Parque Real favela and upscale Morumbi neighborhood, São Paulo, Brazil.

Most Unequal on EARTH

Nora Lustig

Latin America is a region of stark income contrasts but has been making progress

LATIN America is a region with tremendous contrasts. Home to the second richest man in the world and about 5 percent of the world's billionaires, the poor are strikingly poor.

Infant mortality and malnutrition in rural areas and shantytowns, and among disadvantaged groups in Latin American middle-income countries, are much the same as in notably poorer nations. Poverty among afro-descendants and indigenous groups is two, three, and sometimes even more times higher than among the white population.

Latin America is not the region with the largest share or number of poor people in the world (south Asia has that distinction). But it is the one with the most unequal income distribution, which means that the poor there receive a smaller share of total national income than poor people in other regions. As a result, poverty rates in Latin America are systematically higher than would be expected compared with other countries with similar average incomes.

The Gini coefficient is an index of inequality widely used in the social sciences. If all income were to go to one person, the Gini coefficient would be 1. If everybody had the same income, the Gini would be zero. The higher the Gini, the more unequal the country or region. Countries in Latin America, by this measure, are 30 percent more unequal than the world average (see Chart 1).

Fall in inequality

Nevertheless, as inequality was rising in nearly every part of the world, it has been declining in almost every Latin American country since 2000 (see Chart 2). It fell in countries with high growth, such as Chile and Colombia, but also in countries with more modest growth, such as Brazil and Mexico. It fell in countries governed by left-leaning regimes (such as Argentina, Bolivia, Brazil, Chile, Ecuador, El Salvador, Nicaragua, Paraguay, Uruguay, and Venezuela) and in countries with center or center-right regimes (such as Mexico and Peru). It fell in commodity-exporting countries and in commodity importers, in countries with minimum wages on the rise, and in countries with stagnant minimum wages.

An important consequence of the decline in inequality is faster poverty reduction. If the income distribution does not change, any decline in poverty depends on per capita income growth. A reduction in inequality enhances the impact

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of such growth on poverty. In the 2000s, the proportion of extremely poor people in Latin America declined from 25 percent to about 12 percent—a decrease of more than 50 percent (see Chart 3). Sixty percent of this fall in poverty can be attributed to economic growth, while lower inequality accounts for 40 percent. The two main factors that contributed to the decline in inequality in Latin America are more equal distribution of earnings and government transfers.

More equal distribution of labor earnings among wage earners and the self-employed is the most important factor, accounting for 60 percent of the region's decline in inequality. This is because wages of workers with very little education rose faster than those of more educated workers, especially those with tertiary—college or other postsecondary—education. In fact, in Brazil and Mexico, wages for workers with tertiary education have stagnated and, at times, even declined. The common force throughout the region contributing to the narrowing wage gap between skilled and low-skilled workers has been a larger share of workers entering the labor force with secondary and tertiary education (see Chart 4).

The expansion of access to education, especially during the 1990s, produced the expected result: a decline in the wage gap between skilled and low-skilled workers. The number of workers with secondary and postsecondary education grew faster than the number of jobs requiring their higher skills. At the same time there was a rise in demand for low-skilled workers in countries experiencing an agricultural commodity boom, and low-skill wages also rose in response to minimum wage increases—for example, in Argentina and Brazil.

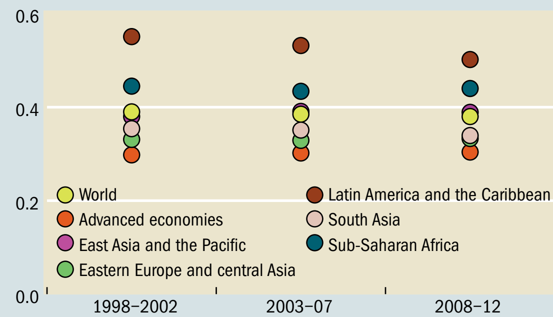
The second most important factor in reducing inequality has been ***government transfers***, which on average explain about 20 percent of the decline. Government transfers have increased in size and are better targeted to the poor. Almost every country in the region runs a flagship cash transfer program that requires families to keep their children in school and receive regular health checkups as a condition for benefits.

Chart 1

Converging fortunes

Latin America is the region with the highest inequality in the world, but one of only two—along with south Asia—where inequality is falling.

(average Gini coefficient by region and income level, five-year averages)



Sources: Author's calculations based on OECD Income Distribution Database: Gini, Poverty, Income, Methods and Concepts; World Bank, PovcalNet: An Online Poverty Analysis Tool; and CEDLAS and World Bank, Socioeconomic Database for Latin America and the Caribbean.

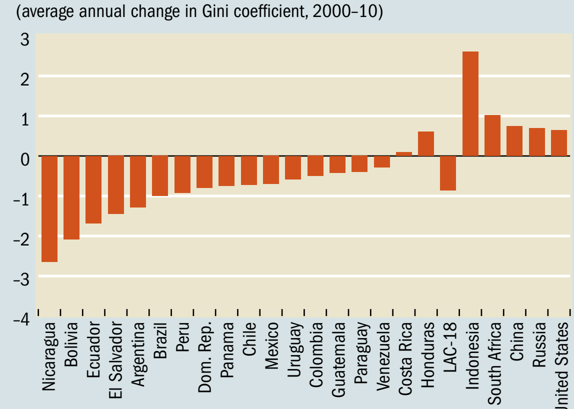
Note: Regional averages were calculated as the averages of within-country inequality for the countries for which data were available; thus, country coverage varies markedly by region.

Chart 2

Strong showing

Almost all countries in Latin America have enjoyed a decline in inequality, in contrast to many countries in the rest of the world.

(average annual change in Gini coefficient, 2000–10)



Source: Lustig, Lopez-Calva, and Ortiz-Juarez (forthcoming).

Note: LAC-18 includes the Latin American countries listed on the *x*-axis.

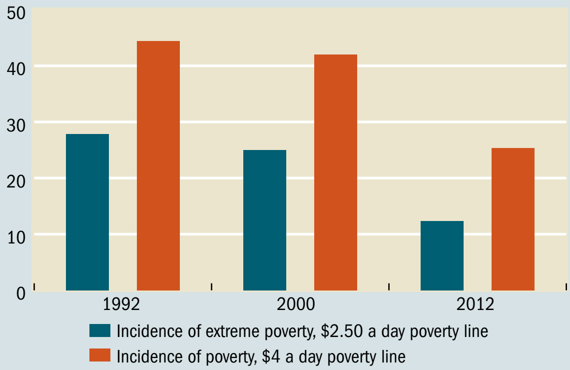
Faced with diminished access to resources in the aftermath of the 1980s debt crisis, many governments in Latin America replaced costly general price subsidies with programs targeted to the poor. Since they were first implemented in Brazil and Mexico in the second half of the 1990s, conditional cash transfers have constituted one of the most important innovations in social policy to benefit the poor. Today, about 27 million households in the region—most of them poor—are beneficiaries of so-called conditional cash transfers. In addition to improving the living standards of the poor, cash transfers have helped improve the health,

Chart 3

Speeding up the fight

A noteworthy consequence of Latin America's decline in inequality has been accelerated poverty reduction.

(number of people with incomes below the poverty line as a share of total population)

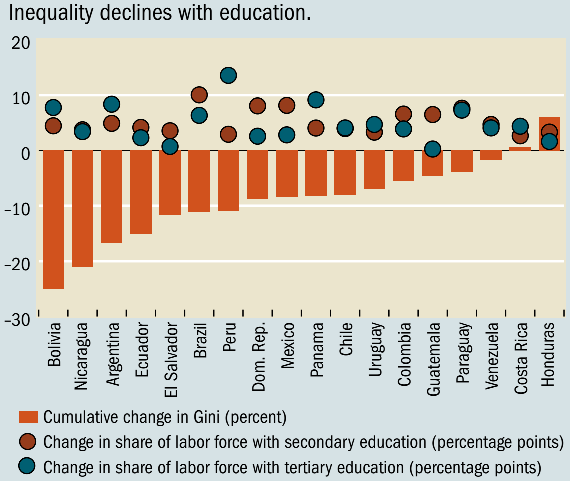


Source: Lustig, Lopez-Calva, and Ortiz-Juarez (forthcoming).

Chart 4

Learning to be equal

Inequality declines with education.



Source: Lustig, Lopez-Calva, and Ortiz-Juarez (forthcoming).
Note: The average change in the Gini coefficient for each country is calculated as the percent change between the end and initial years. The change in educational attainment is calculated as the absolute change between the shares in the end and initial years. Secondary education is defined as 9–13 years of schooling and tertiary education as more than 13 years of schooling. Data cover 2000–12 or closest available for each country.

education, and nutrition of children living in poverty and therefore carry the promise of better employment opportunities in the future.

More recently, some cash transfer programs have incorporated components such as technical assistance, credit, and modest asset transfers to small agricultural producers and microentrepreneurs geared toward increasing productivity and output, especially in rural areas. Many Latin American countries have also instituted noncontributory pensions to provide an income floor to elderly people who are not protected by the formal social security system.

Future prospects

Predicting the evolution of income inequality is tricky. With the Latin American economies facing lower growth prospects and tighter budgets, two things could bring the era of declining inequality to an end. Lower growth—especially in agricultural commodity exports—will translate into less demand for low-skilled workers. Hence, their wages are likely to stop rising and may even decline.

The prospects for inequality depend on how long the slowdown in growth prevails.

Lower growth also means lower tax revenues. As governments try to keep their fiscal accounts under control, they will need to raise taxes, cut expenditures, or both. In such circumstances, minimum wages will not continue their ascending trend and transfers will not continue to grow—indeed, in some countries they may have to be cut back (and in some, cuts have already begun; for example, in Guatemala). In countries with high inflation, transfers may simply be eroded by rising prices.

All else equal, less demand for low-skilled workers and flat or falling minimum wages and government transfers will make inequality go up. However, if lower growth reduces the demand for skilled workers faster than the demand for low-skilled workers, causing the wage gap between the two groups to continue to narrow, the decline in inequality could persist. With the U.S. economy in recovery mode, another potentially equalizing force is increased remittances from Latin Americans living and working in the United States.

In the end, the prospects for inequality depend on how long the slowdown in growth prevails and which forces—equalizing or unequalizing—dominate.

In spite of the decline in household income inequality, the distribution of income in Latin America remains strikingly unequal. By some accounts, the number of billionaires in Latin America in 2014 increased faster than anywhere else. Policymakers must find ways to continue the momentum of declining inequality even in the face of austerity. Improving the lot of the poor should remain a priority even in times of fiscal duress. It is the right thing to do. ■

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Reference:

Lustig, Nora, Luis F. Lopez-Calva, and Eduardo Ortiz-Juarez, forthcoming, "Deconstructing the Decline in Inequality in Latin America, in Proceedings of IEA Roundtable on Shared Prosperity and Growth, *ed. by Kaushik Basu and Joseph Stiglitz (New York: Palgrave MacMillan).*