbes' 30 billionaires
    - Approximately **US\$15 million/month**
  - Forbes' Carlos Slim US\$35 billion
    - Approximately **US\$150 million/month**
- Note: estimating by assuming a 5% return on assets*
- Average income of two richest households in Mexican HH surveys around **US\$45,000/month**; Brazilian, roughly **US\$80,000/month**

- => What do we know about trends in top incomes and how much top incomes are taxed?



**What to expect in more  
challenging times?**

# Labor earnings

Lower labor demand and fiscal consolidation imply that

- Market-determined wages at the bottom, will grow less, not at all or decline
- Real minimum wages cannot continue to rise

But wages of skilled workers are also likely to continue to decline

- Net effect will depend on which factor dominates

# Private Transfers: Remittances

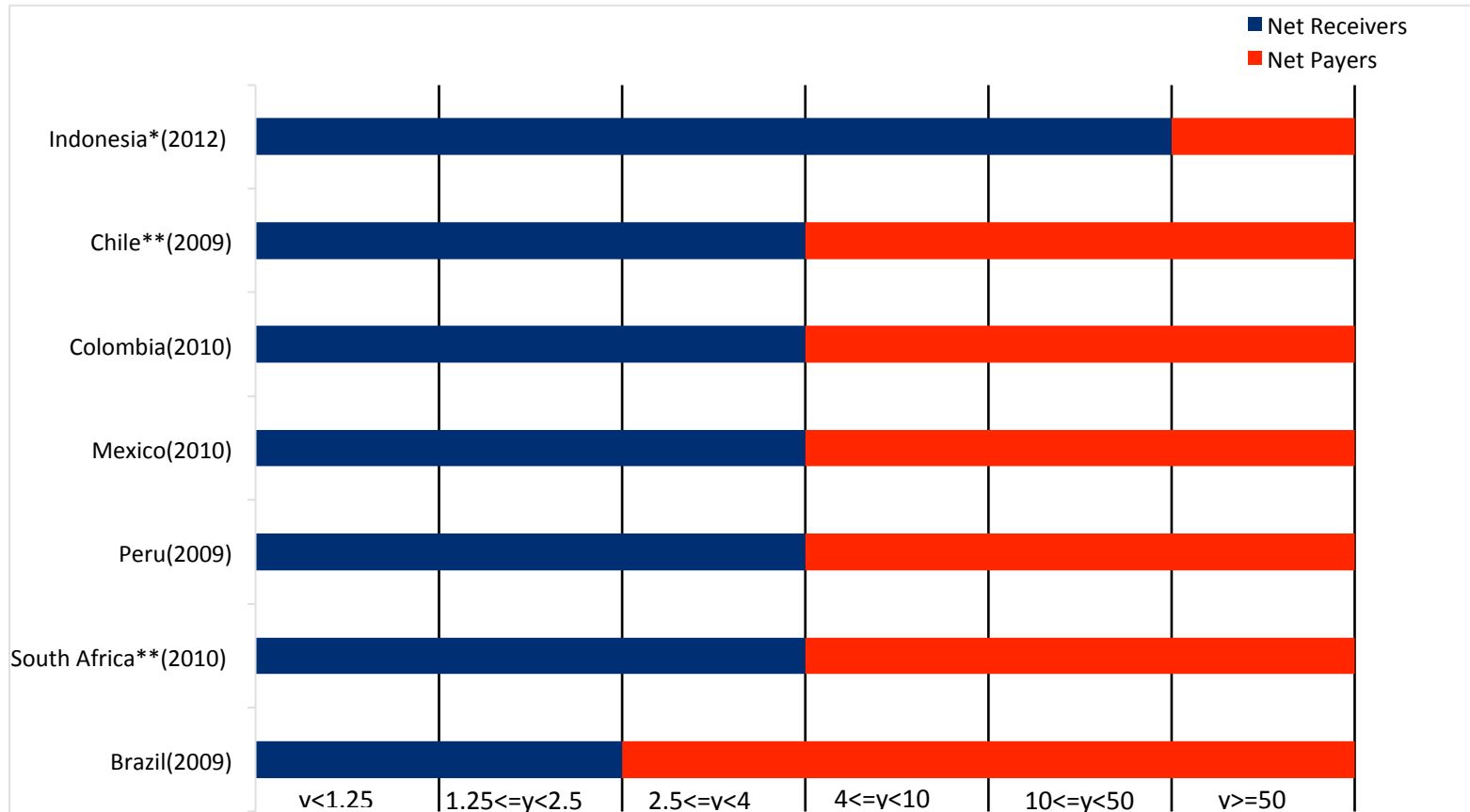
- With US recovery, remittances are likely to continue being a positive equalizing force

# Government transfers

With most countries facing limited or no fiscal space, or worse

- Transfers will not continue to be an important equalizing force
- Some countries may even have to cut them down
- In others they will get eroded by inflation
- In addition, taxes are likely to rise

# Net Payers to the Fisc (circa 2010)



Source: Lustig, Nora. 2015a. [\*The Redistributive Impact of Government Spending on Education and Health: Evidence from Thirteen Developing Countries in the Commitment to Equity Project\*](#). CEQ Working Paper No. 30,

# References

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- Lustig, N. 2015a.  
[\*The Redistributive Impact of Government Spending on Education and Health: Evidence from Thirteen Developing Countries in the Commitment to Equity Project.\*](#) CEQ Working Paper No. 30, Center for Inter-American Policy and Research and Department of Economics, Tulane University and Inter-American Dialogue.
- Lustig, Nora. 2015b. *Inequality and Fiscal Redistribution in Middle Income Countries: Brazil, Chile, Colombia, Indonesia, Mexico, Peru and South Africa. Evidence from the Commitment to Equity Project (CEQ)*. CEQ Working Paper No. 31, Center for Inter-American Policy and Research and Department of Economics, Tulane University and Inter-American Dialogue. Forthcoming.

**Thank you**