The Dynamics of Income Inequality in Latin America

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1st Catalan Economic Society Conference
Barcelona, Spain
May 27, 2017
• Huge increase in attention to inequality – both among economists and the general public

• Large literature on rising inequality in the United States
  – Juhn, Murphy and Pierce (1993)
  – Autor, Dorn and Hanson (2013)
  – Alvaredo, Chancel, Piketty, Saez, Zucman (2017)

• But inequality can and does fall, as well as rise
  – 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 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)

- Household per capita income
- Household equivalized income
Average Gini Coefficient by Period

- **Early 1990s** (12 countries): Average (a) 0.508
- **Mid-1990s** (16 countries): Average (a) 0.525, Average (b) 0.524
- **Late 1990s** (18 countries): Average 0.533
- **Mid-2000s** (18 countries): Average 0.533, Average (b) 0.520
- **Late 2000s** (17 countries): Average 0.525
- **2015*** (17 countries): Average (a) 0.495, Average (b) 0.495
- **Average (a)** refers to all countries
- **Average (b)** refers 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

<table>
<thead>
<tr>
<th>Region</th>
<th>Gini Coefficient&lt;sup&gt;a&lt;/sup&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2000</td>
</tr>
<tr>
<td>World</td>
<td>0.390</td>
</tr>
<tr>
<td>Advanced Economies</td>
<td>0.298</td>
</tr>
<tr>
<td>East Asia and the Pacific</td>
<td>0.38</td>
</tr>
<tr>
<td>Eastern Europe and Central Asia</td>
<td>0.331</td>
</tr>
<tr>
<td>Latin America and the Caribbean</td>
<td>0.551</td>
</tr>
<tr>
<td>Middle East and North Africa</td>
<td>Not Enough Data</td>
</tr>
<tr>
<td>South Asia</td>
<td>0.354</td>
</tr>
<tr>
<td>Sub-Saharan Africa</td>
<td>0.445</td>
</tr>
</tbody>
</table>
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

Azevedo, Lopez-Calva, Lustig and Ortiz. 2015. Inequality, Mobility and Middle Classes in Latin America. In Dayton, Jeff (editor)
Poverty reduction: growth contributed with 61 percent and inequality reduction with 39 percent, on average

Lustig et al. (2014) based on SEDLAC
Expansion of the middle-class: growth contributed with about 79 percent and inequality reduction with 21 percent, on average

Redistribution effect
Growth effect
Change in the size of the middle class (percentage points)

Lustig et al. (2014) based on SEDLAC
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

- Labor income, 62
- Transfers, 17
- Other non-labor income, 15
- Pensions, 2
- Capital, 4
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).
Change in Gini
Change in returns to primary education
Change in returns to secondary education
Change in returns to tertiary education

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?
http://www.commitmenttoequity.org/
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)

Source: Lustig (forthcoming)
Argentina: Rising role of transfers

Argentina-Reduction in Inequality: Market (blue) vs. Redistribution (red)

2003-06
-24%

2006-09
124%

43%

58%

Redistribution
Market

Lustig, N. and C. Pessino. 2014.
### Mexico: Rising role of transfers

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

<table>
<thead>
<tr>
<th>Year</th>
<th>Gini</th>
<th>Net market income</th>
<th>Disposable income</th>
<th>% change wrt net market income</th>
<th>Headcount index ($2.5 PPP)</th>
<th>% change wrt net market income</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td></td>
<td>0.522</td>
<td>0.520</td>
<td></td>
<td>30.2%</td>
<td>-1.0%</td>
</tr>
<tr>
<td>2000</td>
<td></td>
<td>0.544</td>
<td>0.539</td>
<td></td>
<td>22.1%</td>
<td>-2.3%</td>
</tr>
<tr>
<td>2010</td>
<td></td>
<td>0.503</td>
<td>0.495</td>
<td></td>
<td>13.8%</td>
<td>-1.7%</td>
</tr>
</tbody>
</table>

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


Thank you