

The Dynamics of Income Inequality in Latin America

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- Huge increase in attention to inequality – both among economists and the general public
 - Stiglitz (2012), Piketty (2014), Atkinson (2015)
- Large literature on rising inequality in the United States
 - US Gini for household incomes rose by 8 points between 1967 and 2011 (Jacobson and Occhino, 2012)
 - Juhn, Murphy and Pierce (1993)
 - DiNardo, Fortin and Lemieux (1996)
 - Autor, Levy and Murnane (2003)
 - Autor, Dorn and Hanson (2013)
 - Alvaredo, Chancel, Piketty, Saez, Zucman (2017)
- But inequality can and does fall, as well as rise
 - Declines > 1 Gini point in 39 of 91 countries, 1993-2008. (World Bank, 2016)
 - López-Calva and Lustig (2010) on Latin America
- What can we learn from the success stories?

Declining inequality in Latin America

Outline

- The facts
 - Warning: top incomes/incomes from capital in surveys are grossly underestimated or nonexistent
- Determinants
 - Labor earnings
 - Government Transfers
- Declining earnings inequality
 - Zooming in: Brazil and Mexico
- Rising role of transfers
 - Impact of transfers on inequality and poverty: Argentina and Mexico

Inequality in LA and the Rest

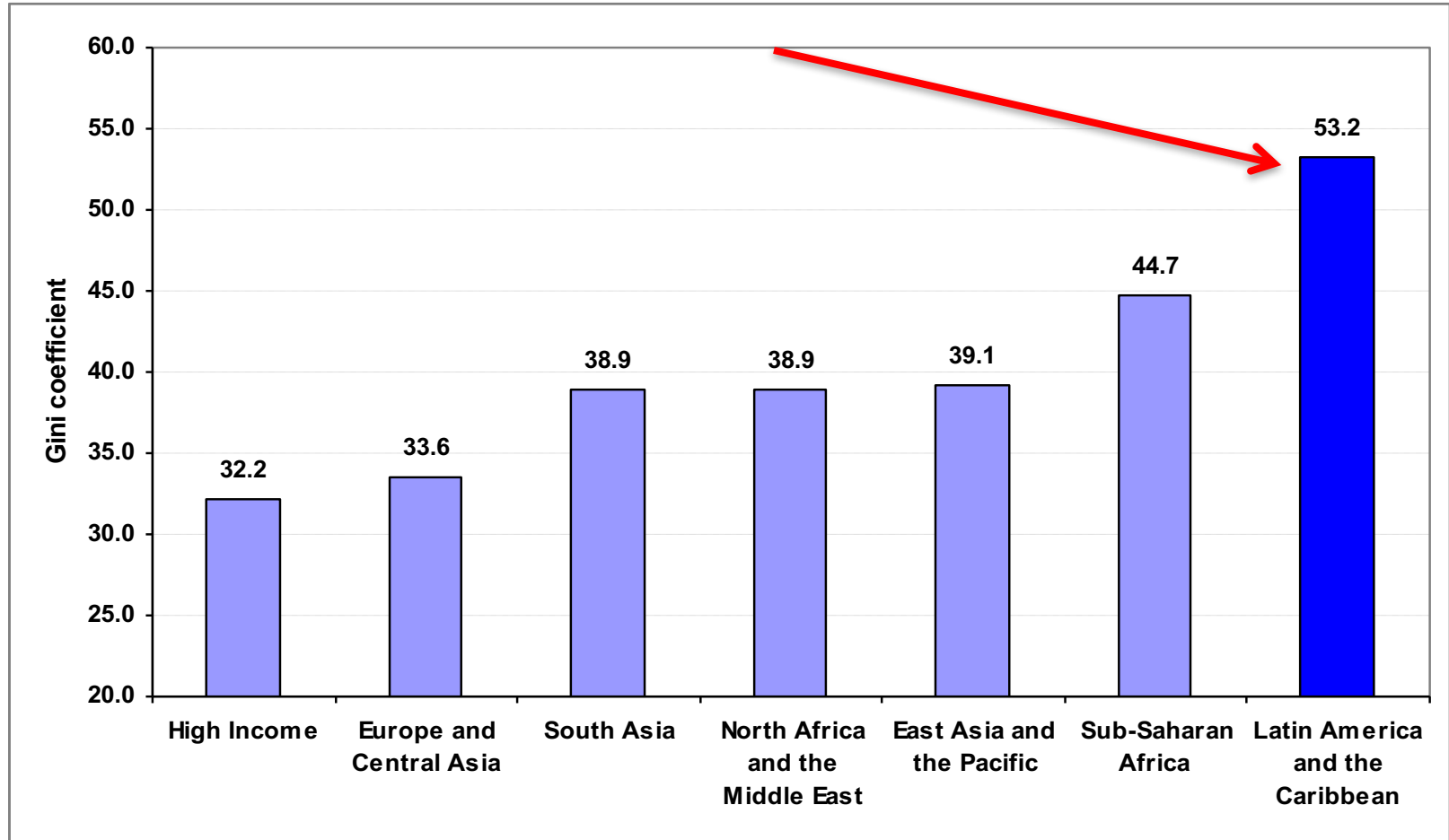
Inequality in Latin America is high...

...but has been declining since around 2000

- Decline is pervasive and significant
- Larger than the rise in inequality in 1990s
- Important contribution to the decline in poverty
- Contributed to the rise of the middle-class
- In countries with high growth & low growth
- In countries with left and nonleft governments
- In commodity exporters and commodity importers

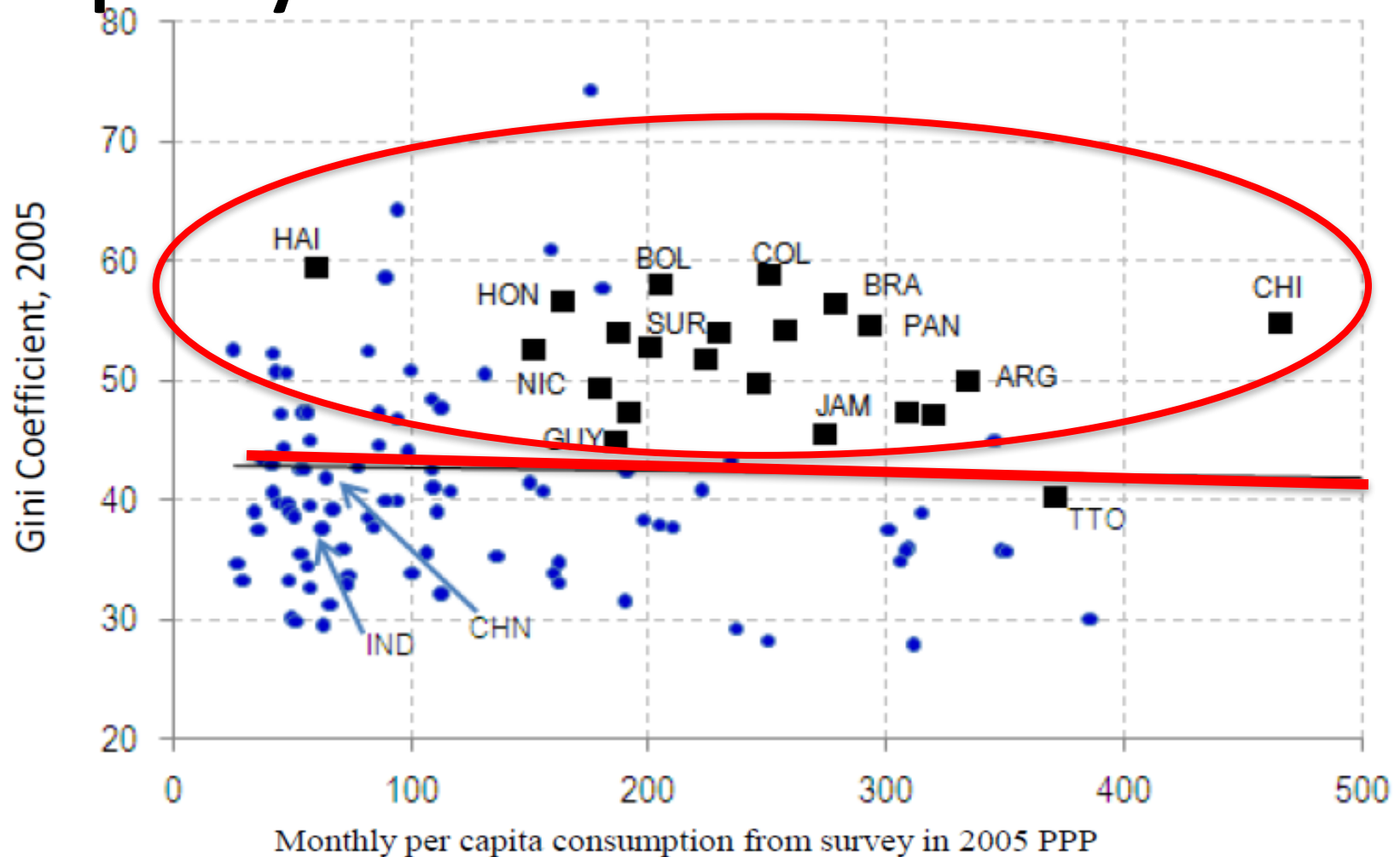
LATAM IS THE MOST UNEQUAL REGION IN THE WORLD

Gini Coefficient by Region (in %), 2004

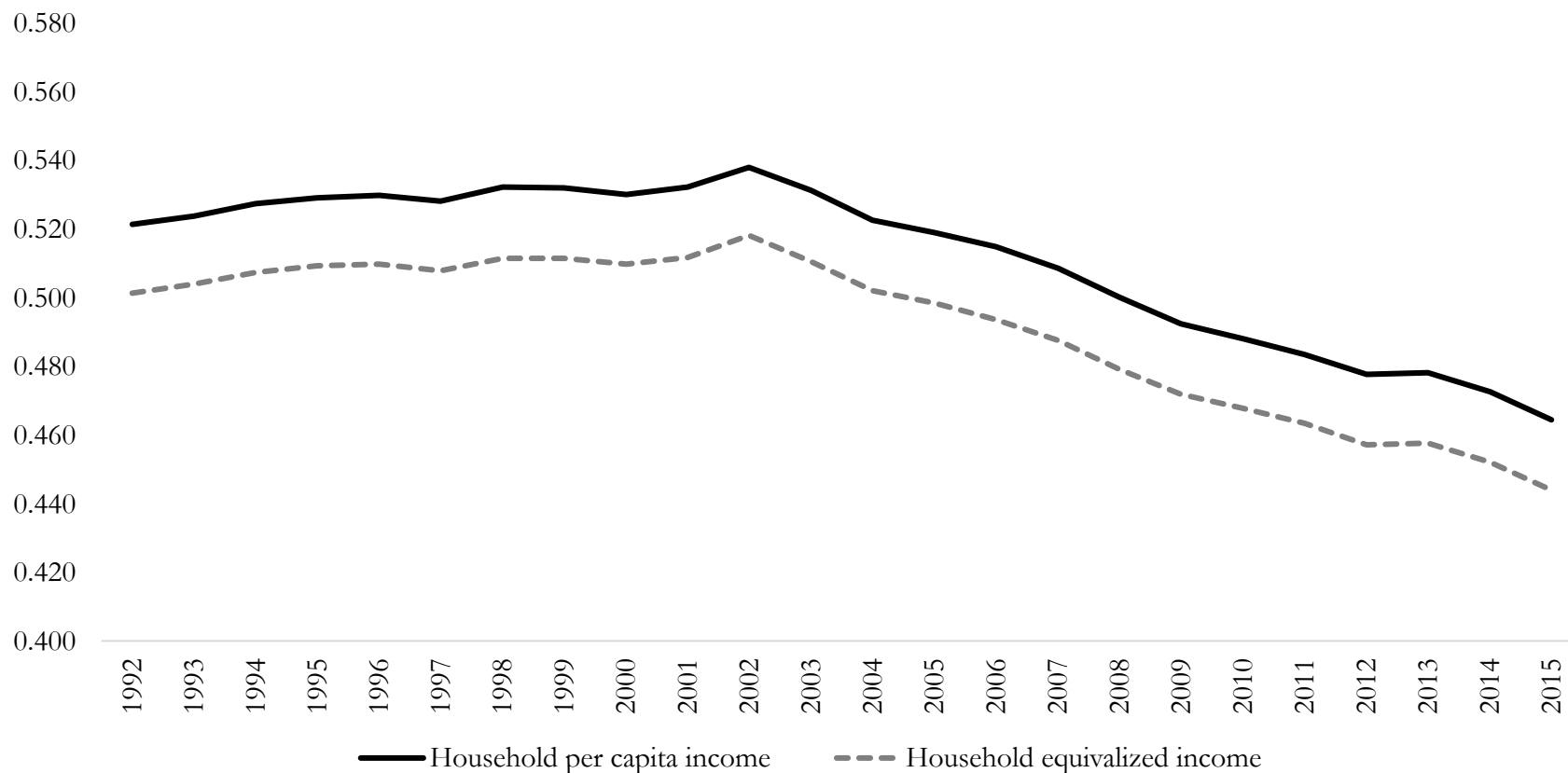


Ferreira and Ravallion, 2008.

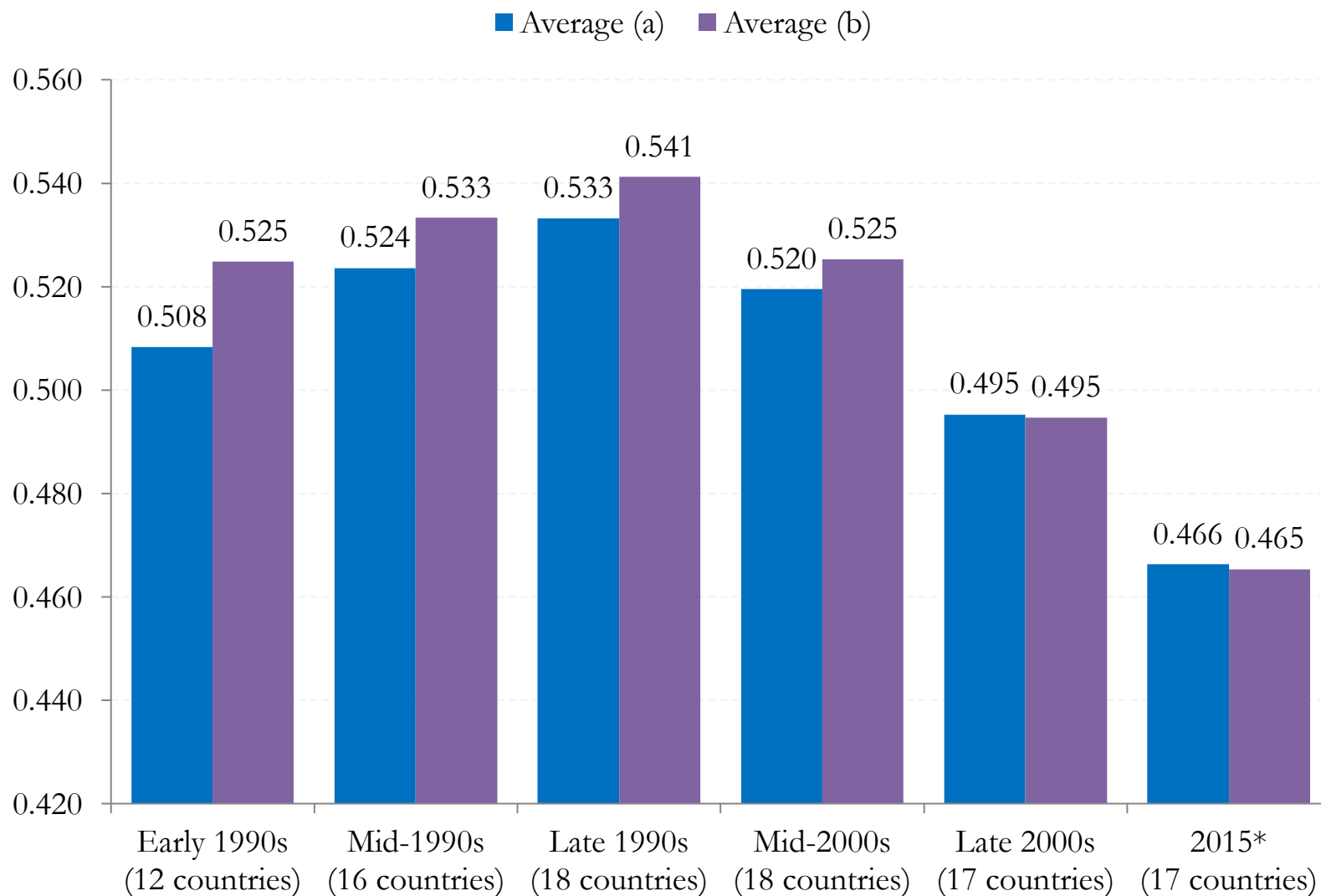
Latin America, a region with 'excess' inequality



Panel B1: Unweighted averages of the Gini coefficient, Latin America (18 countries)

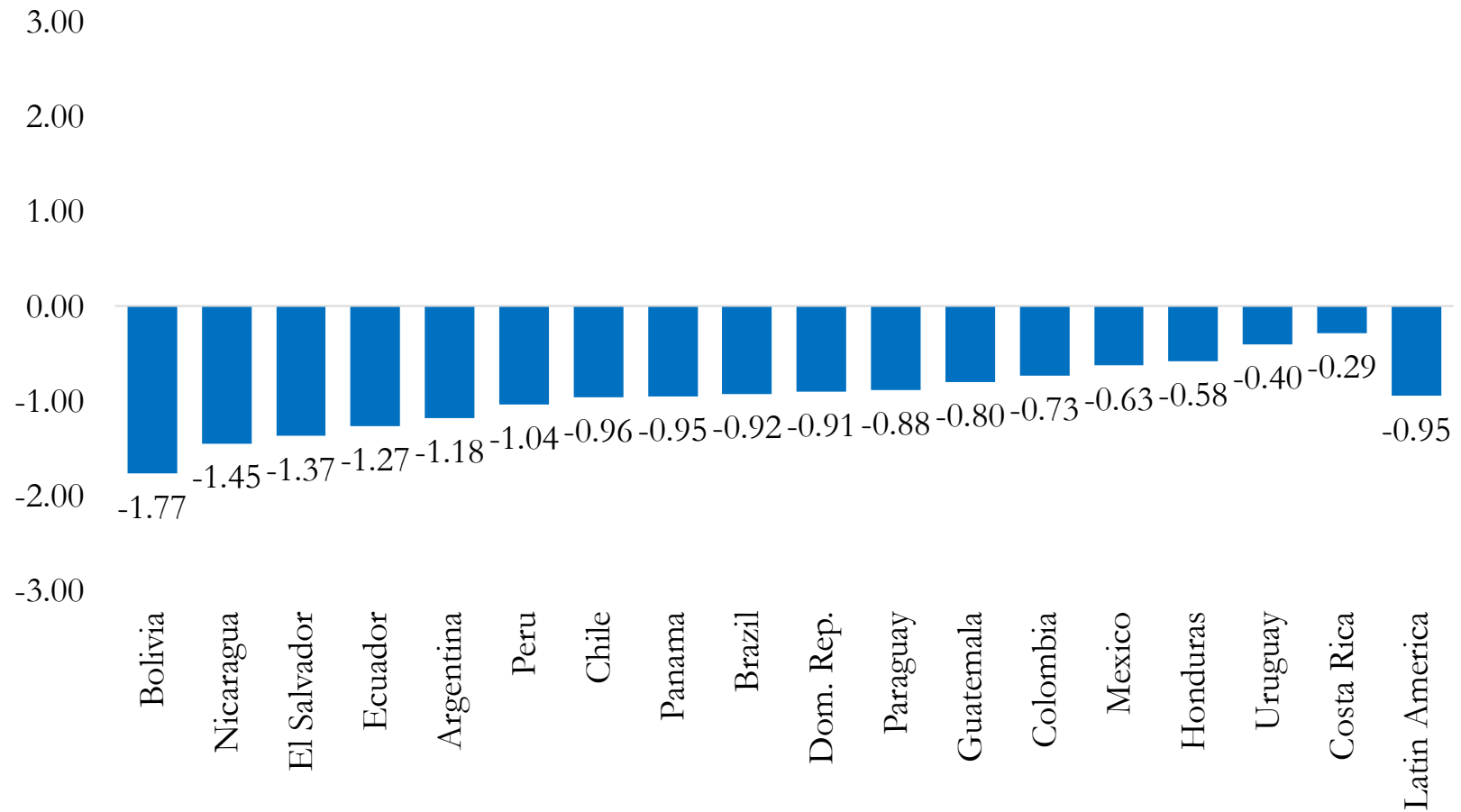


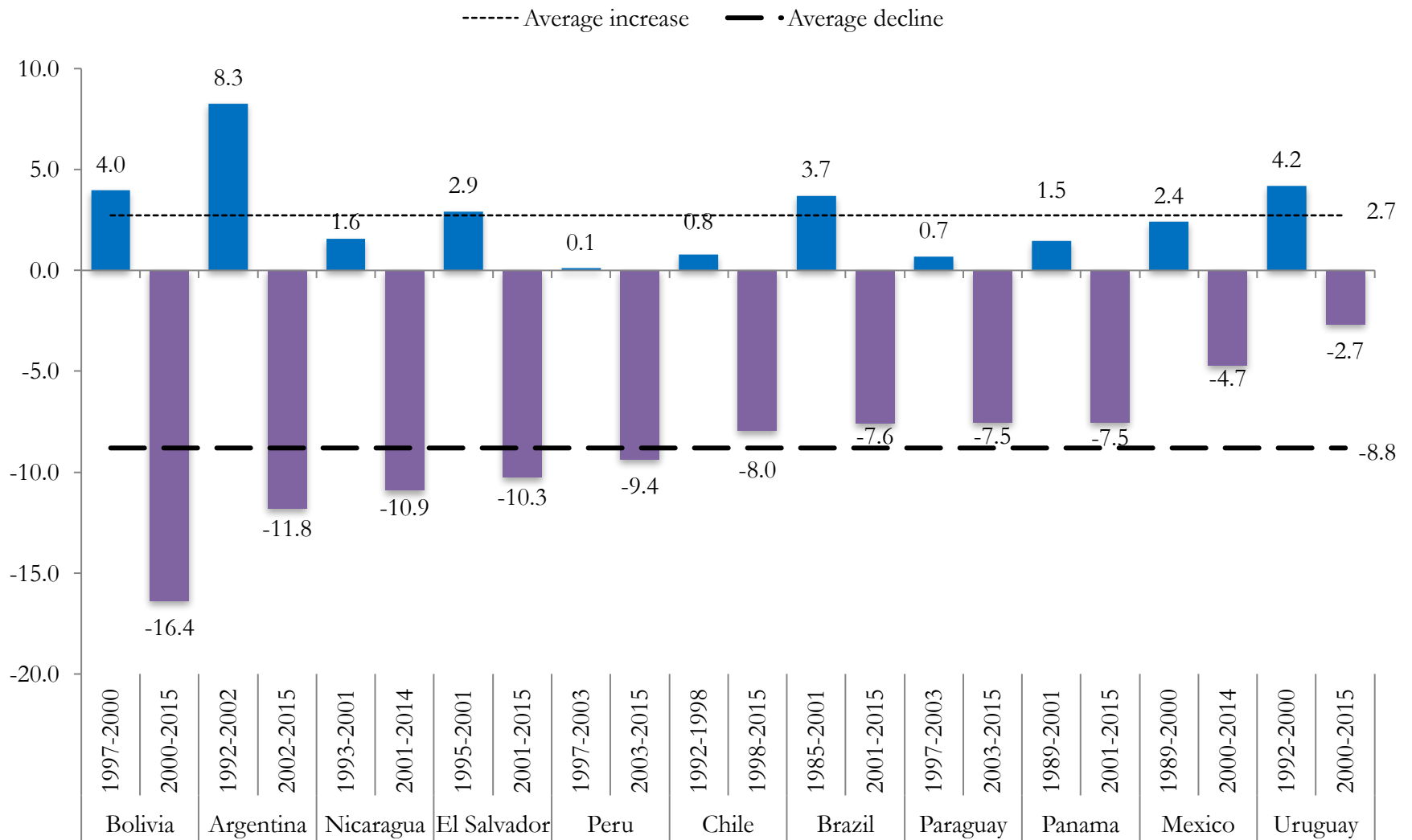
Average Gini Coefficient by Period



a) Refers to all countries and b) to the 16 countries in which ineq declined 2000-2015

**Panel C. Annual percentage change in Gini coefficient between
circa 2000 and 2015**





**The decline of income inequality in the 2000-2015 (-8.8%)
has been higher than the rise in the 1990s (2.7%)**

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

<u>Region^b</u>	<u>Gini Coefficient^a</u>		
	2000	2005	2010
<i>World.....</i>	<i>0.390</i>	<i>0.385</i>	<i>0.380</i>
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

Inequality in Latin America is high...

...but has been declining since around 2000

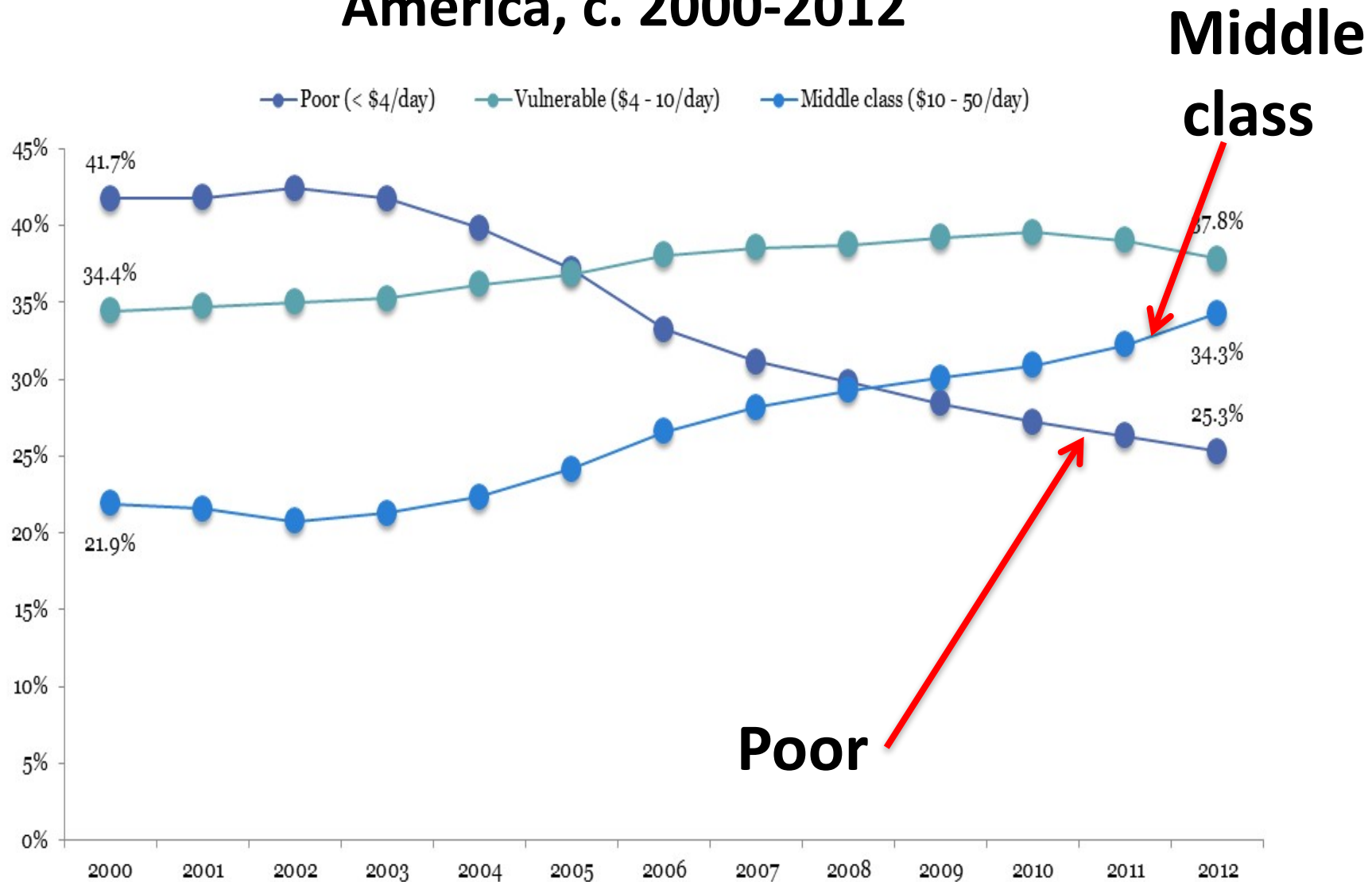
- Decline is pervasive and significant
- Larger than the rise in inequality in 1990s
- The region with the most significant decline
- Important contribution to the decline in poverty and the rise of the middle-class

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

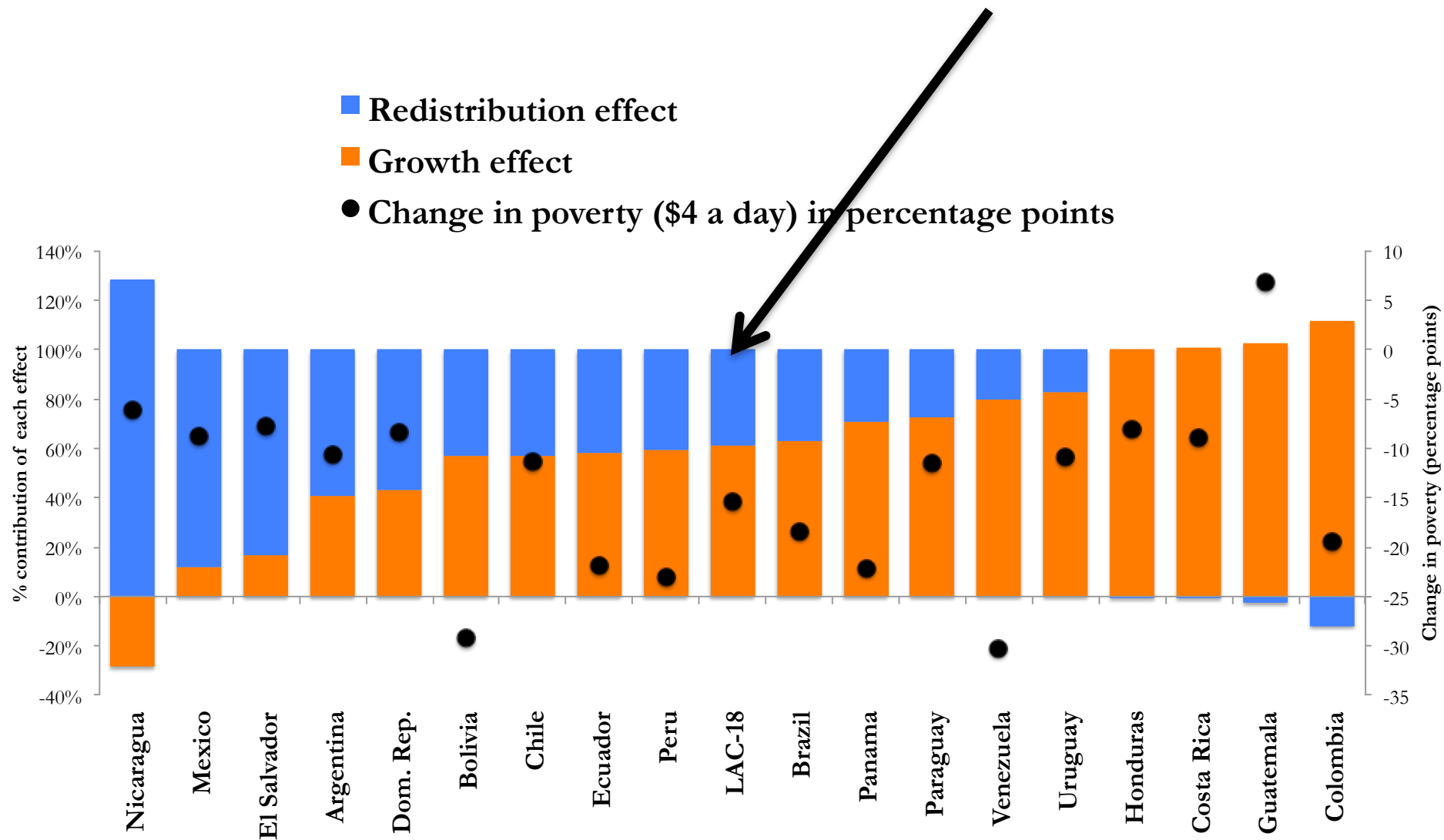
In the 2000s, economic growth and declining inequality led to

- significant poverty reduction: proportion of poor declined from 42 to 25 percent (poverty line US\$4 ppp (2005)/day)
- a robust expansion of the middle-class: proportion of middle class population rose from 22 to 34 percent

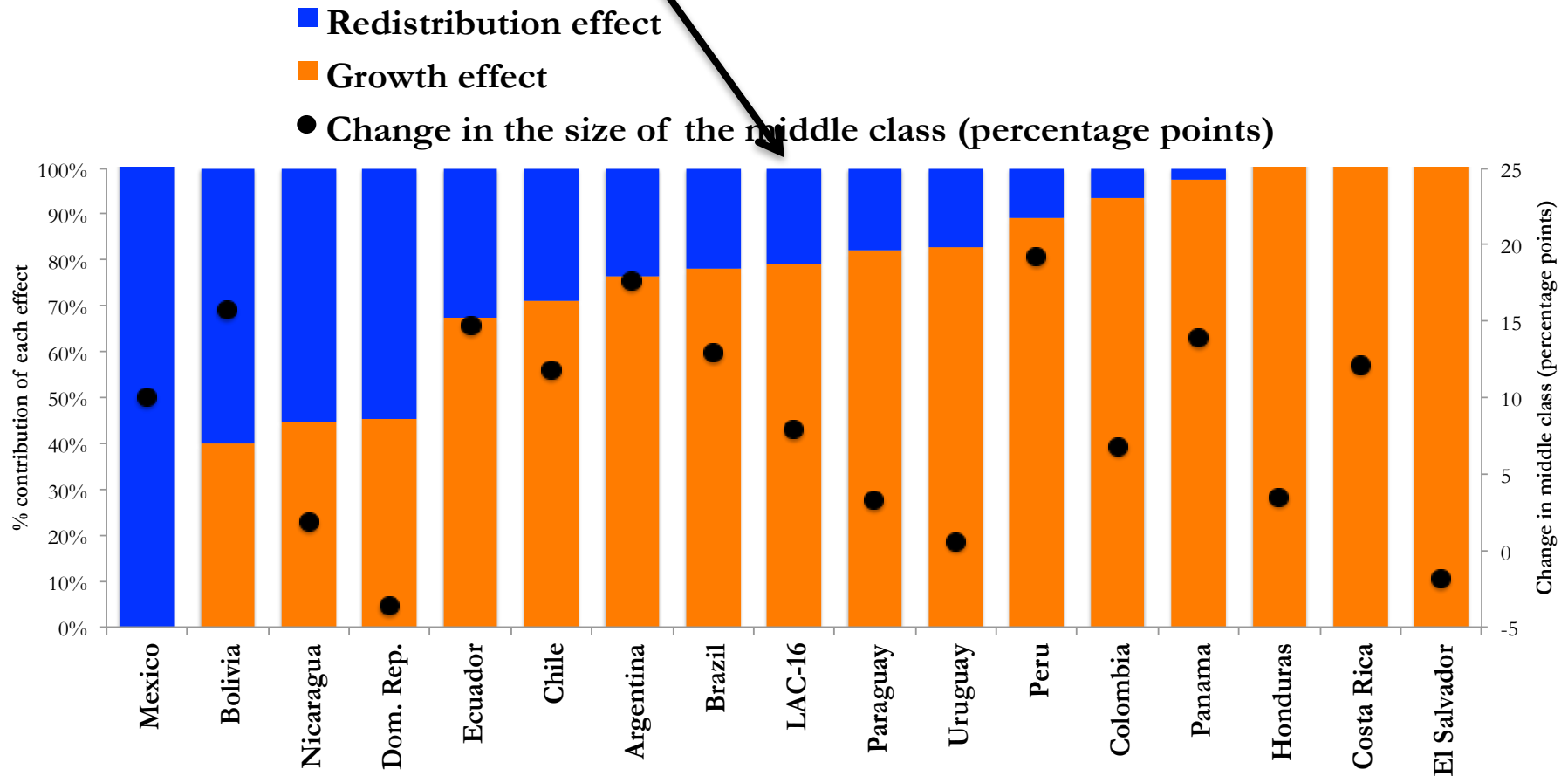
Percentage of population by income groups Latin America, c. 2000-2012



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 income inequality
decline?**

Inequality in Latin America is high...

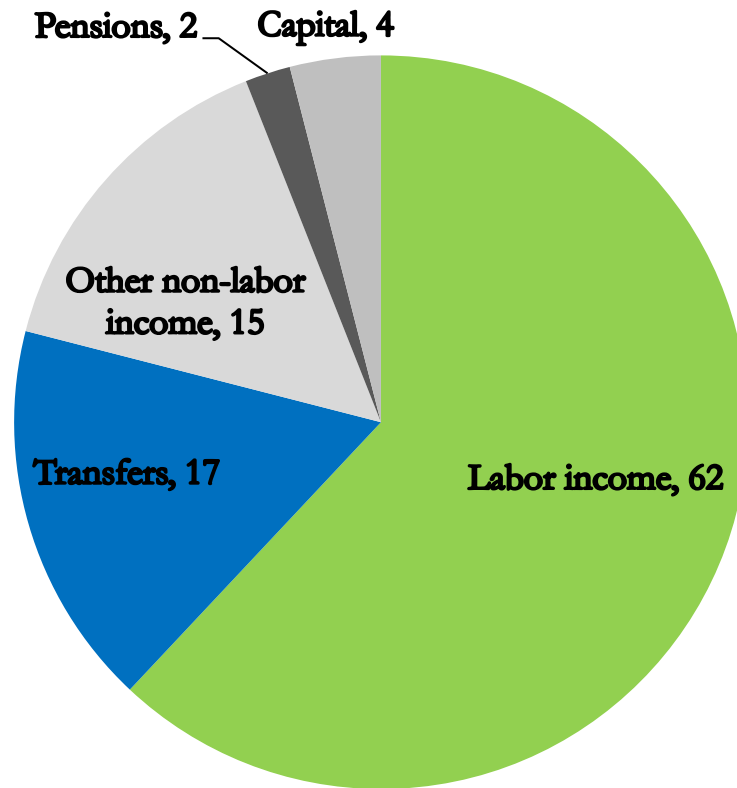
...but has been declining since around 2000

- In countries with high growth (Chile & Peru) & low growth (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

Determinants of the decline in inequality

- Declining inequality of hourly labor income
- Larger and more progressive transfers
- Higher labor participation rates
- Expansion of private transfers (remittances)

Determinants



Schooling and Inequality in Latin America

- On average, 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

**Why did labor income inequality
decline?**

Determinants of declining inequality in labor earnings:

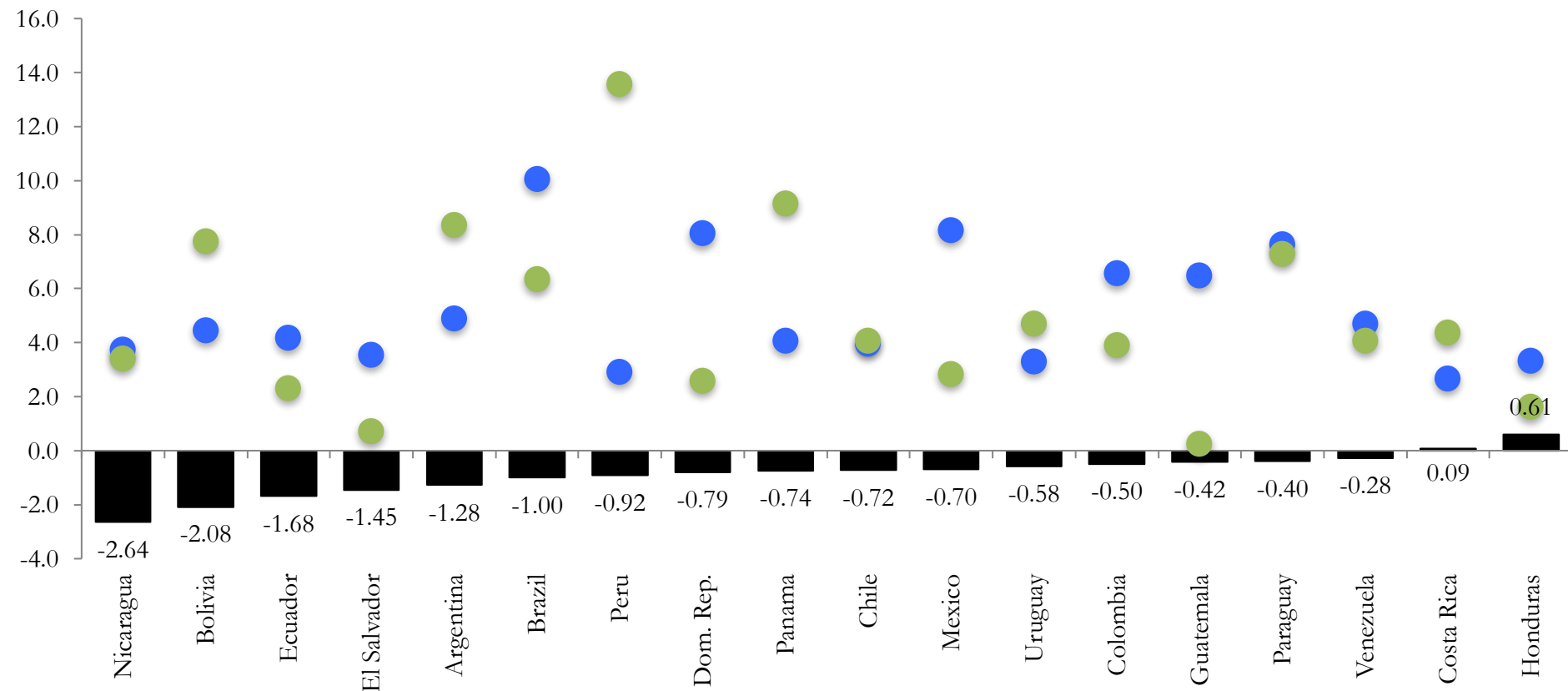
Decline in returns to tertiary education (aka. skill premium)

- The race between technology and education
 - Demand for and supply of skills
- Labor market institutions: minimum wages
- Declining “quality” in workers with tertiary degree

Gini coefficient and educational attainment; circa 2000-2012

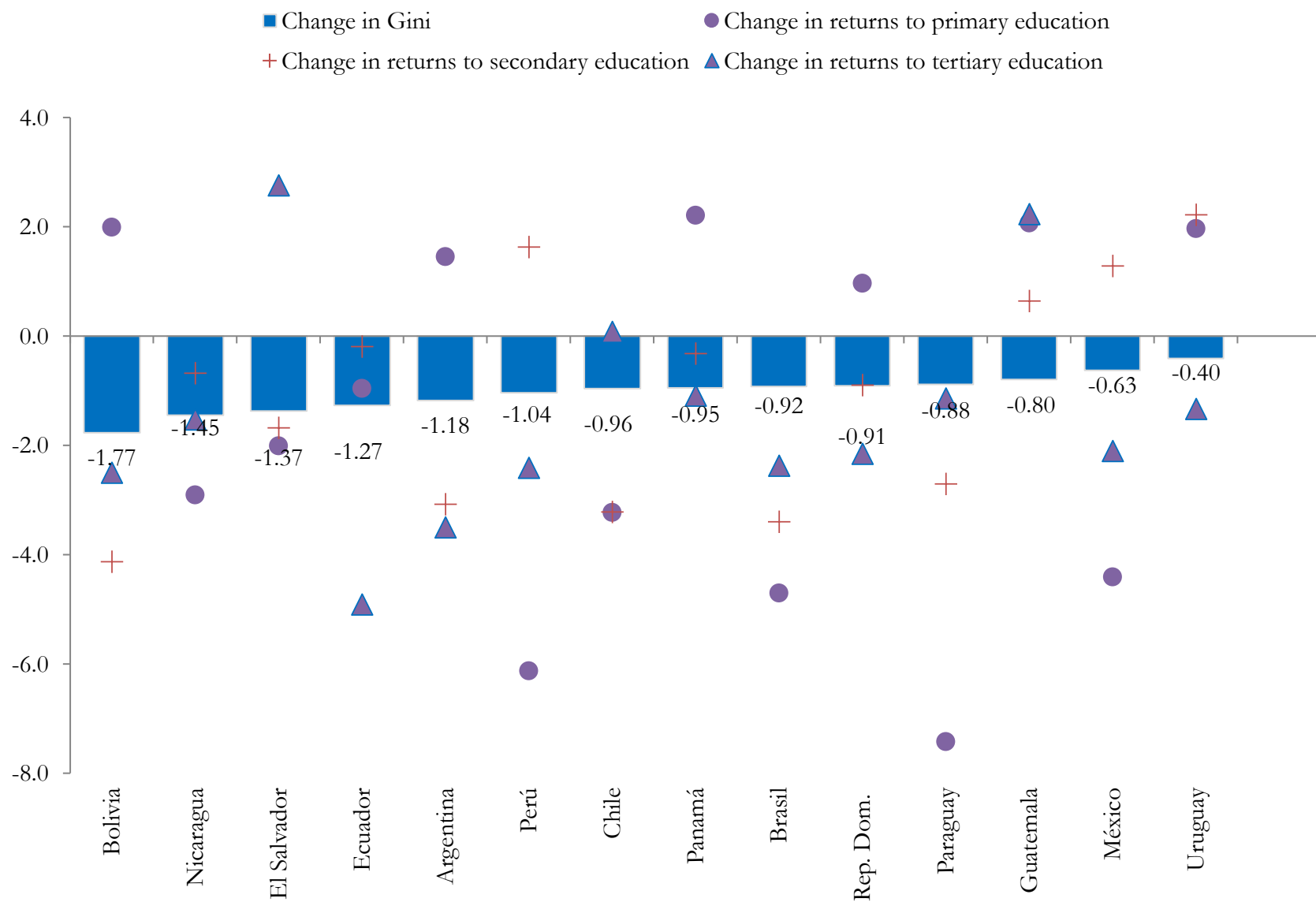
Educational attainment for total population aged 25-65

- 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).



Determinants of declining inequality in labor earnings:

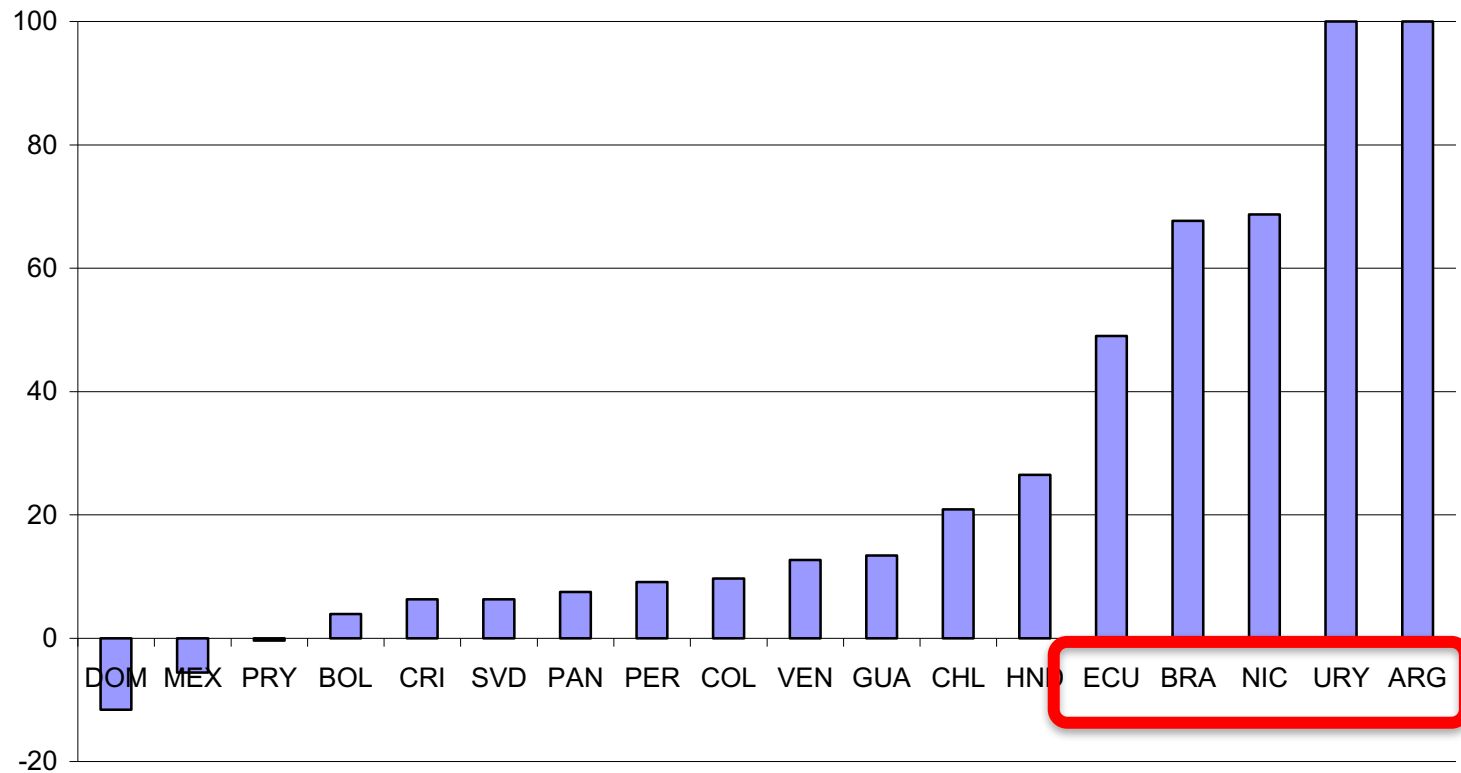
Reinforcing factors

- Labor market institutions: rising minimum wages
 - Rise of the Left
- Commodity boom=> higher demand for low-skilled workers
- Skill obsolescence and skilled labor saving technical change: Brazil and Mexico

Countervailing forces

- Assortative matching?

Increase in real value of minimum wage (2002-2010)



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

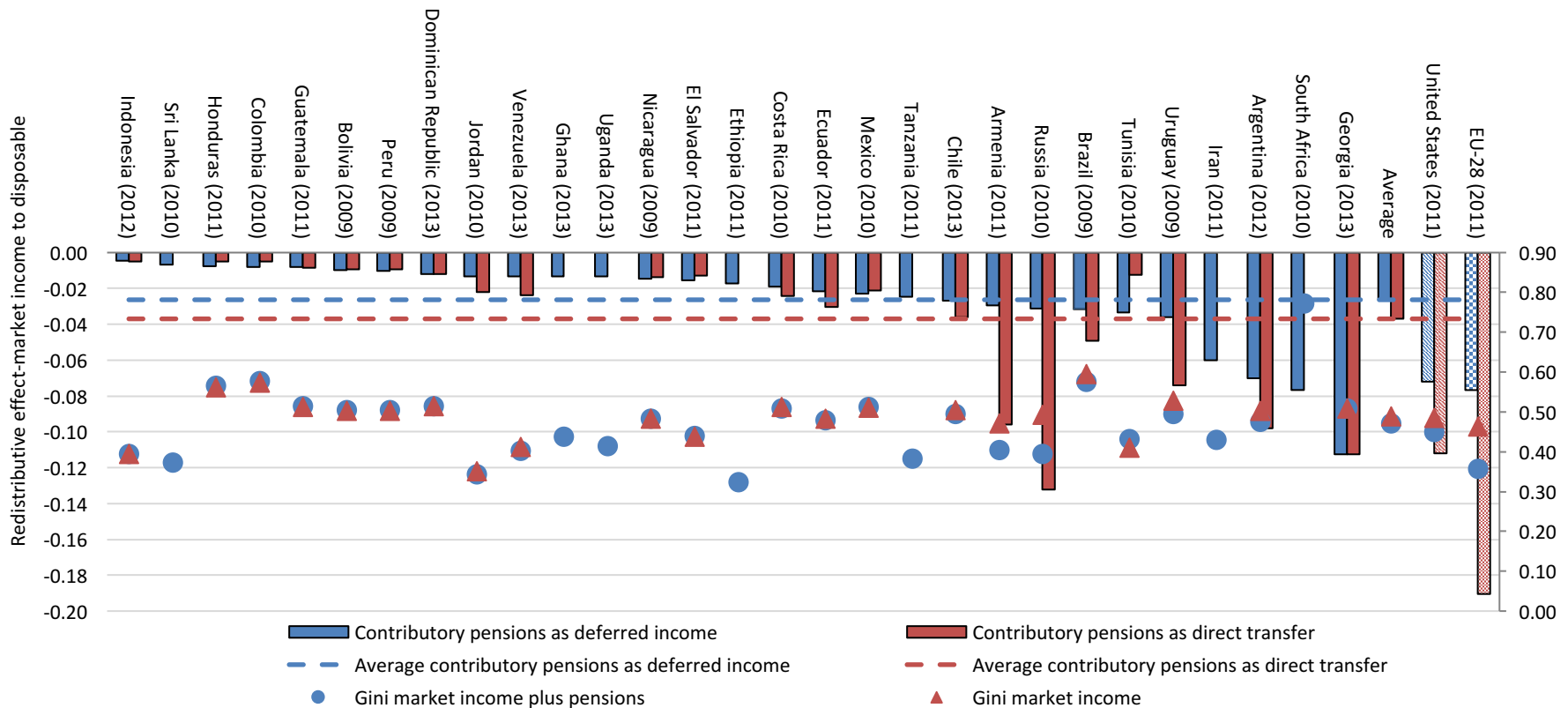
**Why did transfers become more
redistributive?**



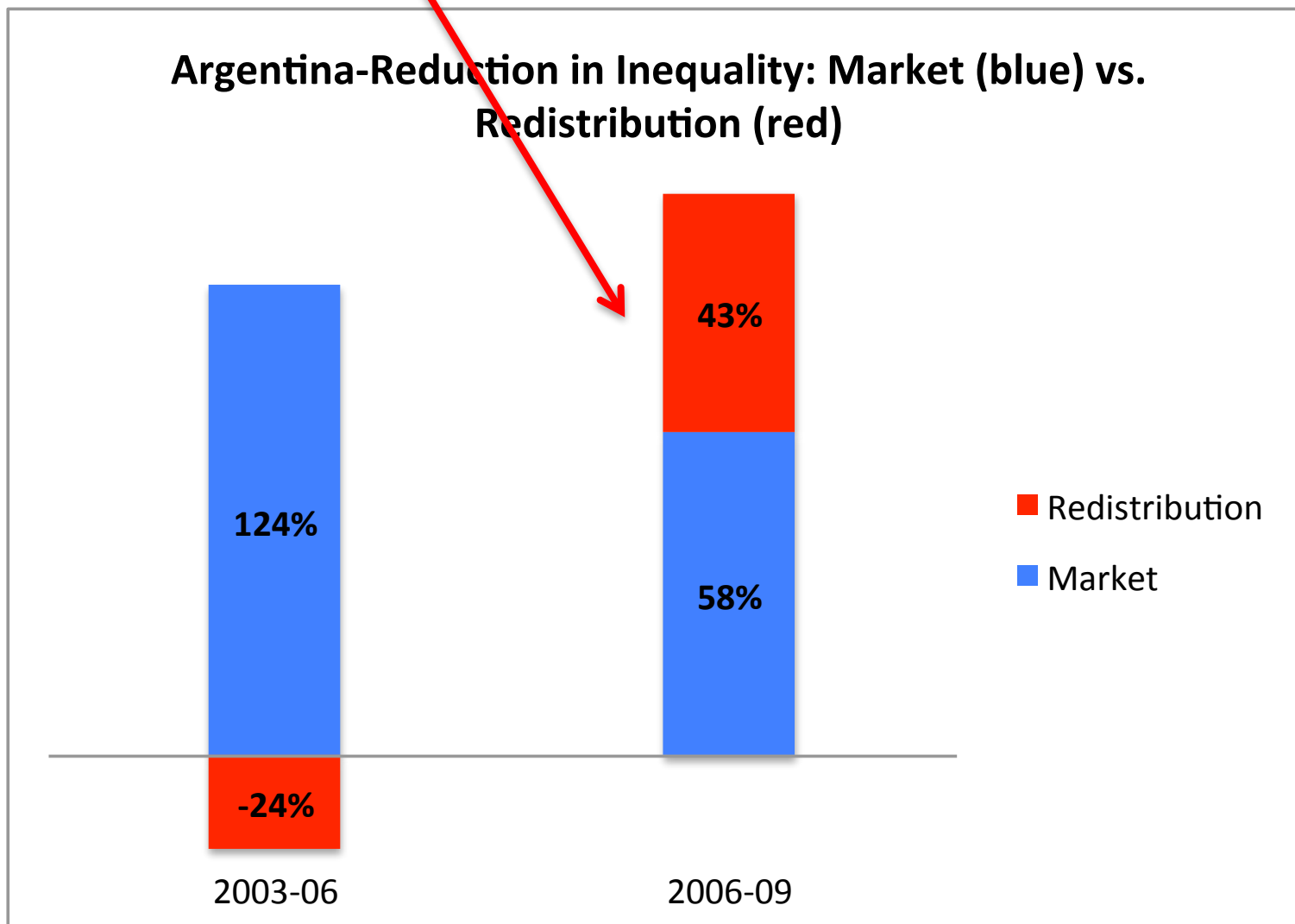
Redistributive Effect

(Change in Gini: market income plus pensions and market income to disposable income, circa 2010)

(ranked by redistributive effect (left hand scale); Gini coefficients right hand scale)



Argentina: Rising role of transfers



Mexico: Rising role of transfers

Mexico: The impact of cash transfers on inequality and poverty, 1996, 2000 and 2010

		Net market income	Disposable income
1996	Gini	0.522	0.520
	% change with respect to net market income	—	-0.4%
	Headcount index (\$2.5 PPP)	30.2%	29.9%
	% change wrt net market income	—	-1.0%
2000	Gini	0.544	0.539
	% change wrt net market income	—	-0.9%
	Headcount index (\$2.5 PPP)	22.1%	21.6%
	% change with respect to net market income	—	-2.3%
2010	Gini	0.503	0.495
	% change wrt net market income	—	-1.7%
	Headcount index (\$2.5 PPP)	13.8%	11%
	% change with respect to net market income	—	-20.1%

Campos, R., G. Esquivel and N. Lustig. 2014. "The Rise and Fall of Income Inequality in Mexico, 1989–2010," Chapter 7 in Giovanni Andrea Cornia, ed., *Falling Inequality in Latin America: Policy Changes and Lessons*, WIDER Studies in Development Economics, Oxford University Press,

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

References

- Azevedo, J. P., L. F. Lopez-Calva, N. Lustig, E. Ortiz-Juarez (2015) “Inequality, Mobility and Middle Classes in Latin America”, in: Dayton-Johnson, J. (2015) *Latin America’s Emerging Middle Class*. Palgrave MacMillan.
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- Lustig, Nora. Forthcoming. [“Fiscal Policy, Income Redistribution and Poverty Reduction in Low and Middle Income Countries,”](#) Chapter 9 in *Commitment to Equity Handbook. Estimating the Impact of Fiscal Policy on Inequality and Poverty*, edited by Nora Lustig (Brookings Institution Press and CEQ Institute, Tulane University).

Thank you