

# Poverty, the Middle Class and Inequality in Latin America

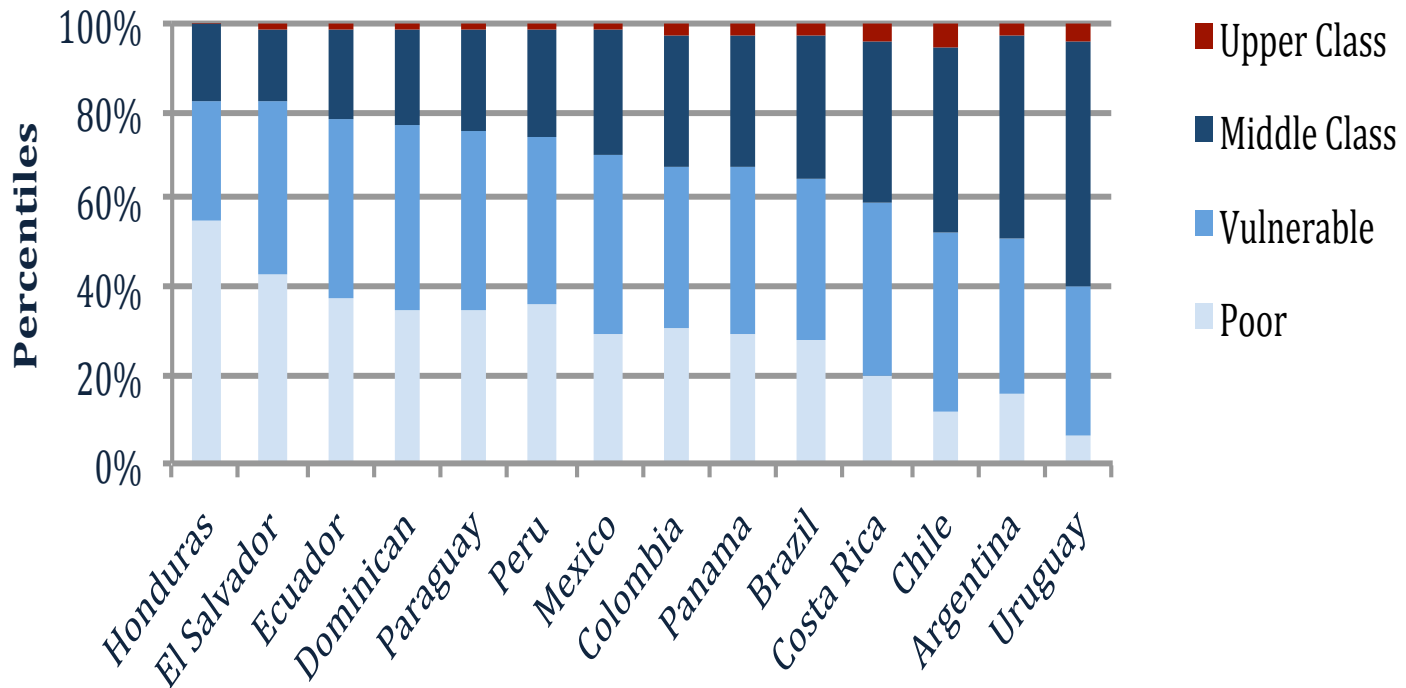
Nora Lustig

Professor, Tulane University

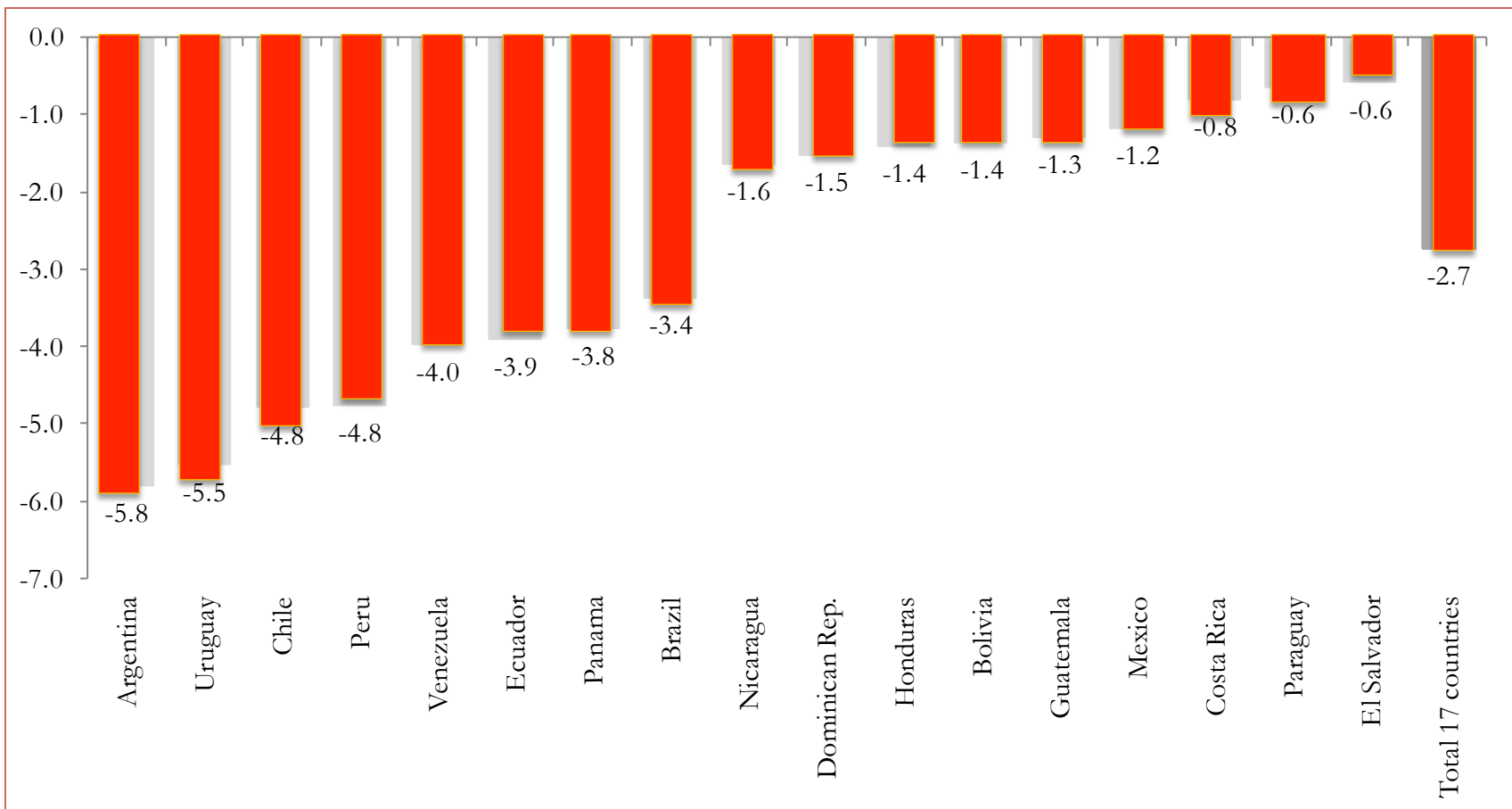
Nonresident Fellow, CGD and IAD

*LASA, San Francisco, May 26, 2012*

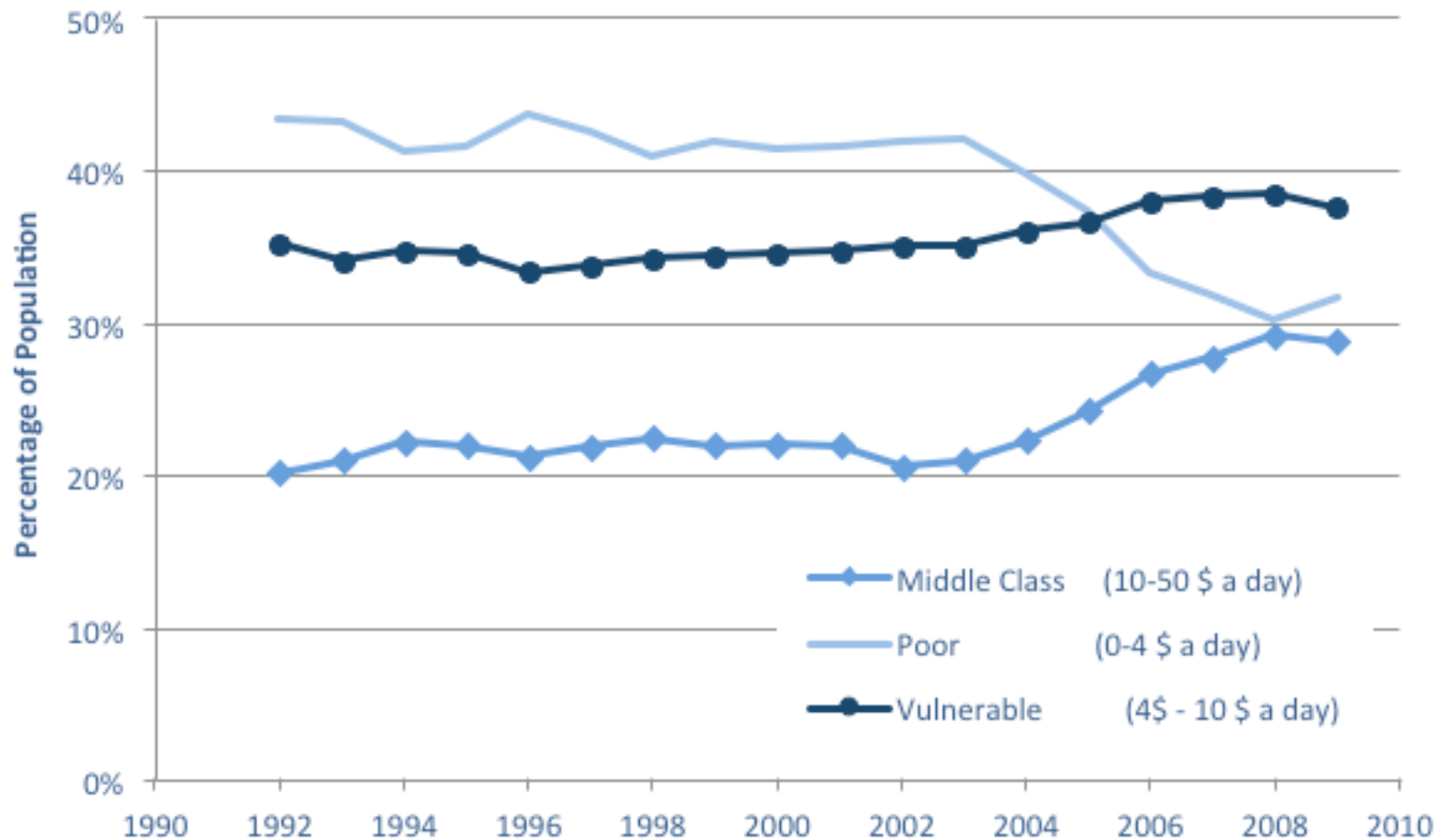
## Class composition by country (2009)



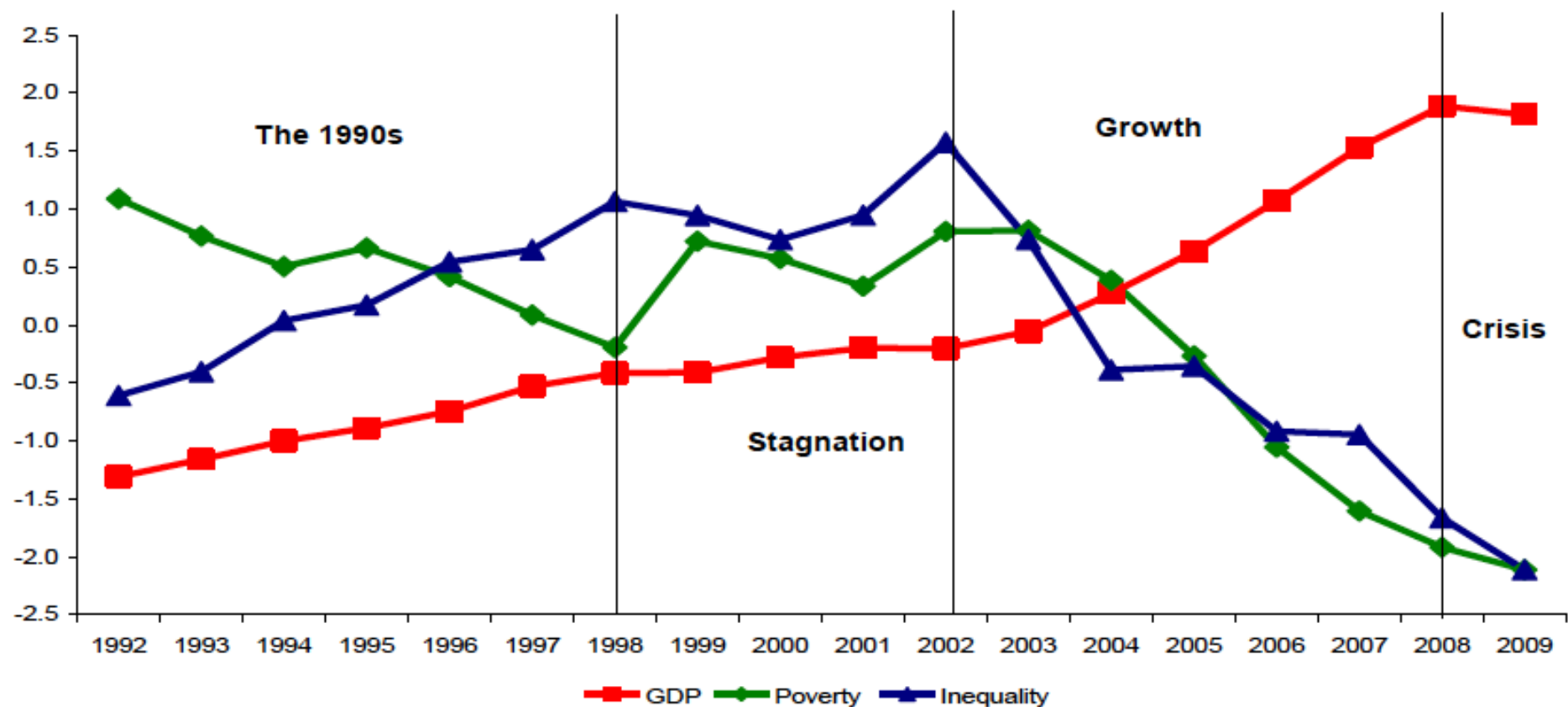
# Decline in Extreme Poverty (2000-2010)



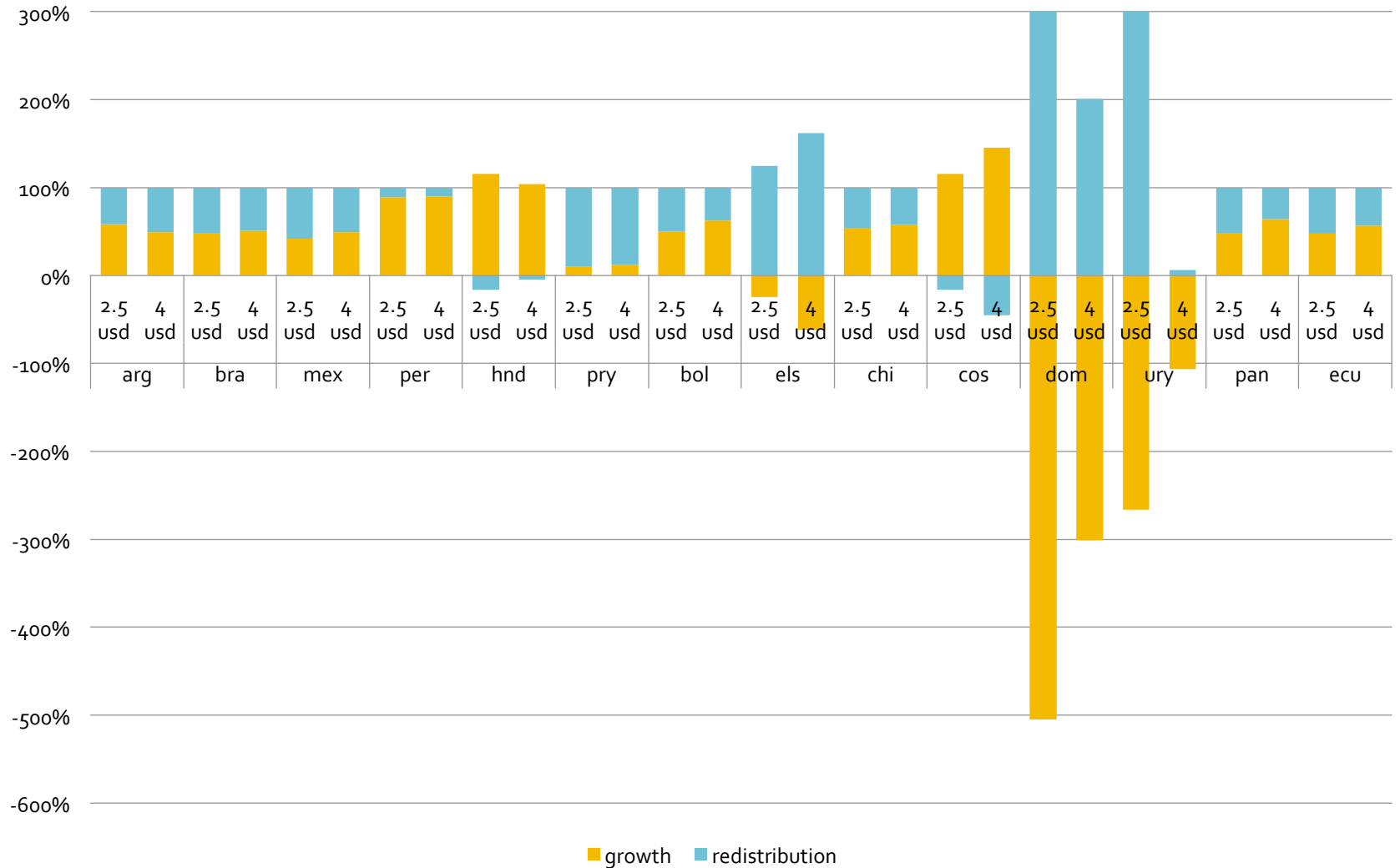
# LA: Trends in Poverty, Vulnerable and Middle Class



**Gini coefficient, poverty based on the 4USD international line and GDP.  
Average for Latin America, 1992-2009**



## Change in Poverty: Growth and Redistribution





# Decomposing into Growth & Redistribution (2000-2010)

- Decline in poverty, 54 percent due to redistribution
- Increase in middle class, 35 percent due to redistribution
- => Declining Inequality plays an important role



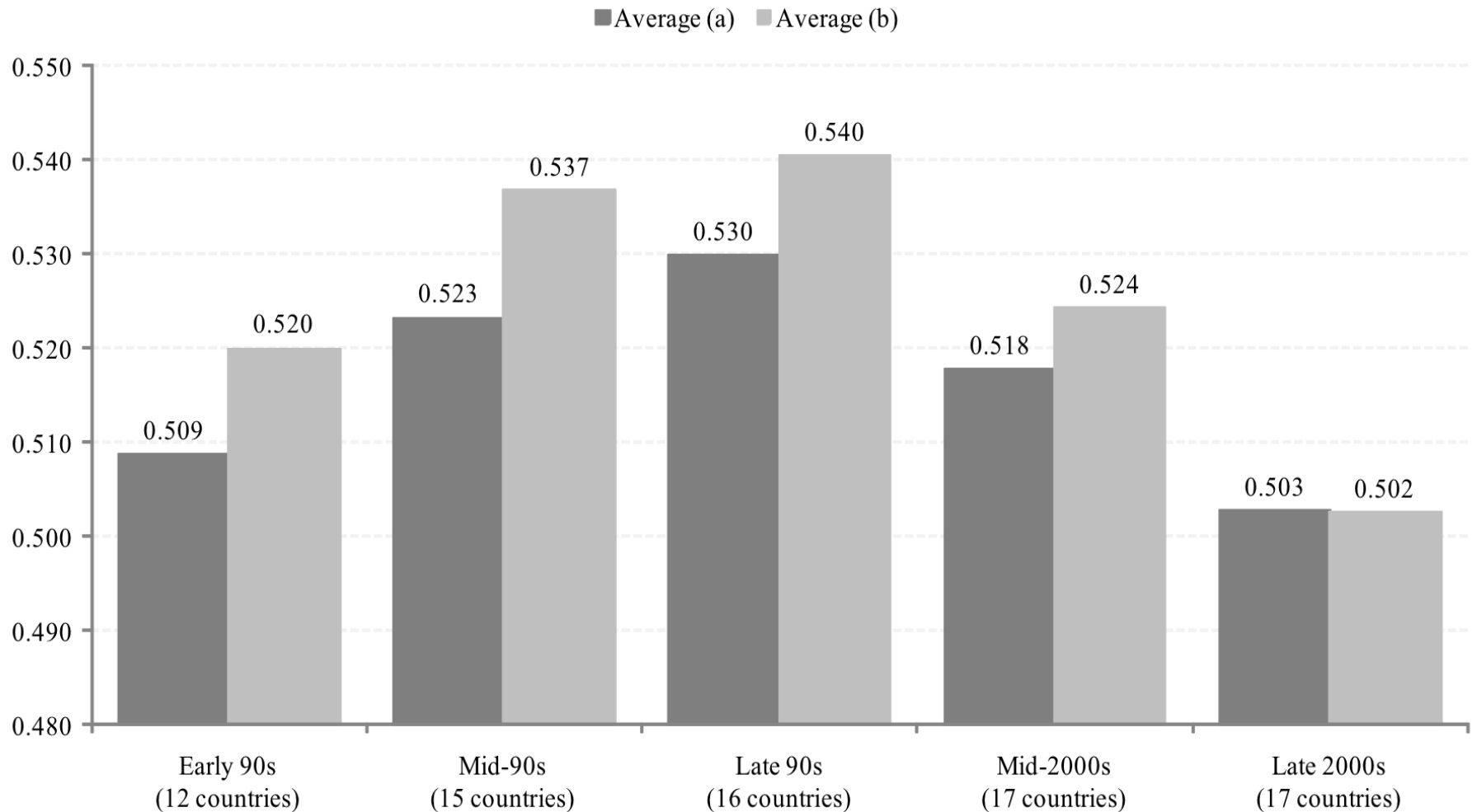
# Declining Inequality in LA: How Much?

- Inequality in most Latin American countries (13 out of 17) has declined (roughly 1% a year) between (circa) 2000 and (circa) 2010
- Decline continued through the global financial crisis in 2009
- Inequality declined in LA while it rose in other regions

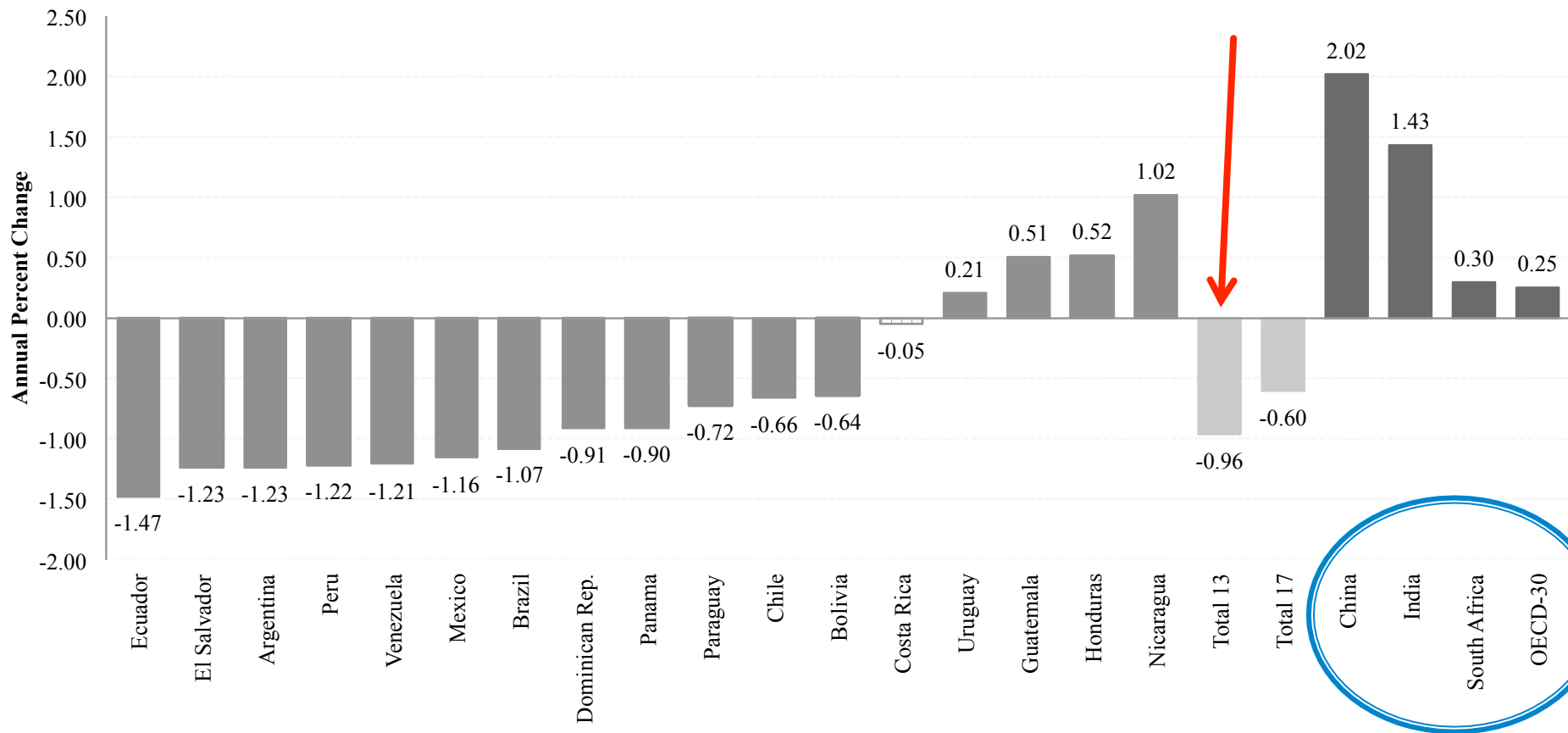
# Trends in Inequality

Gini Coefficient Early 1990's-Late 2000's (Unweighted ave.)

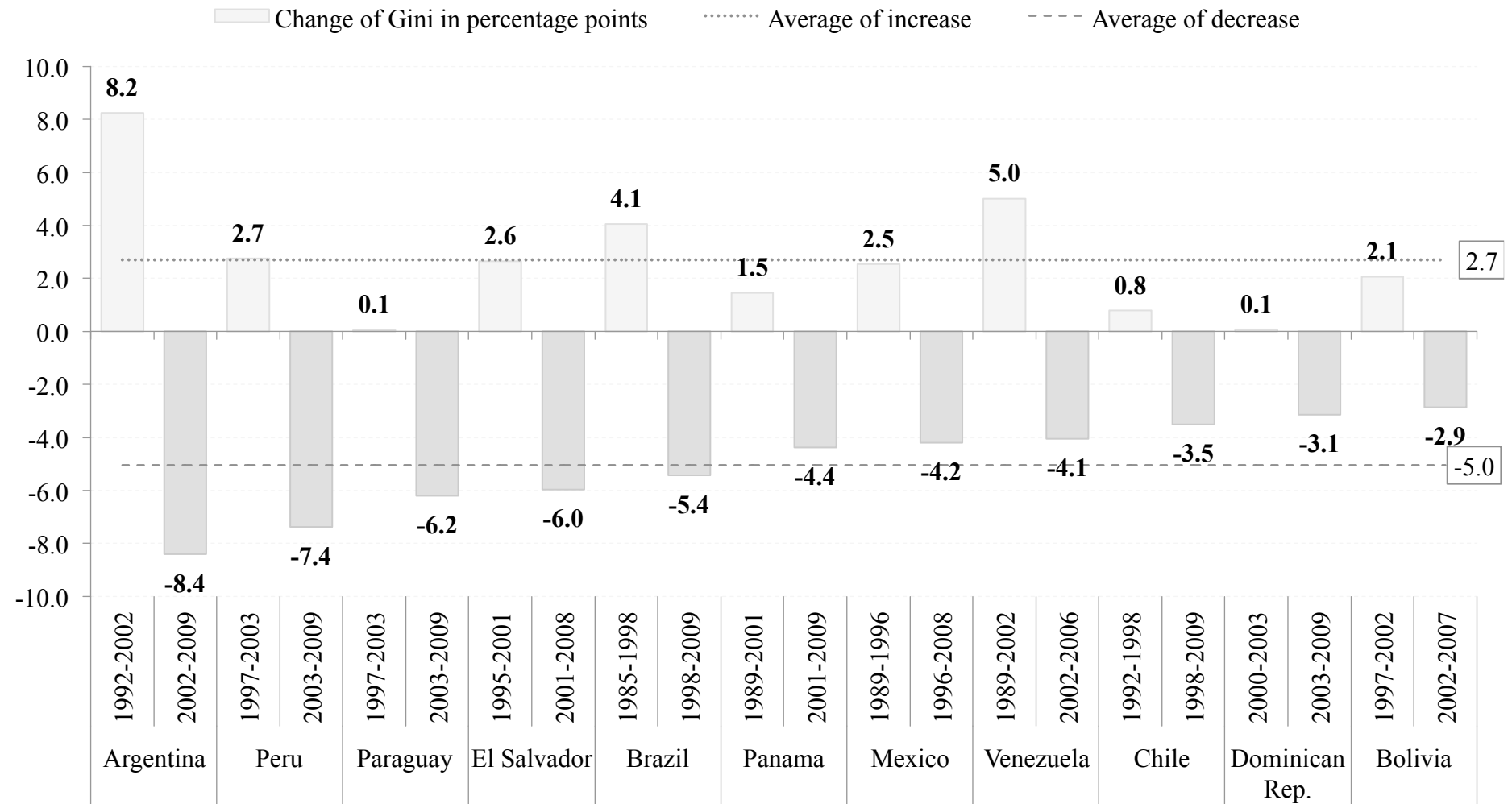
Light Grey: Countries with Falling Ineq (Lustig et al., 2011)



# Change in Gini Coefficient by Country: circa 2000-2009 (yearly change in percent)



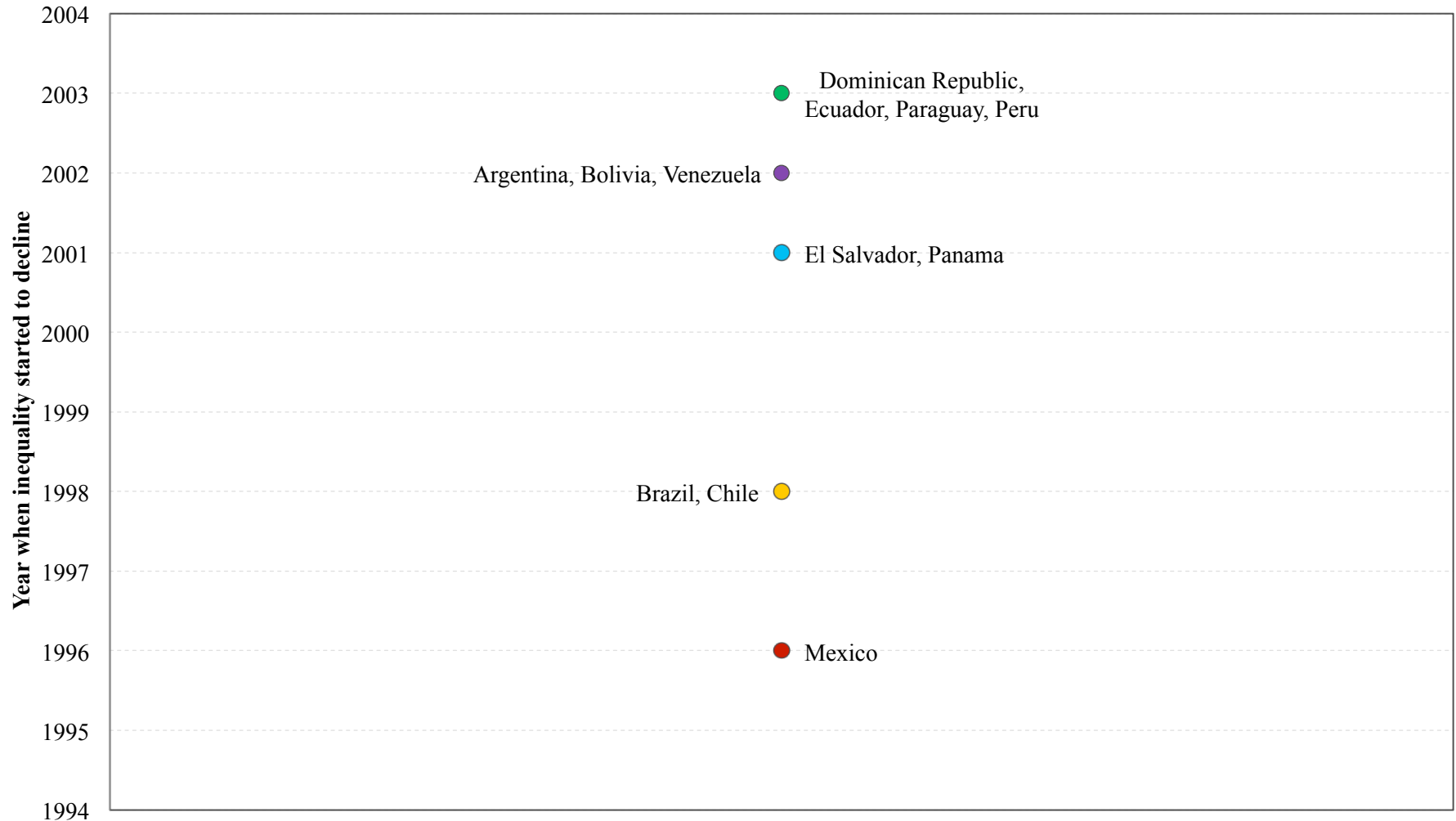
# Comparing the Increase in the 1990's with Decline in the 2000's (Lustig et al., 2011)



# Declining Inequality in LA: Since When?

- In three countries, during second half of 1990s: Mexico, Brazil and Chile
- In six, started in 2002-2003: Argentina, Bolivia, El Salvador, Paraguay, Panama and Peru
- In others, although there are fluctuations, inequality between 2000 and 2009 increased: Costa Rica, Honduras and Uruguay

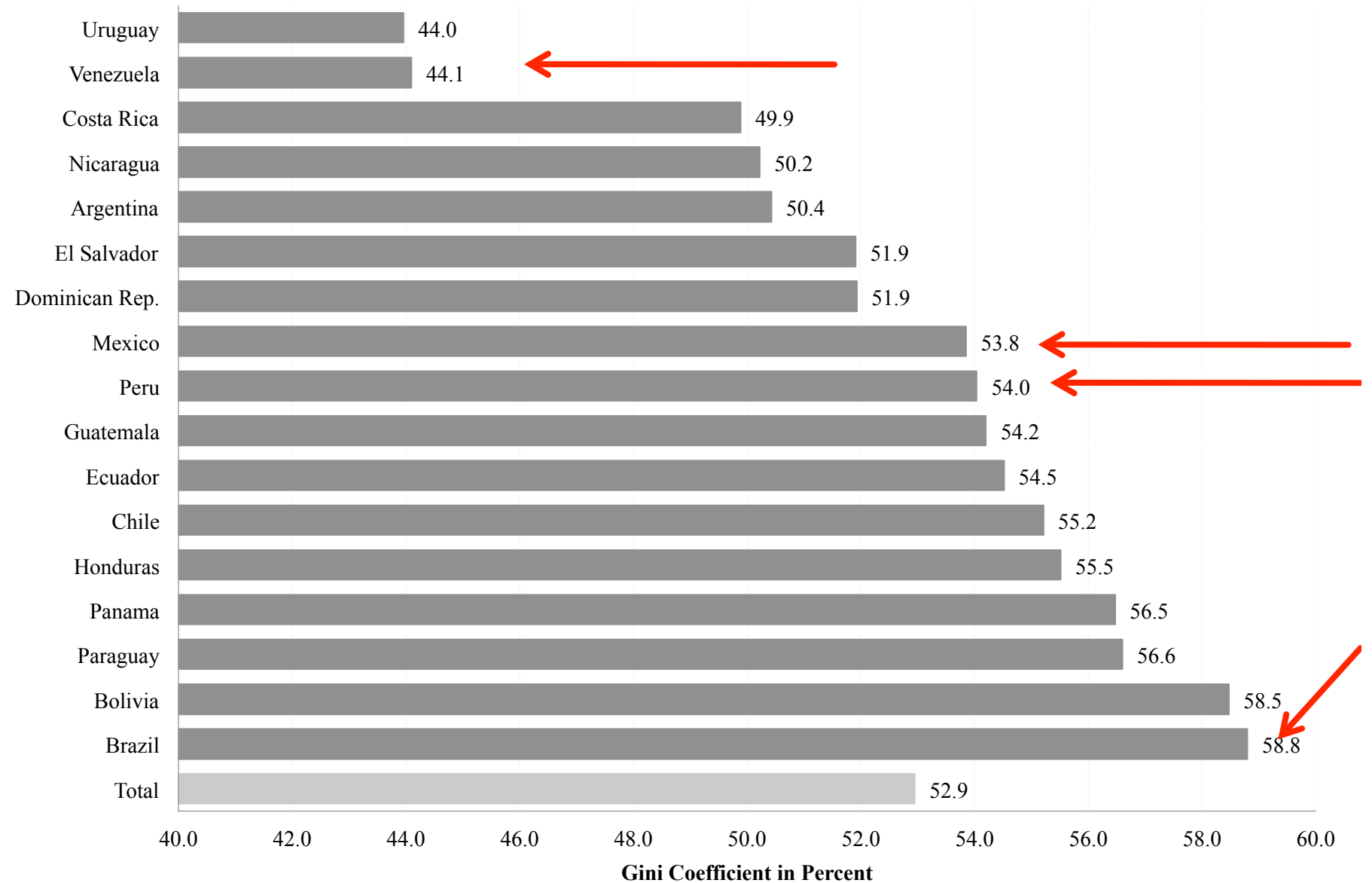
# First Year in Which Inequality Started to Decline (Lustig et al, 2011)



# The decline in inequality has been widespread

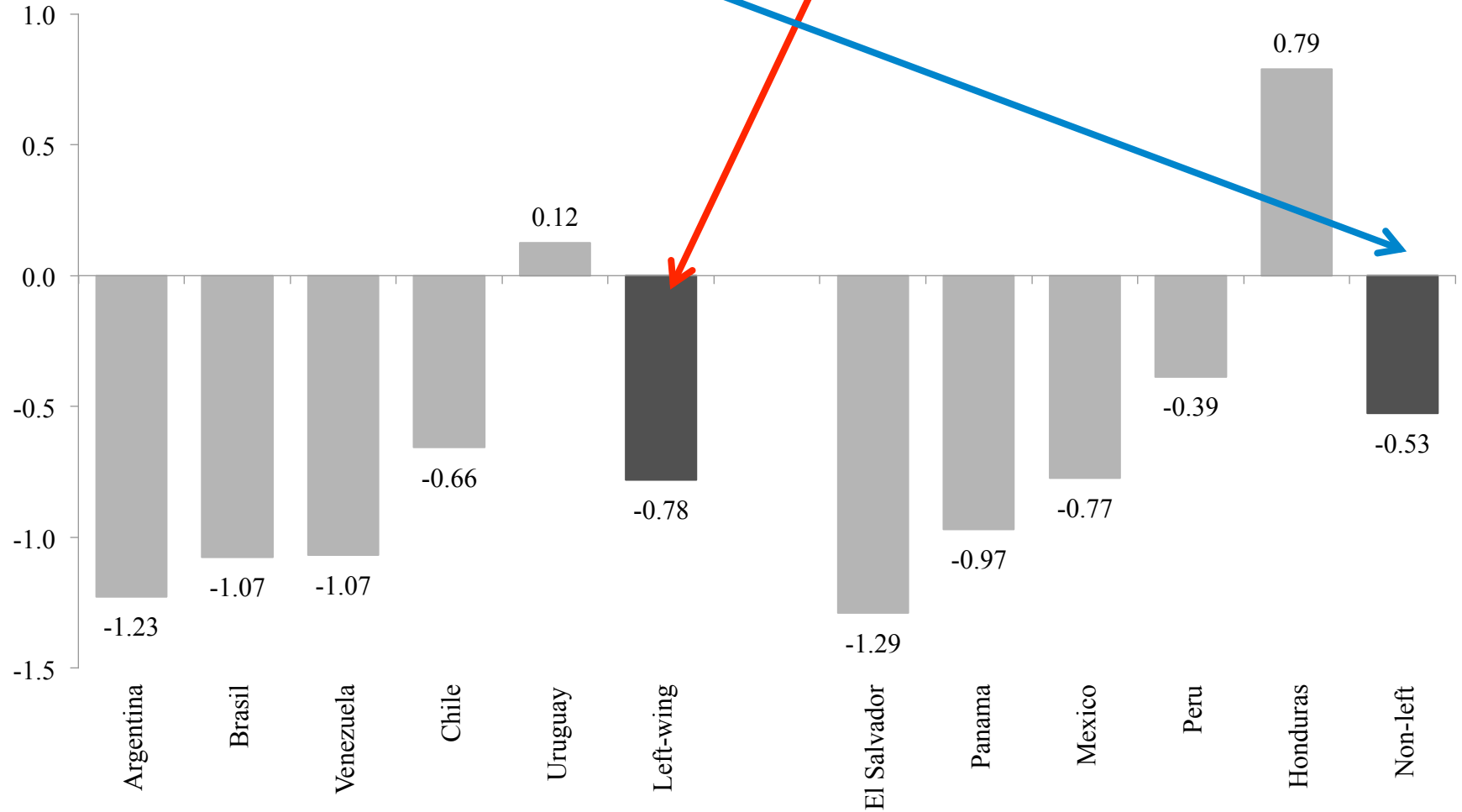
- Fast growing countries (Chile and Peru), slow growing countries (Brazil until 2007 and Mexico) and countries recovering from crisis (Argentina and Venezuela)
- Persistently high inequality countries (Brazil) and normally low inequality countries (Argentina)
- Commodity exporters (Argentina, Brazil, Chile, etc.) and manufacturing exporters (integrated with US market such as Mexico and CA)
- Countries with leftist regimes (e.g., Brazil, Chile) and center/center-right governments (e.g., Mexico and Peru)

# Gini (Circa 2000)





# Yearly Change in Gini: Left and Non-left Regimes (circa 2000-2009)



# Factors behind the decline in inequality

- Demographics
  - Dependency ratios (equalizing)
  - Working adults (equalizing)
- Declining wage inequality
  - Hours (unimportant)
  - **Distribution of Education (unequalizing; paradox)**
  - **Returns to skills (equalizing)**
- Declining non-labor income inequality
  - Income from capital (unequalizing)
  - **Private and Public Transfers (equalizing)**

# Declining wage inequality

- Decline in wage inequality plays an important role in explaining decline in overall inequality
- Affected by two main factors:
  - distribution of characteristics of workers (e.g., education, experience, gender, talent.)
  - returns to those characteristics

# Declining wage inequality

- Workers' characteristics, in turn, are affected by:
  - 'fate' (e.g., gender, race, talent)
  - households' decisions (e.g., to enroll children in school)
  - policy (e.g., expanding access to education).
- Distribution of education became more equal but because of wage structure, this was unequalizing: the "paradox of progress"

# Declining wage inequality

- Returns to households' characteristics depend on:
  - market forces (i.e., demand and supply of workers of different skills and experience)
  - institutional/policy factors (e.g., minimum wage policy and the unionization rate).

# Wage skill premia (16 LA countries)

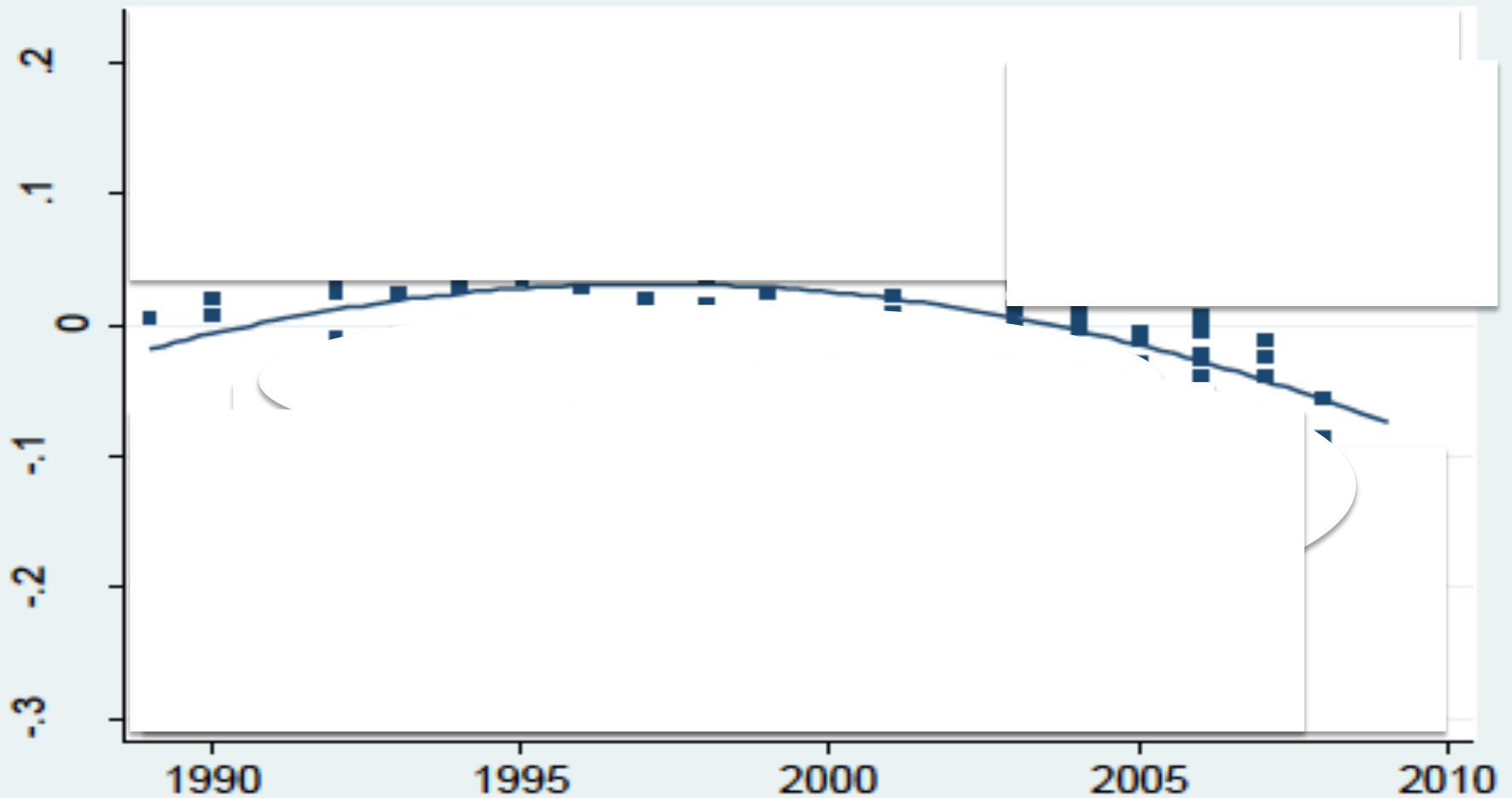
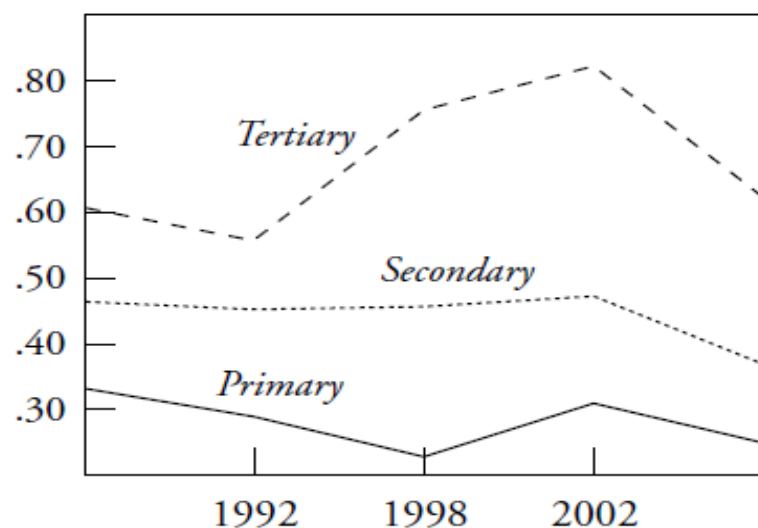


Figure 1-5. *Ratio of Returns to Education for Argentina, Brazil, Mexico and Peru<sup>a</sup>*

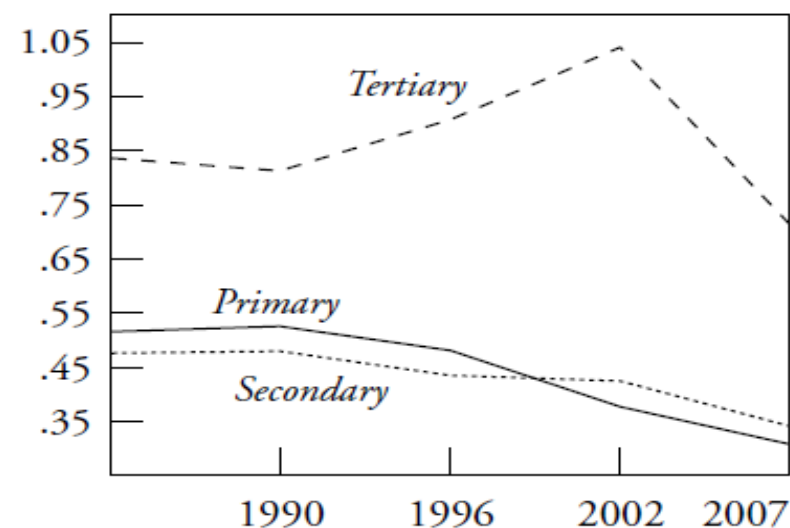
Argentina (urban areas): 1986–2006

Percent



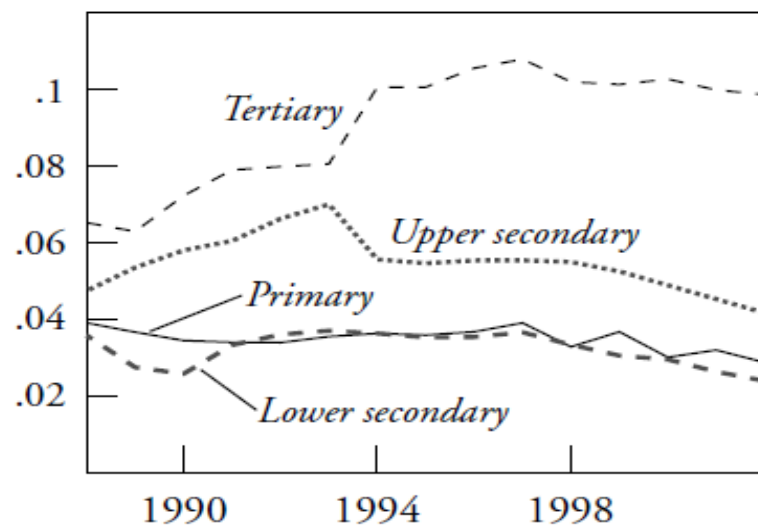
Brazil: 1986–2007

Percent



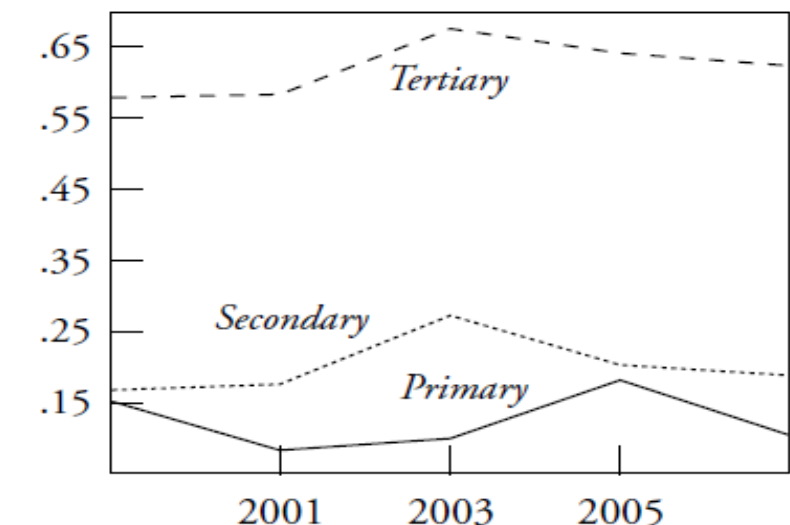
Mexico: 1988–2002

Percent



Peru: 1998–2007

Percent



# Why has the skill premium declined?

- Increase in relative supply of high-skilled workers
- Decline in relative demand for skilled labor petered out
- Institutional factors that compress the wage structure: minimum wages and unionization
- “Degraded” tertiary education



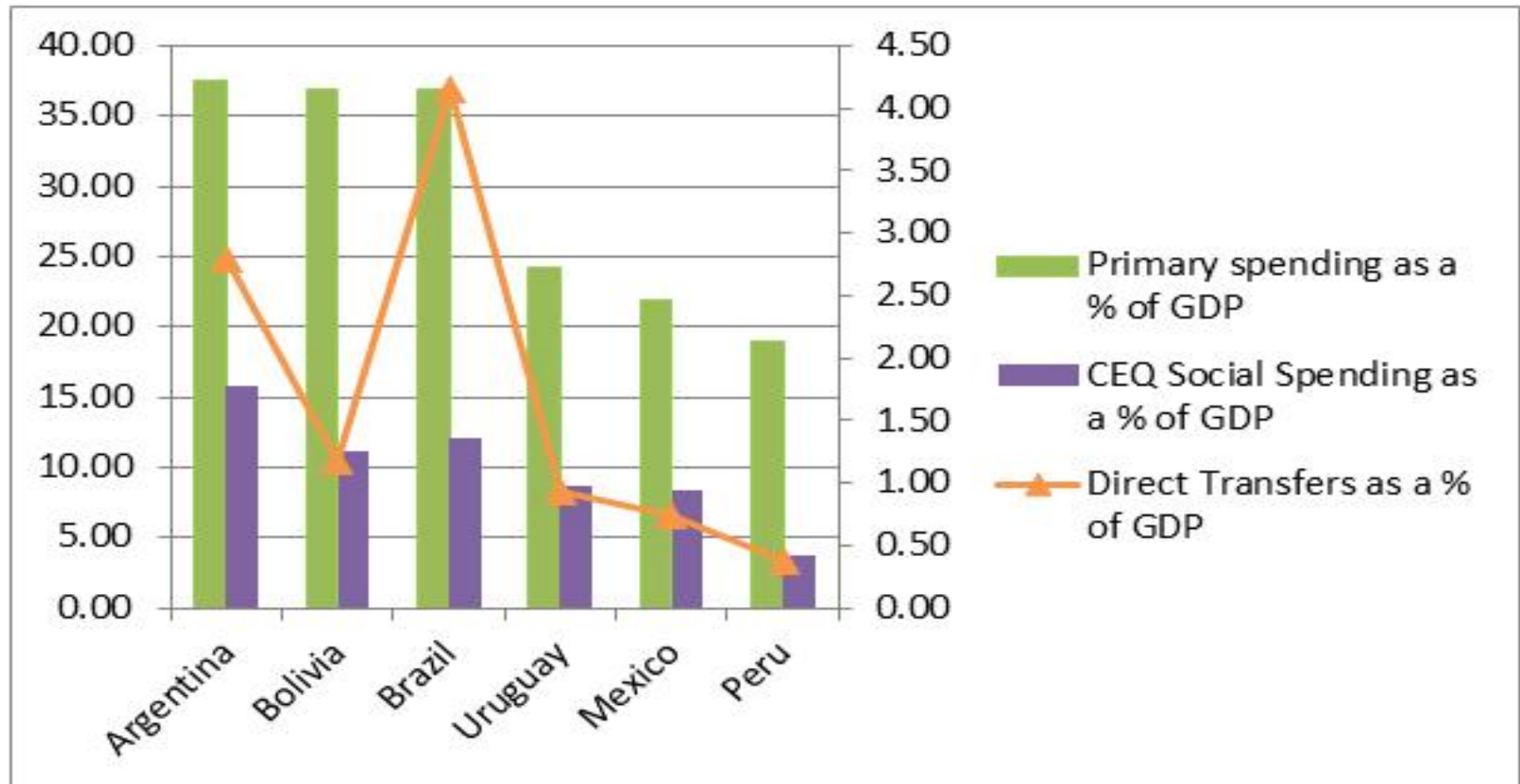
# Declining non-labor income inequality

- Changes in the distribution of non-labor income were equalizing;
- => more generous and progressive transfers, an important factor
- CCT's have increased coverage and average transfer

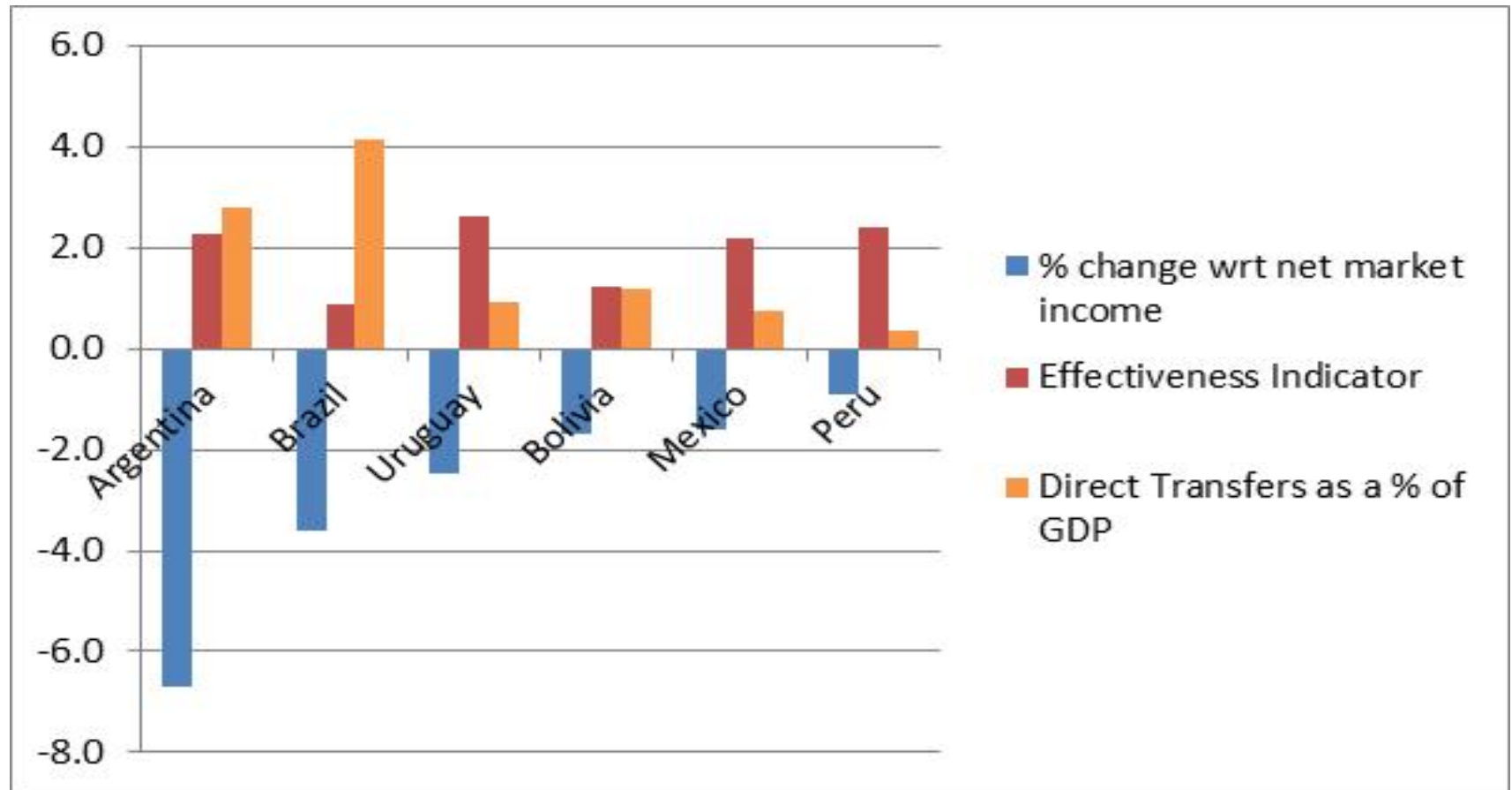
# A redistributive state?

- How much does inequality decline with direct taxes and transfers?
- How much upward and downward movement is induced by direct taxes and transfers?

# Heterogeneous LA: State comes in different sizes



# Decline in Disp Inc Gini, Direct Transfers and Effectiveness Indicator



# Fiscally-induced movements across classes: Argentina

Disposable Income groups

Net Market Income groups	$y < 2.5$	$2.5 < y < 4$	$4 < y < 10$	$10 < y < 50$	$y > 50$	Total
$y < 2.5$	37%	39%	25%	0%	0%	100%
$2.5 < y < 4$	0%	46%	54%	0%	0%	100%
$4 < y < 10$	0%	0%	95%	5%	0%	100%
$10 < y < 50$	0%	0%	0%	100%	0%	100%
$y > 50$	0%	0%	0%	0%	100%	100%

# Fiscally-induced movements across classes: Brazil

Market Income groups	$y < 2.5$	$2.5 < y < 4$	$4 < y < 10$	$10 < y < 50$	$y > 50$	Horizontal s
$y < 2.5$	79%	16%	5%	1%	0%	100%
$2.5 < y < 4$	2%	80%	17%	1%	0%	100%
$4 < y < 10$	0%	2%	93%	6%	0%	100%
$10 < y < 50$	0%	0%	3%	96%	1%	100%
$y > 50$	0%	0%	0%	12%	88%	100%

# Fiscally-induced movements across classes: Bolivia

	$y < 2.5$	$2.5 < y < 4$	$4 < y < 10$	$10 < y < 50$	$y > 50$	Horizontal sum
Net Market Income groups						
$y < 2.5$	91%	7%	1%	0%	0%	100%
$2.5 < y < 4$	0%	87%	12%	0%	0%	100%
$4 < y < 10$	0%	0%	96%	4%	0%	100%
$10 < y < 50$	0%	0%	0%	100%	0%	100%
$y > 50$	0%	0%	0%	0%	100%	100%

# Fiscally-induced movements across classes: Peru

Market Income groups	Disposable Income groups					Horizontal sum
	$y < 2.5$	$2.5 < y < 4$	$4 < y < 10$	$10 < y < 50$	$y > 50$	
$y < 2.5$	92%	8%	0%	0%	0%	100%
$2.5 < y < 4$	0%	94%	5%	0%	0%	100%
$4 < y < 10$	0%	1%	99%	0%	0%	100%
$10 < y < 50$	0%	0%	6%	94%	0%	100%
$y > 50$	0%	0%	0%	13%	87%	100%



**THANK YOU**