

# Inequality trends, constraints, and ways forward: Latin America

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United Nations Department of Economic and Social Affairs, *Inter-agency Expert Group Meeting on Implementation of the Third United Nations Decade for the Eradication of Poverty*

16 May 2022





## Key messages

**1. There are limits to how much inequality can be reduced without diversification**

*Glass ceiling effects of commodity dependence*

**2. We need to pay attention to both pre- and post-distribution inequality, and the role of export diversification**

*Breaking the mould rather than only redistributing the pie*

**3. Without diversification to reduce commodity dependence, Conditional Cash Transfers are insufficient tools**

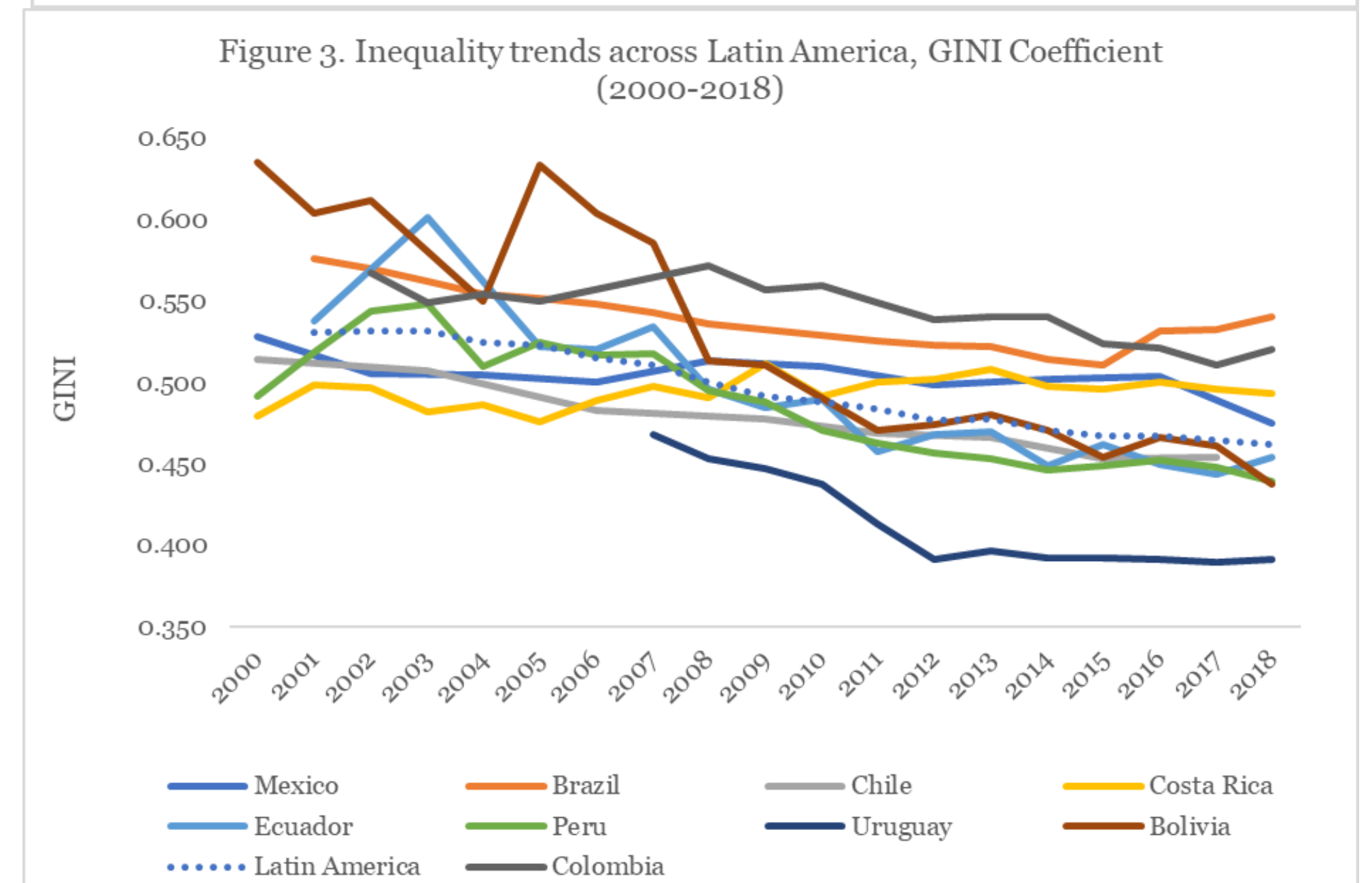
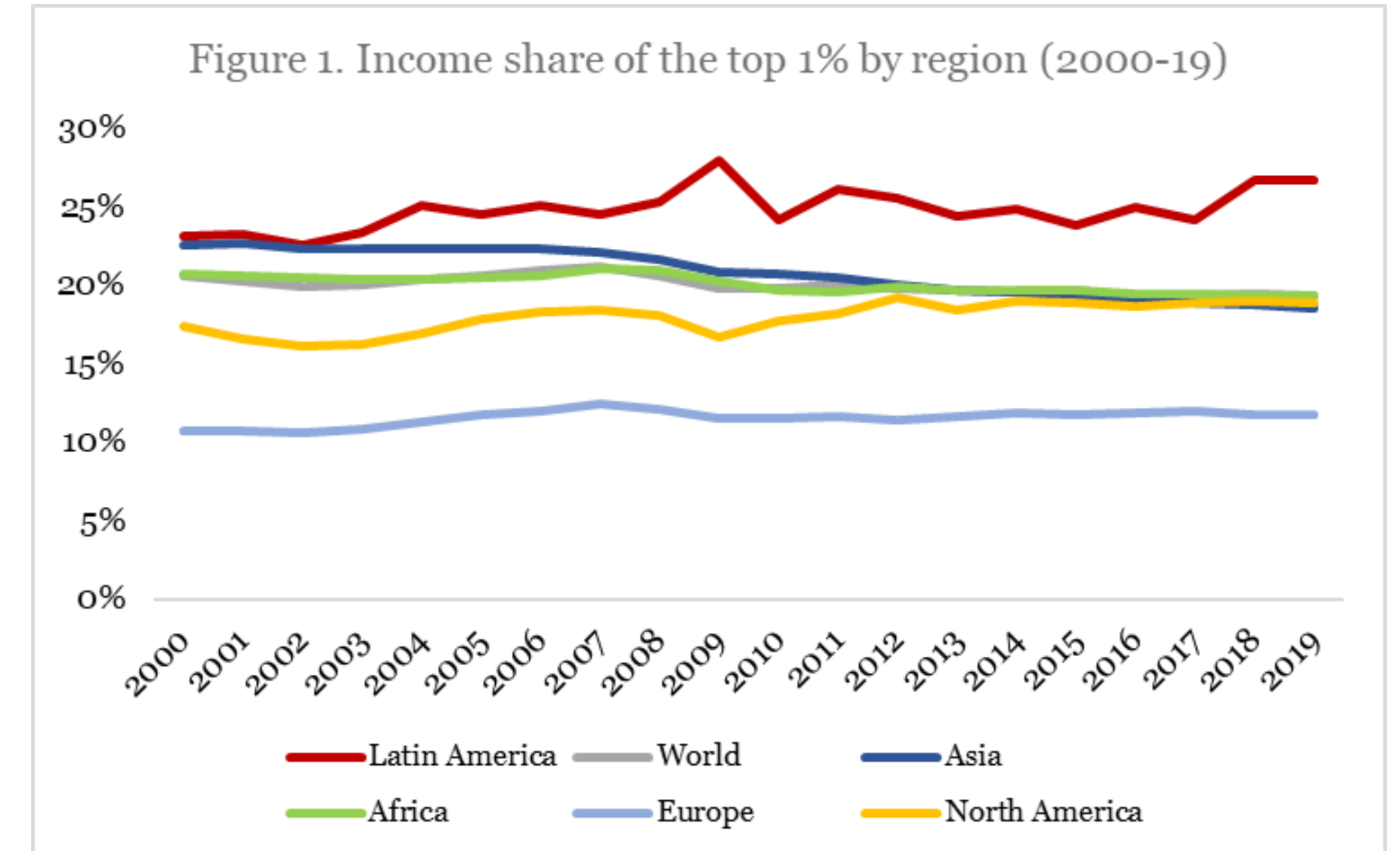
*Learning to fish.... in a fishless lake*

**4. Inequality reduction should be in everyone's interest to avoid further social unrest.**

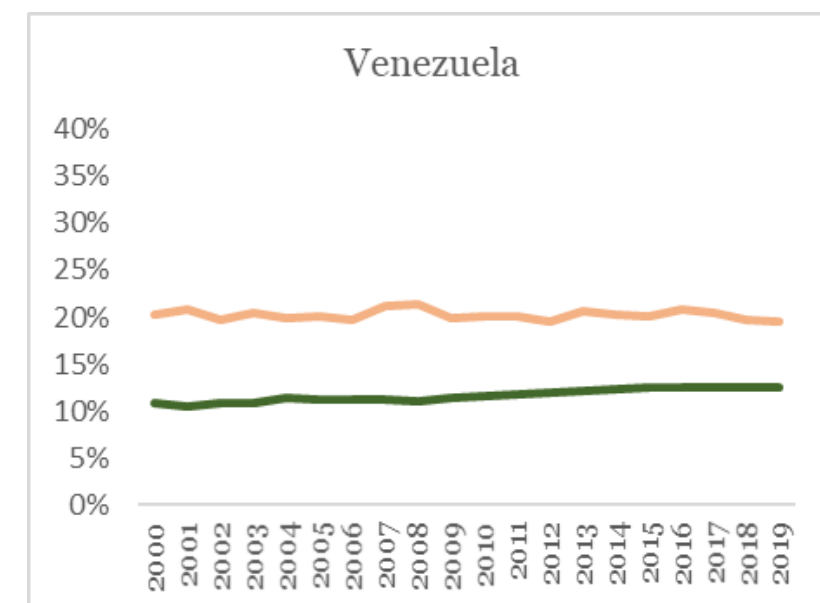
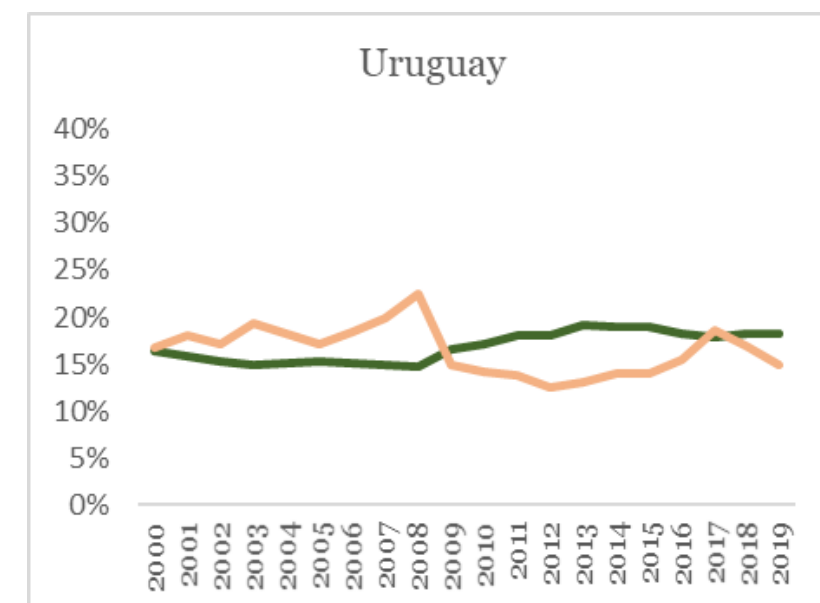
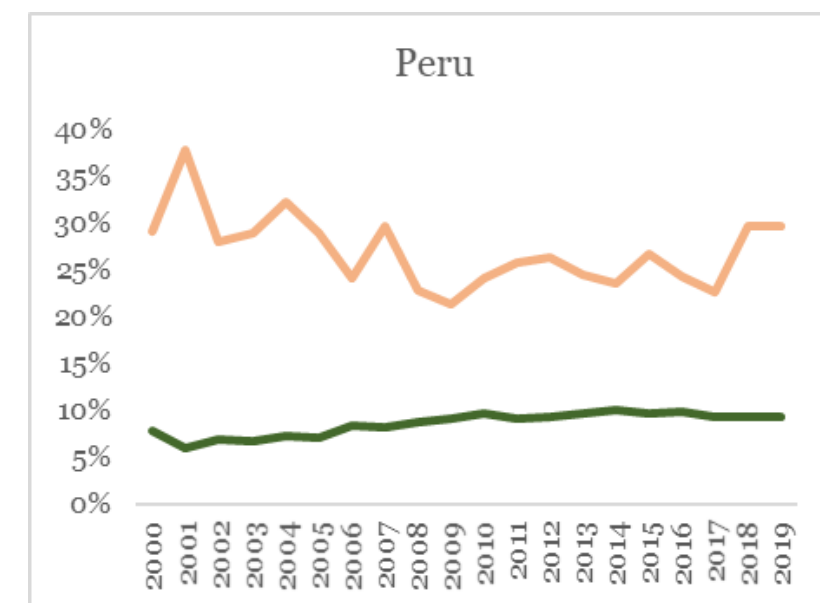
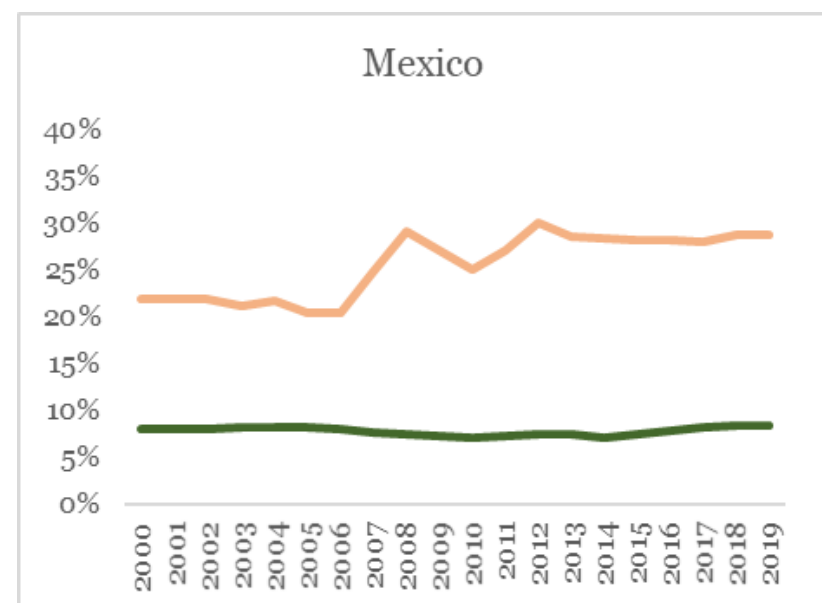
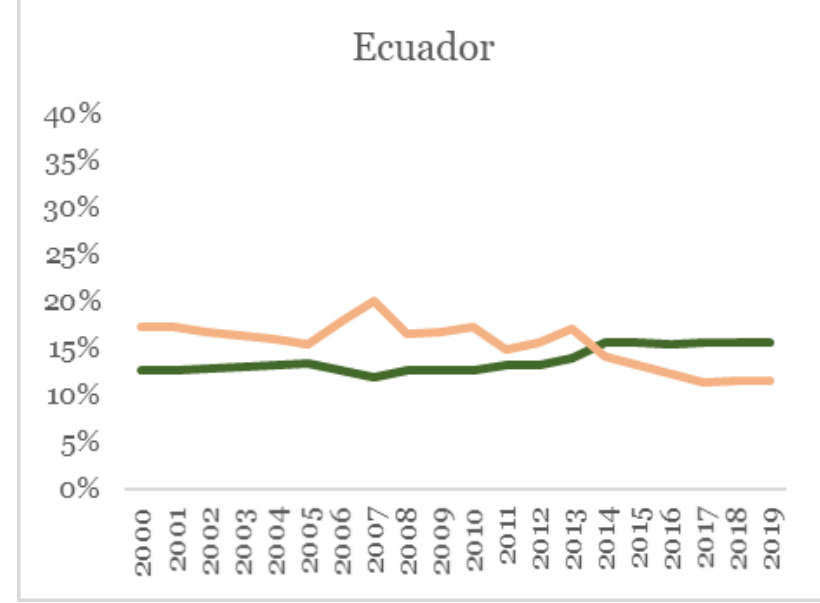
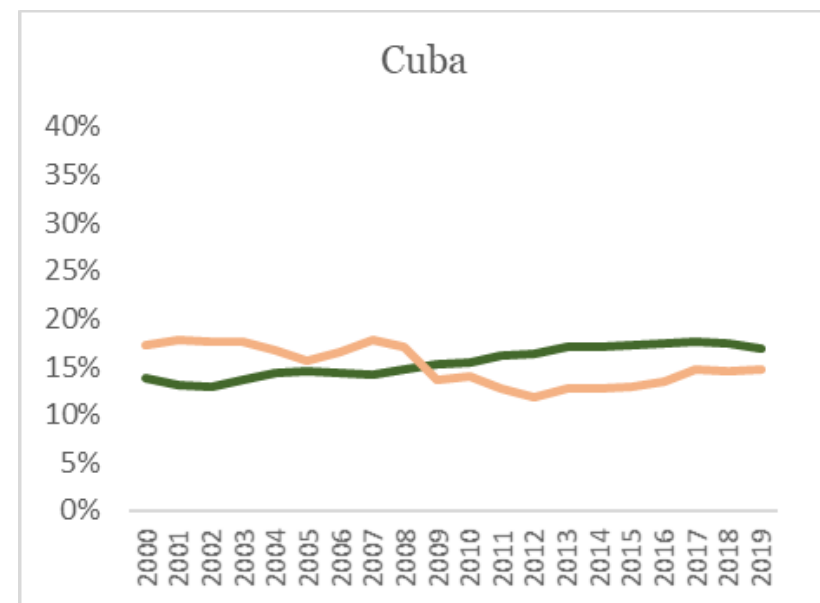
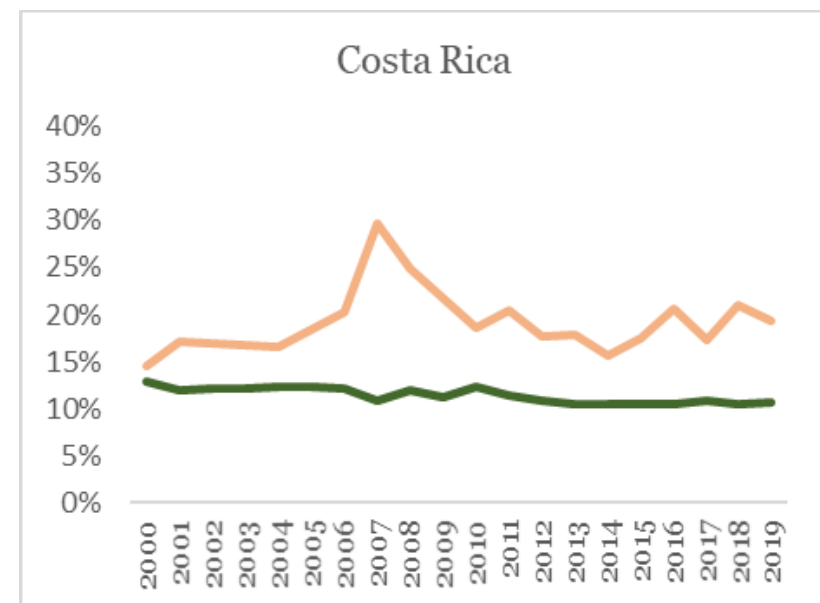
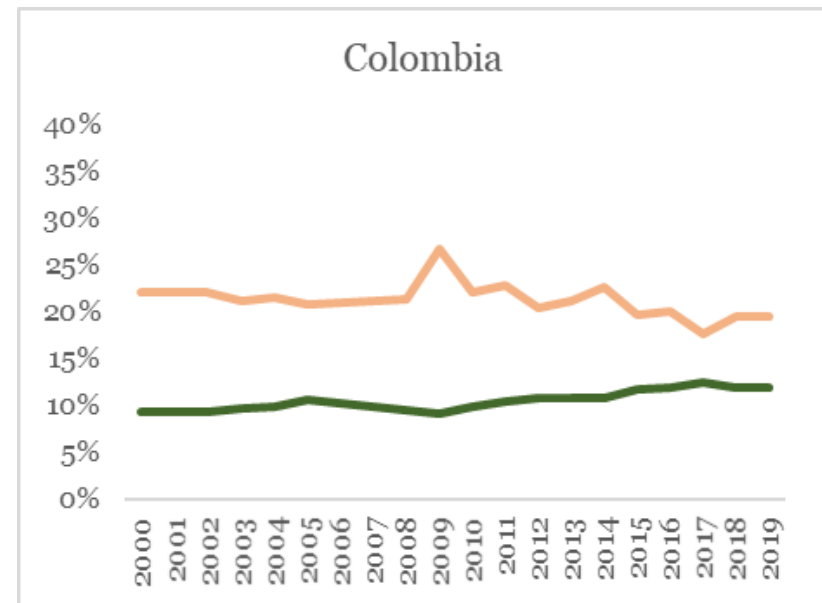
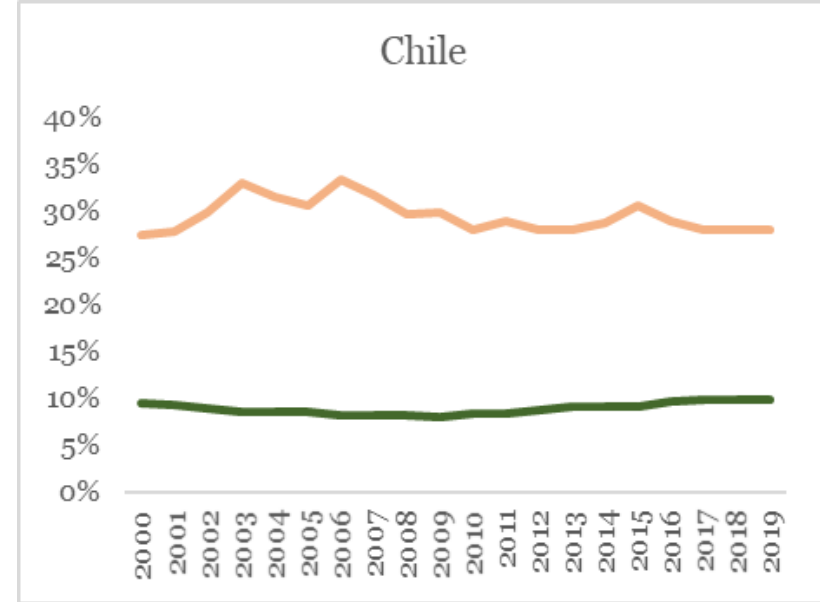
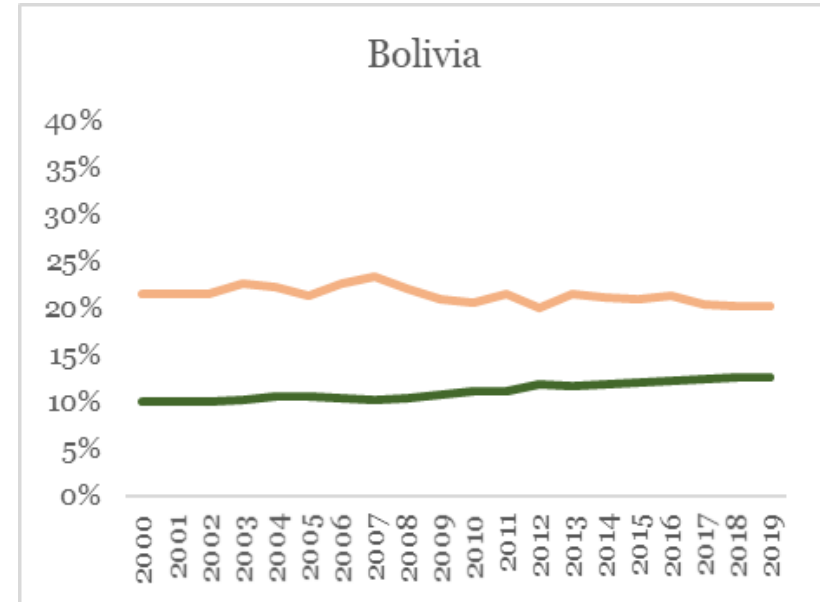
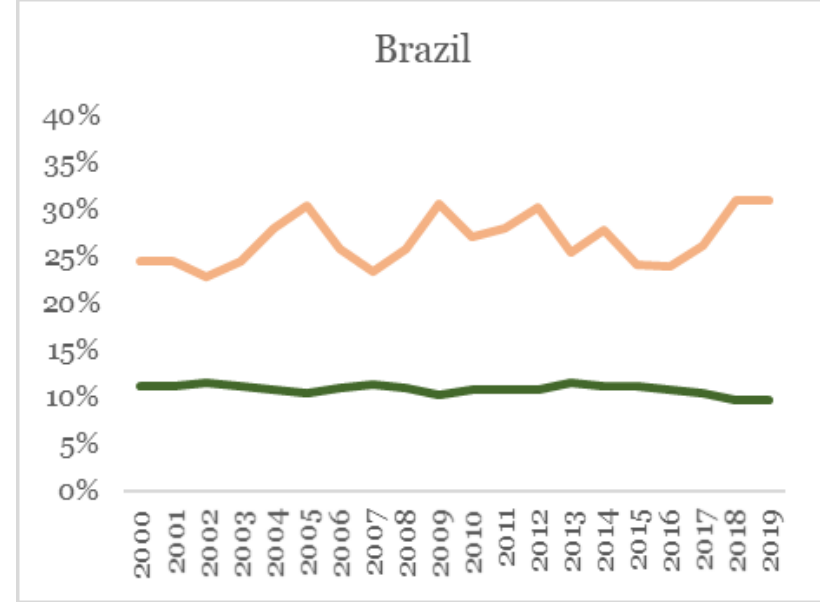
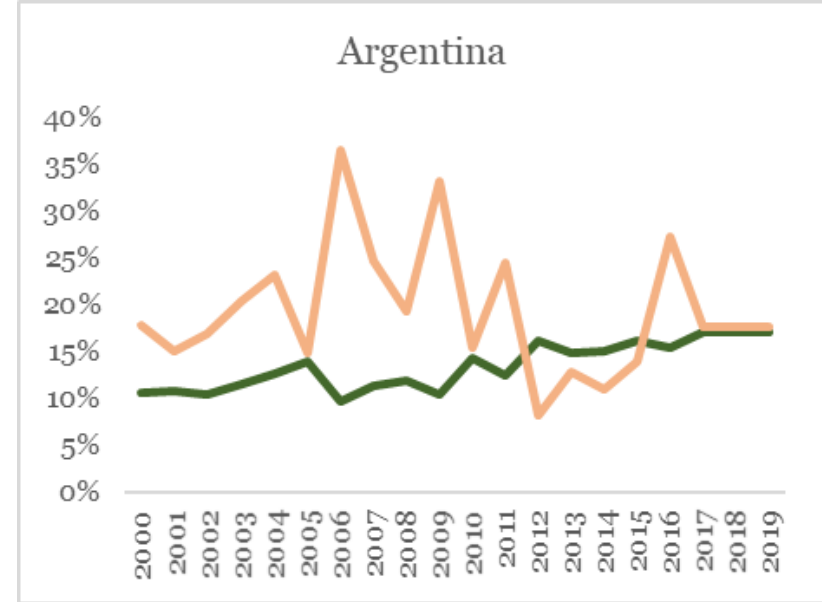
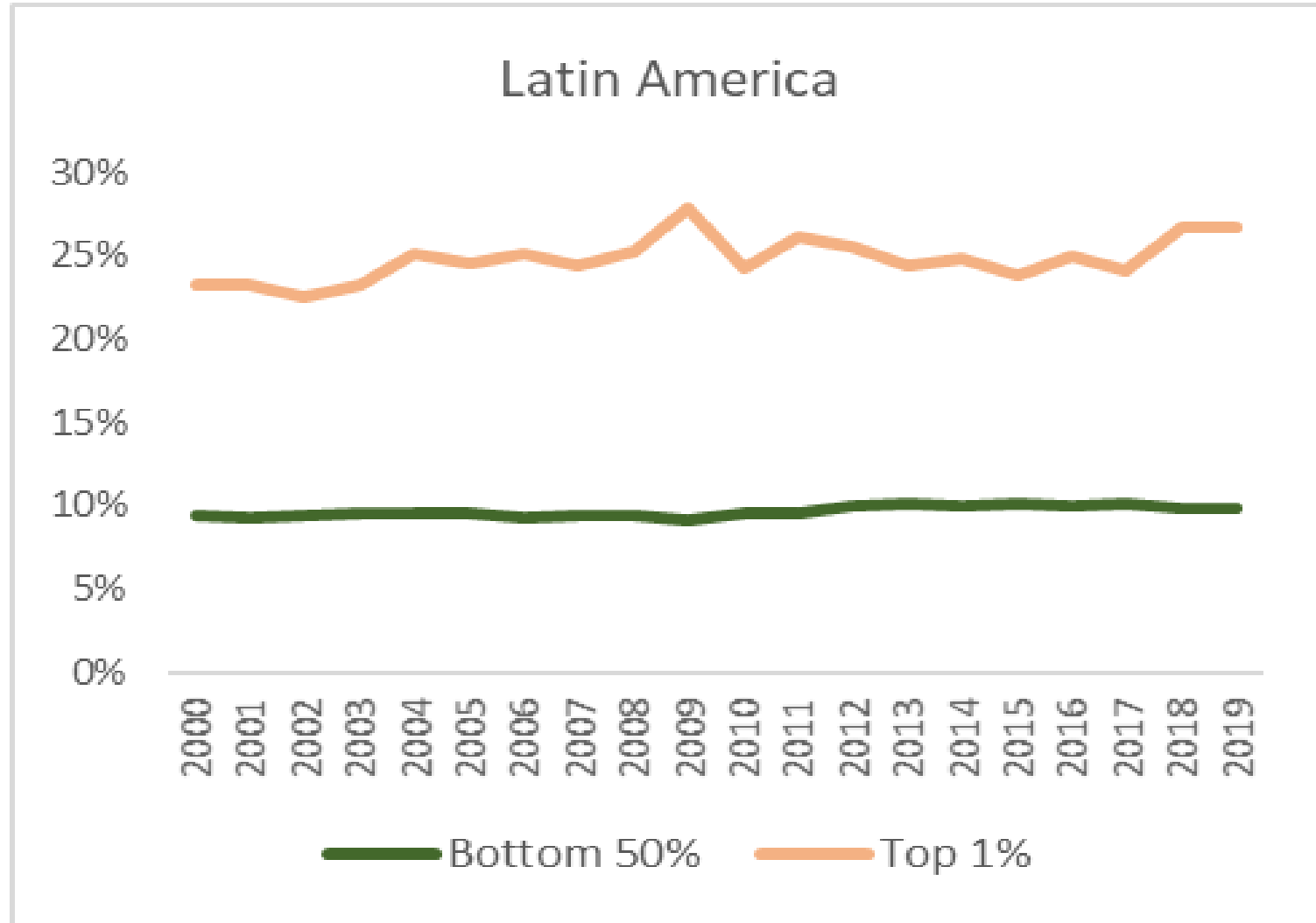
*If the bottom of the pyramid is too unstable, the whole pyramid crumbles*

# Key Trends 1

- Inequality declined in the 2000s (by some measures) but has stagnated and in some cases even risen in the past seven years.
  - The top 10% of income-earners capture 54% of the national income, while the income share of the top 1% in Latin America is by far the highest in the world and is almost double the world average (figure 1).
  - The income share of the richest 1% has increased by 8% between 2014 & 2019, while the income share of the poorest 50% has slightly reduced in the same period.
- Brazil, Chile, Mexico are almost systematically the three most unequal countries in the region with the top 10% share capturing over 57% of the national income in 2019.
- Bolivia, which used to have the highest income inequality rate (across various indicators) in the region in 2000, has experienced the largest drop in inequality rates between 2000 and 2014



# Key Trends 2



Source: World Inequality Database (WID)

## Key Trends 3

- The COVID-19 pandemic has also prompted a rise in poverty and inequality to unprecedented levels even compared with recent decades.
  - The total number of poor people rose to 209 million by the end of 2020
  - Without the transfers made by governments to attenuate the loss of wage income, the increase in the average Gini index for the region would have been 5.6%.

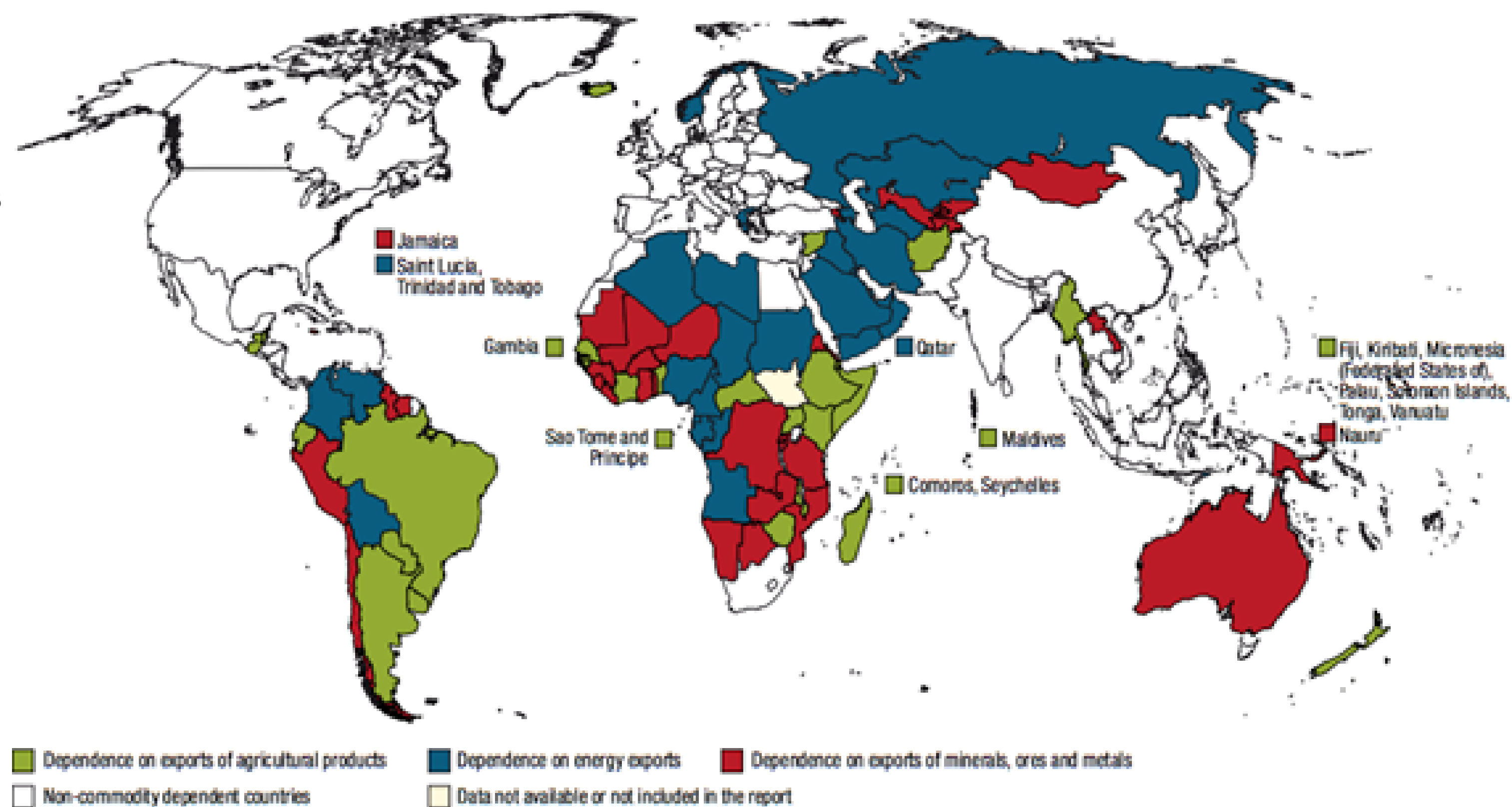
	<i>Change between 2019 &amp; 2020</i>
GINI Index	<b>+2.9%</b>
Unemployment rate	<b>+32.1%</b>
Job losses	<b>41 million jobs lost</b>
People living in poverty	<b>+ 22 million</b>
People living in extreme poverty	<b>+8 million</b>
GDP	<b>-7.7%</b>

Source: Compilation of data from ECLAC, World Development Indicators, the IDB.



# Key Constraining factors: high degrees of commodity dependence

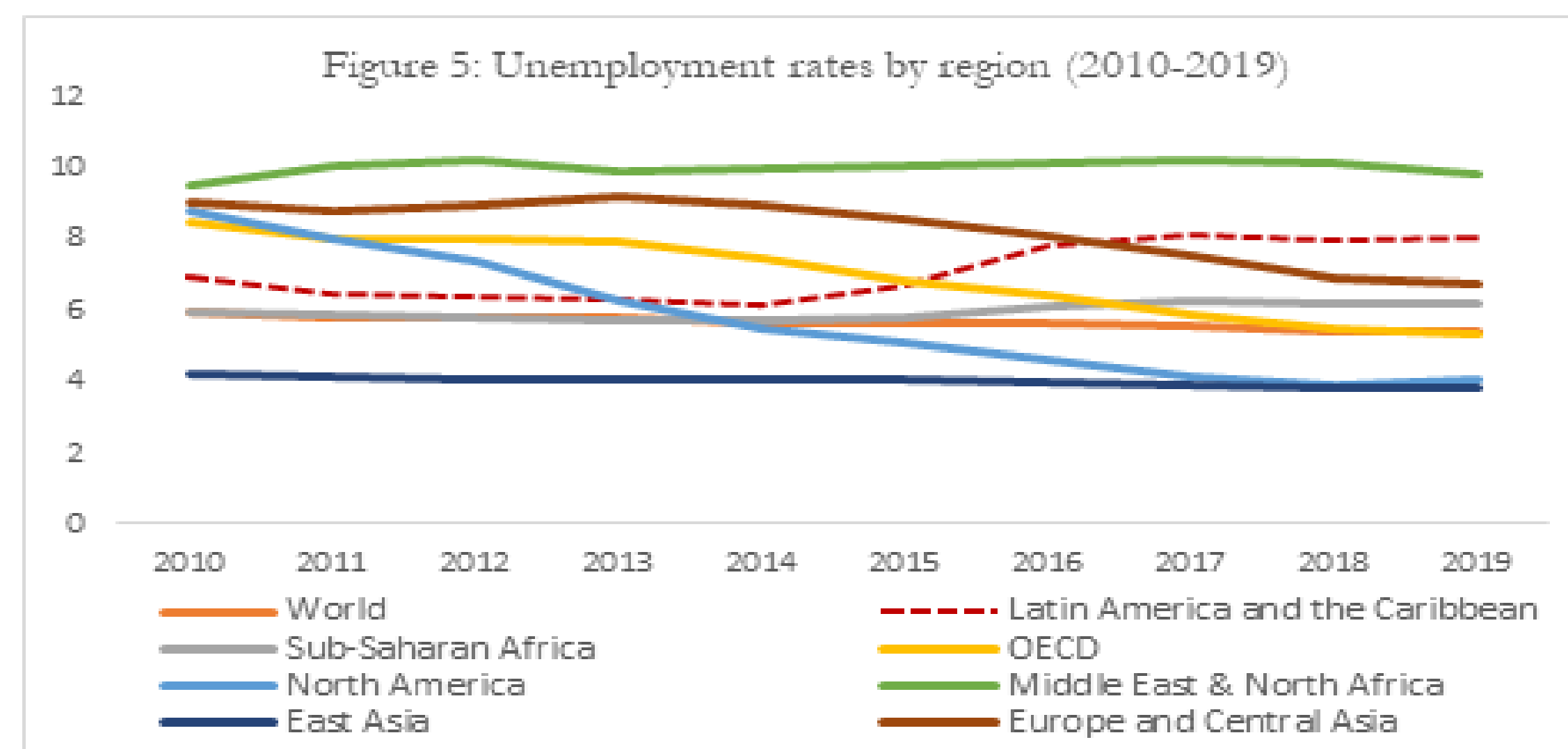
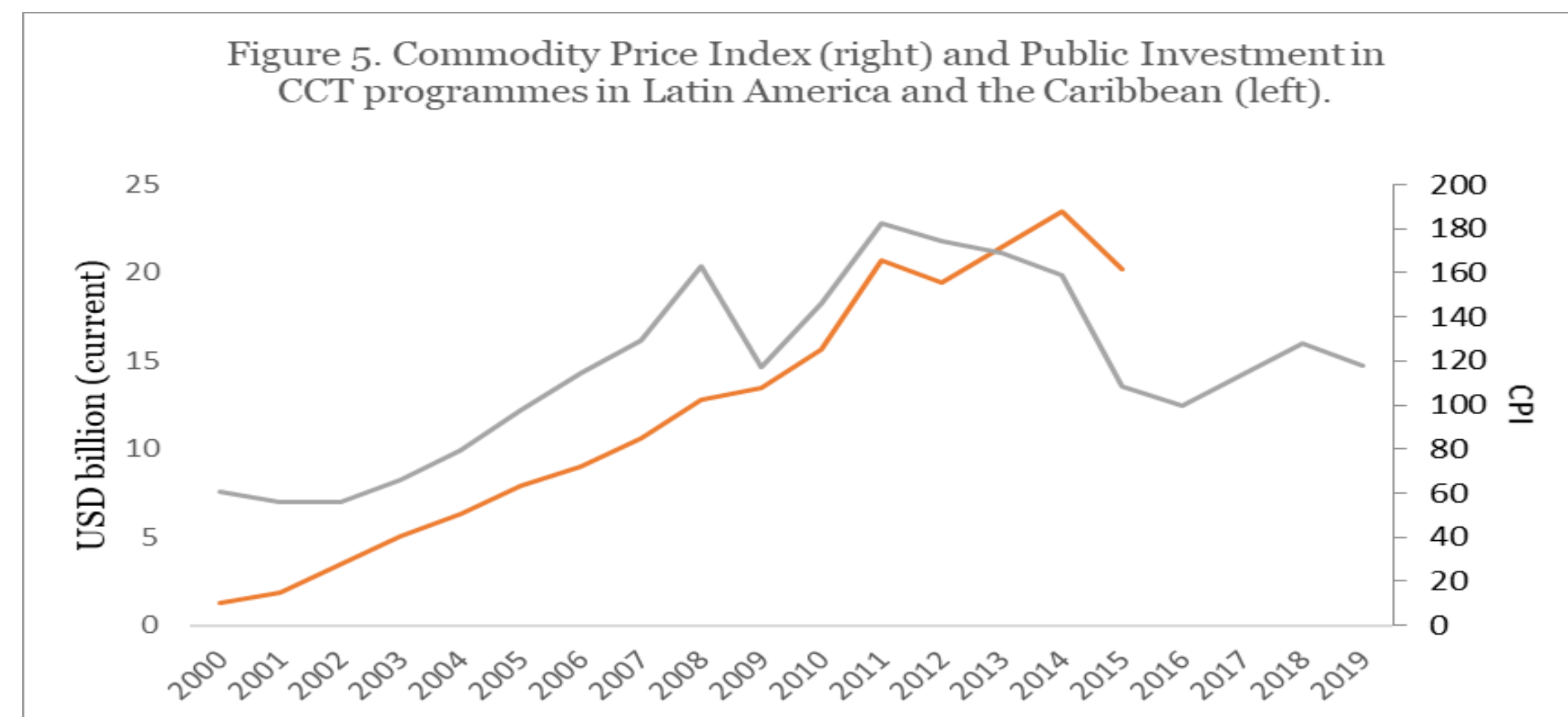
- Most the progress achieved in the 2000s was the result of commodity-financed social spending and education policies, which led to important changes in labour market, the informal sector, minimum wage, and redistributive taxation.
- Public spending on health, housing and social protection increased considerably during the 2000-2013 period, especially in commodity exporting countries (such as Argentina, Bolivia, Brazil, Chile, and Ecuador).
- In commodity exporters, wages of unskilled workers increased more than 5% per year (compared to 1 to 3% for skilled workers), while wage levels in non-commodity exporting countries remained stagnant or decreased.



Source: UNCTAD

# Key Constraining factors: high degrees of commodity dependence

- Implications for income inequality reduction because social spending is particularly tied to commodity price volatility.
- As the commodity boom ended, public investments in social provisions, conditional cash transfers and infrastructure have also dropped
- Governments spending of commodity revenues did not lead to significant transformations in the region's productive structures, which remain concentrated around commodities.
- Unstable model that led to a reversal of the progress achieved in the 2000s



Source: ILO

# Key Constraining factors: the scale of the inequality reduction needed

- **The suitability of redistributive taxation for reducing inequality also depends on the scale of the reduction needed.**
  - Bolivia, Brazil, Chile, Colombia, Mexico, Peru, and Venezuela's pre-tax Gini coefficients  $> 60$ , while OECD countries are mostly in the 40s or high 30s (pre tax).
  - In Latin America, the initial income distribution is so uneven that even major redistributions and tax reforms won't do the job, yet it may still have adverse effects on economic growth (see Ostry et al. 2014 for a study of relationship between level of taxation and growth).
- **Redistributive policies such as wealth taxes are needed but may not suffice to reduce income inequality which is attention also need to be given to pre-distribution inequalities**





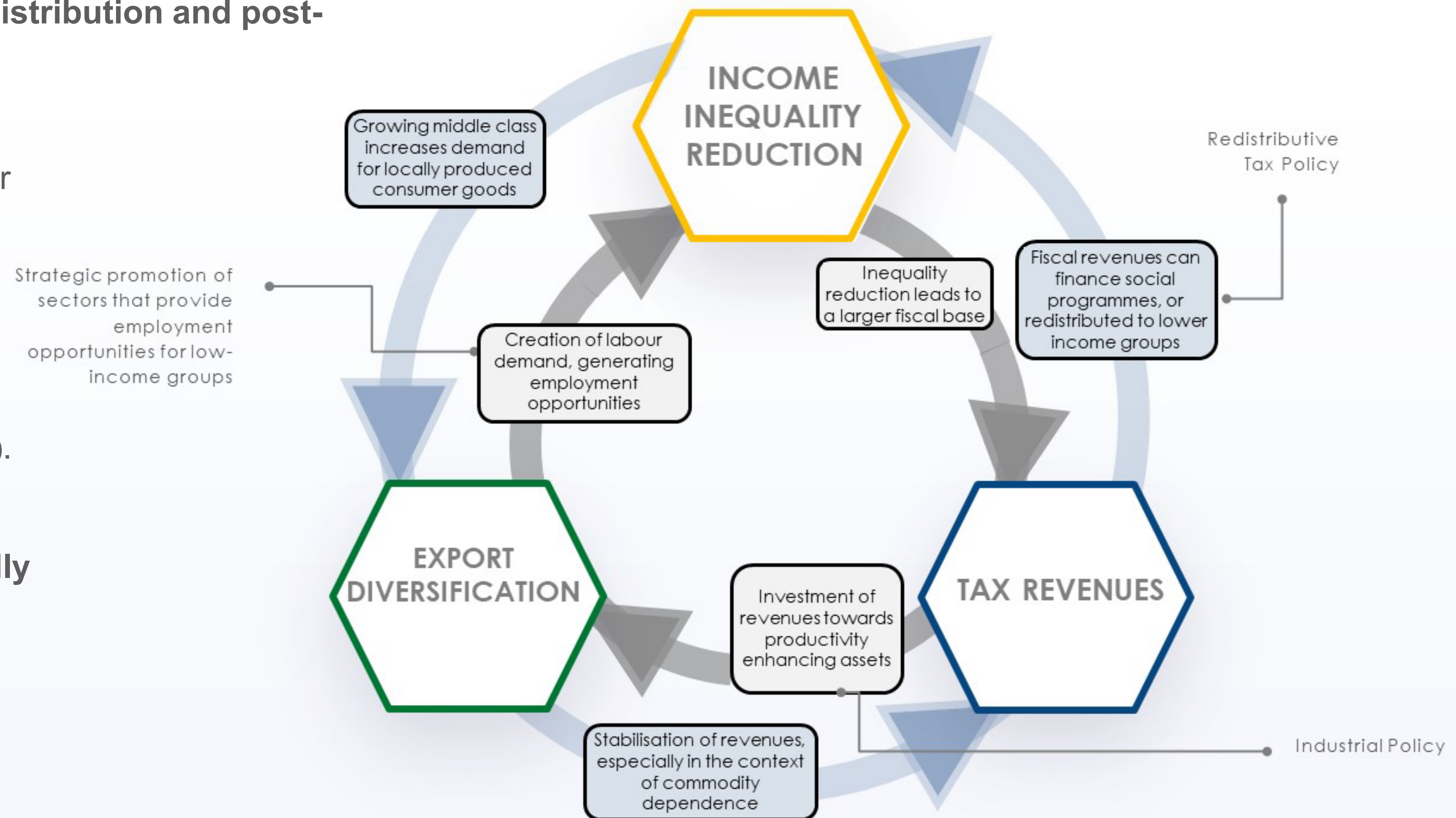
# The Inequality-Diversification-Taxation Nexus

Economic diversification has a central (yet understudied) impact on inequality because it can affect both pre-distribution and post-distribution structure of income.

While the association between inequality & taxation have been relatively well studied over the years, it is only recently that studies have begun to address the correlation between:

- Economic diversification & inequality (see Hartmann et al. 2017; Blancheton et al. 2019; Le et al. 2019)
- Diversification and taxation (Gnangnon, 2020).

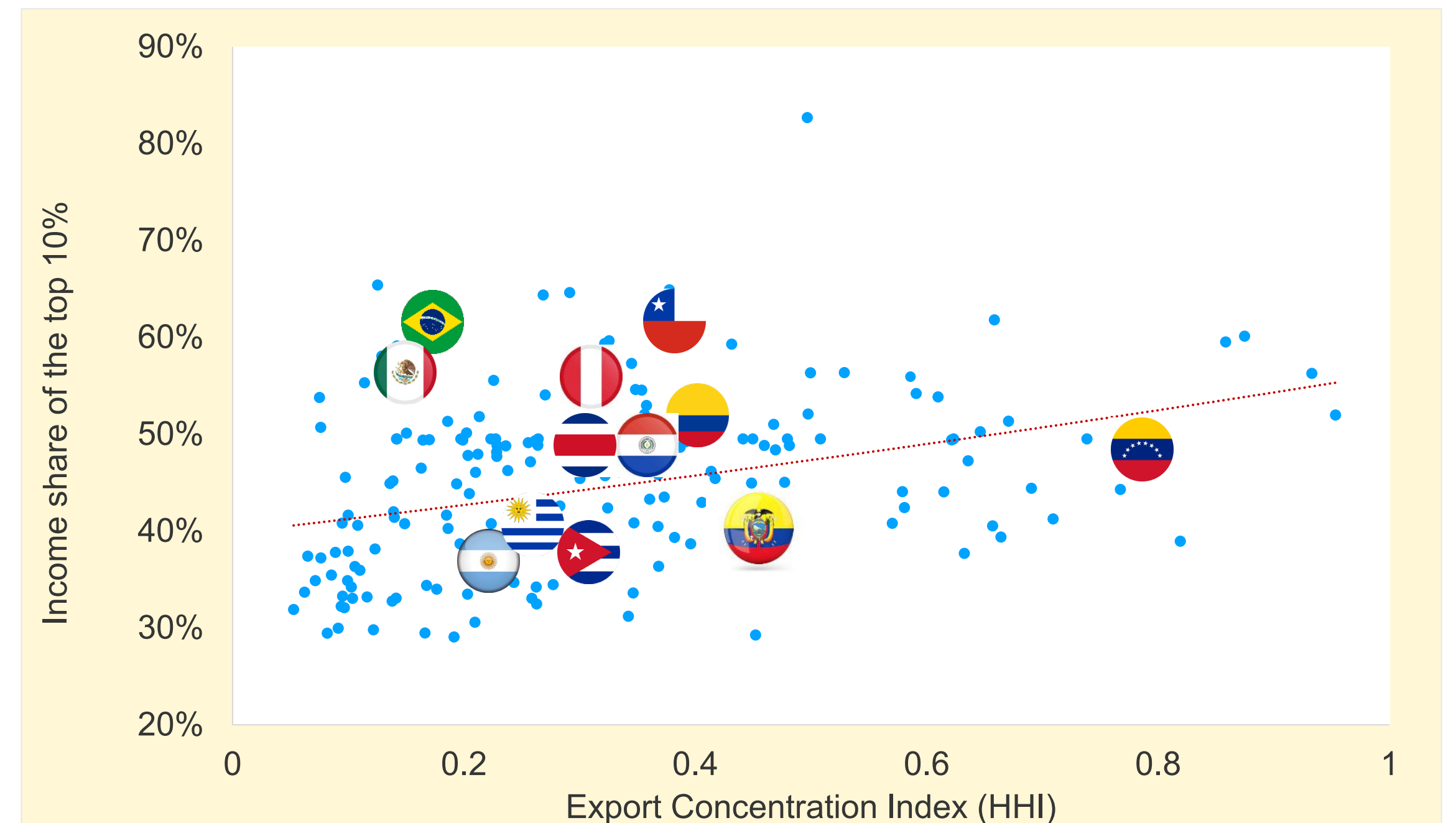
**Economic diversification, income inequality, and tax revenues are intrinsically related to one another.**



# Inequality & Diversification

**Diversification can have a direct impact on income inequality.**

- In countries that predominantly export raw materials, the diversification into more complex products with larger spillovers can help generate and distribute more wealth across society, through the creation of formal and skilled jobs and the expansion of choices of occupation that are otherwise limited.
- Evidence that industrial employment is negatively correlated with income inequality because of the growth of a new middle class and reducing the low-income class in several developing countries (Mehic, 2018; Milanovic, 2012).

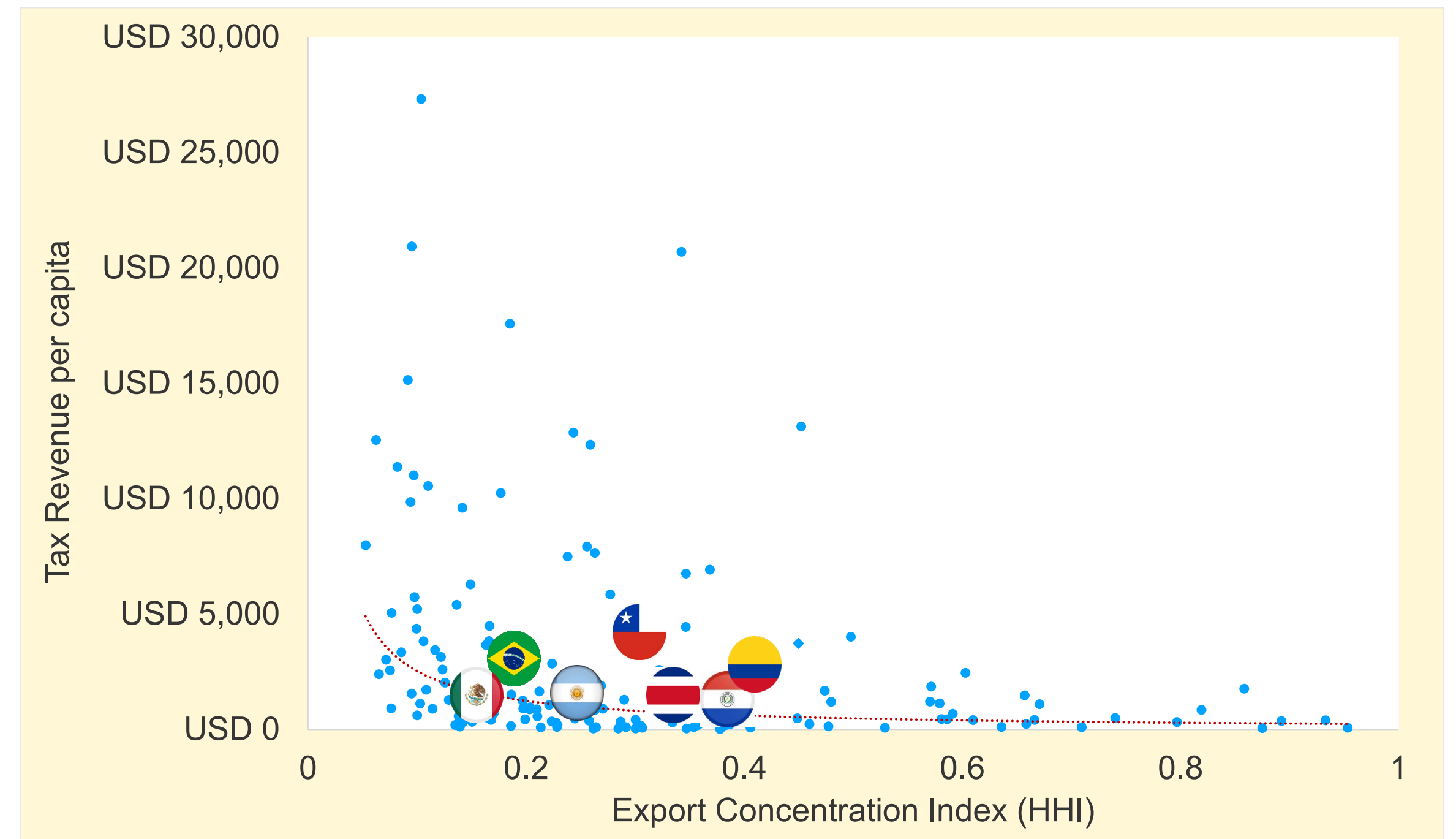




# Diversification & Taxation

Diversification can have a more indirect impact on income inequality through taxation.

- Export diversification enables the stabilisation and increased resilience of tax and foreign exchange revenues in the face of external shocks or commodity price volatility (*Balavac and Pugh 2016; Haddad et al. 2013; Joya 2015; Maggioni et al. 2016; Camanho da Costa Neto and Romeu 2011*)
- Export diversification fosters growth, which generates a rise in corporate & personal income, which translates into higher tax revenues (*Gnangnon, 2020*).
- Higher taxation revenues can promote diversification through a virtuous circle of revenue mobilisation.
  - As tax revenues increases, more revenues are made available for domestic investment in productivity enhancing assets that can leads to the development of new sectors and activities, which in turn would stimulate increases in tax revenues in the long term.



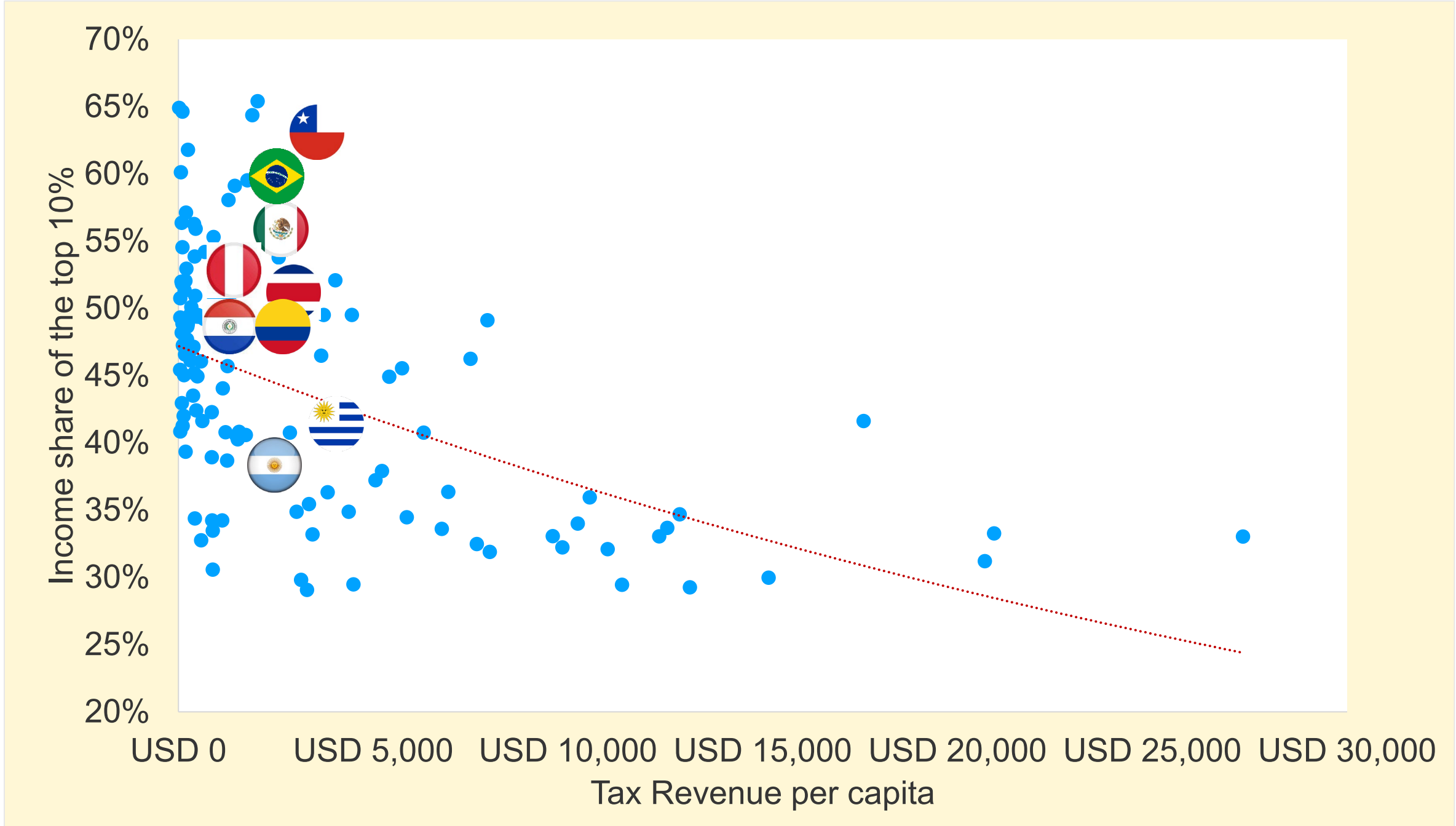
Distribution of countries based on tax revenues & export concentration levels in 2017

	Tax revenues < USD2,500 per capita	Tax revenues > USD2,500 per capita
Diversified economies (108 countries, HHI < 0.5)	60.2%	39.8%
Concentrated economies (19 countries, HHI > 0.5)	100%	0%

# Inequality & Taxation Nexus

**The association between inequality and taxation has been relatively well studied over the years**

Evidence that higher tax revenues can promote the reduction of income inequality because they imply a larger fiscal space for social transfers, including in the Latin American context Martorano, B. (2018)

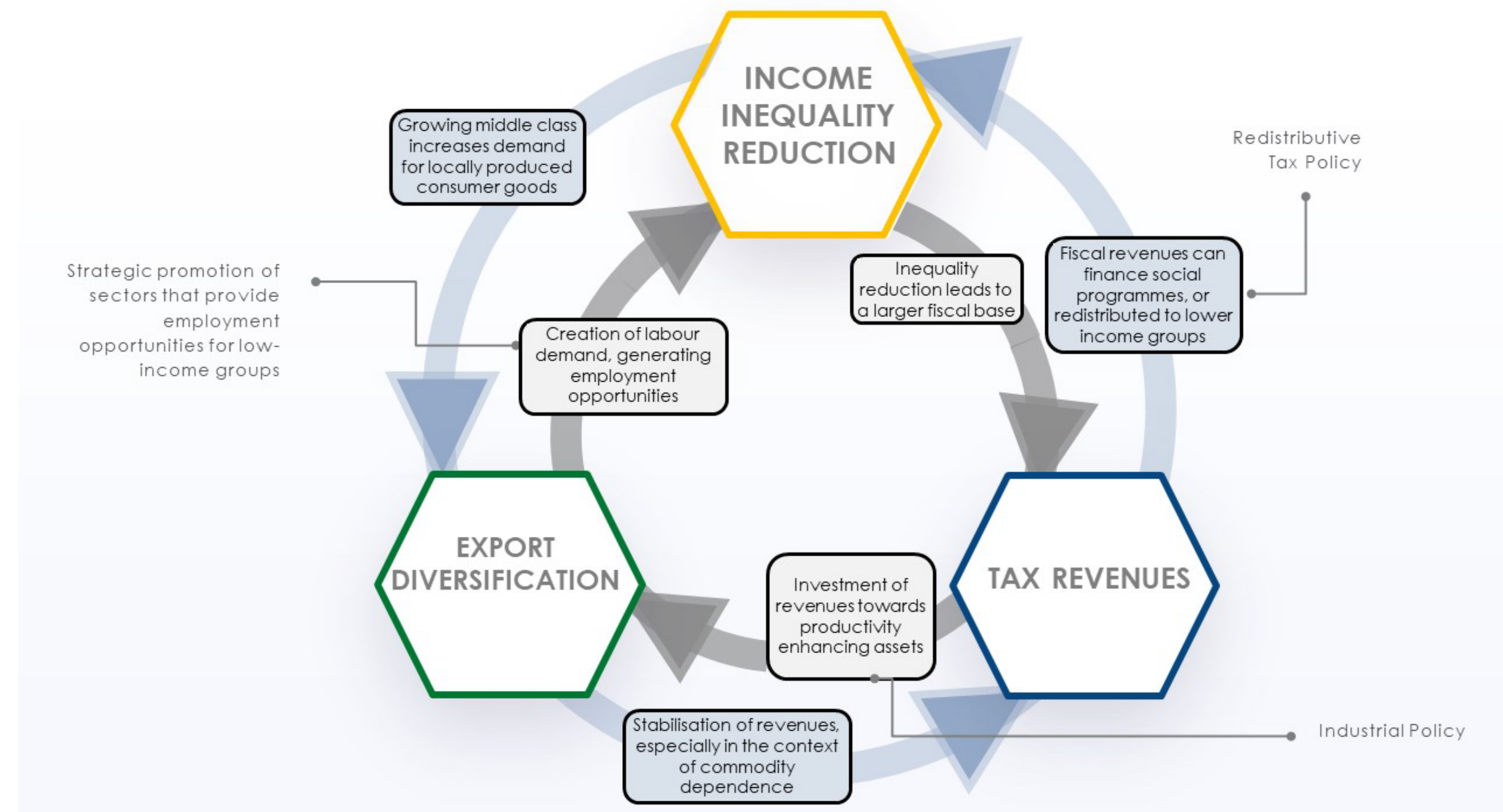




# Further explanations

## The influence of policy inputs

- The above-mentioned relationships are not linear nor automatic. Policy interventions can influence the nature (and the direction) of the relationship between inequality, diversification, and taxation. For instance:
  - *The regressive use of tax revenues can further promote income inequality;*
  - *Diversification towards technology-intensive sectors that is not coordinated with the integration of unskilled low income groups in the labour market is likely to increase demand for a select group of existing skilled workers, which will disproportionately increase their wages relatively to the wages of low income groups.*
  - *Two-level industrial policy*

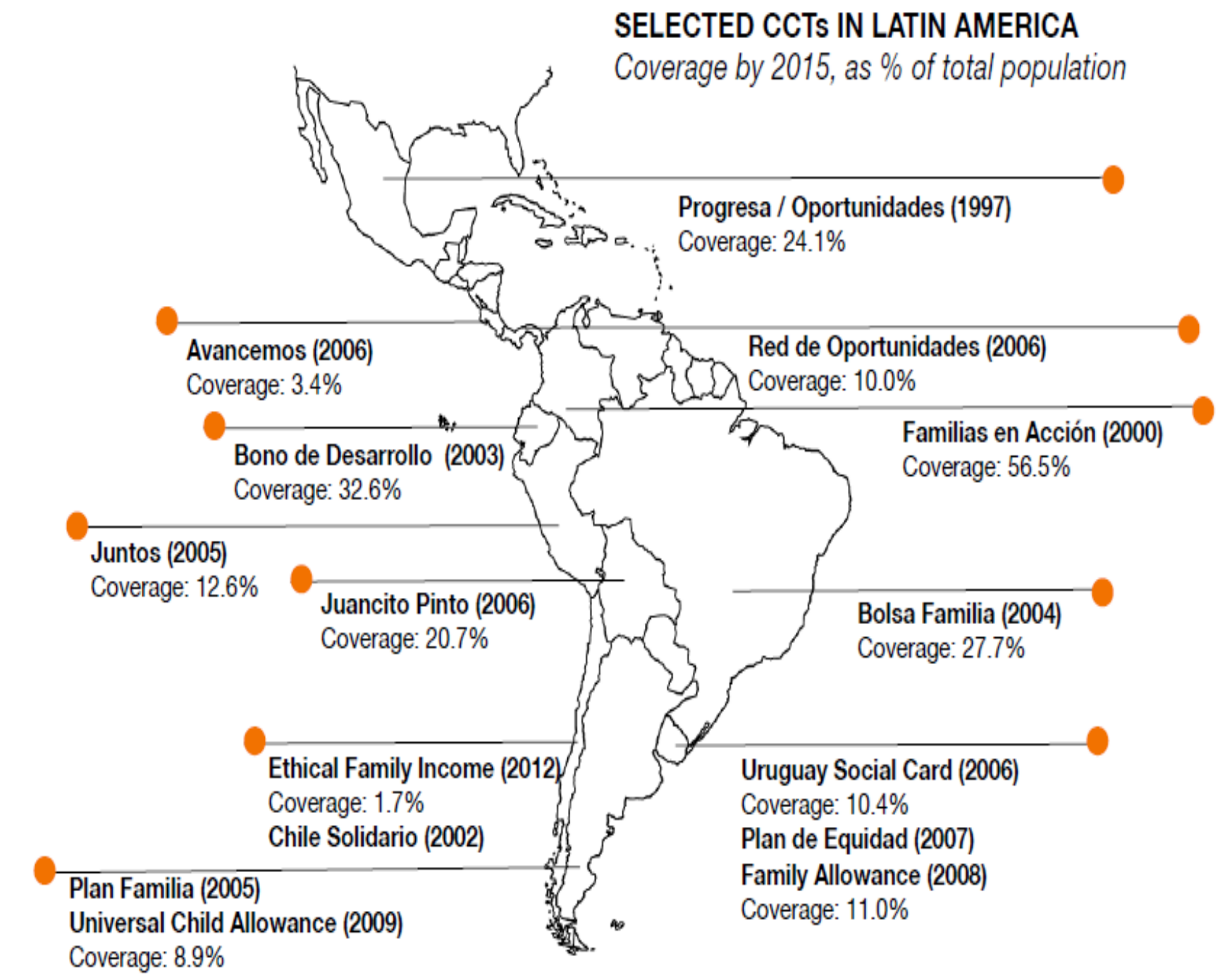




# Ways Forward for Public Policies

## Limitations of Conditional Cash Transfers without demand-side policies

- A CCT consists of a lump-sum cash transfer to poor families along with conditionalities that often relate to education (school attendance of a recipient's children, for example) or health (participating in preventive healthcare services for instance).
- Conditional Cash Transfers (CCTs) have become increasingly used as tools of inequality reduction since their first appearance in the mid-1990s in Mexico and Brazil .
- The CCT model not only assumes that schooling will enable recipients to access available jobs, but also that those jobs will exist when young people enter the labour market.
- CCT programmes such as Bolsa Familia offered the opportunity to the poorest segments of the population to have a better access to education and health, but evidence reveals that students that have benefited from Bolsa Familia have faced significant difficulties in finding good-quality jobs





# Ways Forward for Public Policies

## *Strategic state interventions: industrial policy*

- Coordinated education, social, and industrial policies can also help to generate demand for newly upskilled workers. Relying on market forces fails to break cycles of intergenerational inequalities, particularly when we factor in the impact of social norms, personal and professional networks, racial prejudice, and gender discrimination.
- An industrial policy can be defined as the strategic effort by the state to encourage the structural transformation of an economy, for instance, towards higher value-added activities or towards new sectors.
  - Industrial policies witnessed a resurgence in popularity and are a vital ingredient of economic diversification and sophistication
  - A growing body of evidence suggests that market forces alone are not enough to stimulate economic diversification. Rather, the acquisition of new comparative advantages across now-diversified countries has often been underwritten by significant industrial policies – even when disguised. (e.g. Chile)



Embraer plant in Brazil



Salmon farming in Chile



# Ways Forward for Public Policies

## Strategic state interventions: industrial policy

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INDUSTRIAL POLICY	
<i>Benefits</i>	<i>Challenges</i>
<ul style="list-style-type: none"> <li>• Helps acquire new capabilities and areas of comparative advantage</li> <li>• Can support the structural transformation of an economy towards higher value-added activities and/or new sectors.</li> <li>• Can be used to guide investments towards areas where private investment has been suboptimal</li> <li>• can also be used to balance economic growth and favour disadvantaged geographic areas and income groups.</li> </ul>	<ul style="list-style-type: none"> <li>• Requires considerable state capacity to 'pick winners' to avoid risks of inefficiency and cronyism</li> <li>• Requires some degrees of State autonomy from private interests to avoid state capture.</li> <li>• Requires the political and technical ability to let go of 'losers' (firms that fail to become competitive).</li> <li>• The policy space for industrial policy may be constrained by trade agreements and bilateral investment treaties signed by the government.</li> </ul>
<i>Key elements of a successful industrial policy</i>	
<ul style="list-style-type: none"> <li>• Performance requirements for firms that receive state support</li> <li>• Public-Private dialogue to share information &amp; solve coordination failures</li> <li>• Clear sector-selection criteria to reduce risks of wasteful spending or cronyism.</li> <li>• Monitoring and evaluation mechanisms to assess implementation over time</li> <li>• Coordination with social and education policies to avoid skills mismatches</li> <li>• Provision of incentives rather than requirements on their own</li> <li>• Inclusion of international competitiveness as a long-term objective.</li> </ul>	



# Ways Forward for Public Policies

## Strategic state interventions: Education Policy

Ensuring that low-income groups can benefit not only from unskilled but also skilled employment opportunities enhances the relevance of an appropriate education policy.

The accumulation of skilled human capital to support diversification requires:

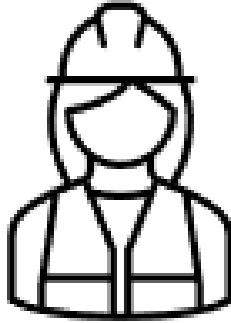
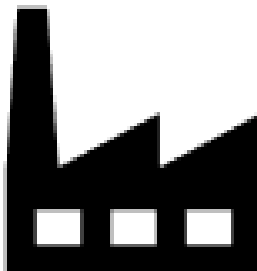
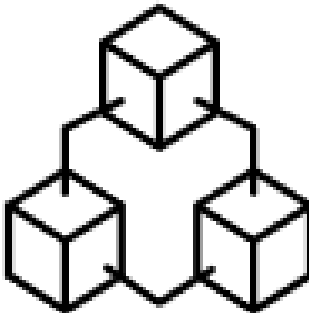
- a major increase in education spending
- but also **shaping human capital accumulation towards strategic areas** (setting strategic priorities in national education systems according to existing and future needs).

Education policy and scholarships systems that do not aim to support specific strategic areas can often result in skills mismatch:

- a discrepancy between the skills that are possessed by individuals and the skills required for available jobs, if the economy does not create jobs that correspond to the skills of individuals.



Table 4: Multi-level Consequences of Skills Mismatch

<b>Individual level</b> 	<b>Firm level</b> 	<b>National Level</b> 
<p>High wage penalties, especially for overqualification that eventually affect both job and life satisfaction.</p> <p>Evidenced in Latin America given the context of decreasing returns on education.</p>	<p>Loss in productivity and competitiveness.</p> <p>When specific skills are not provided by the education system, firms either cannot grow due to the absence of skilled workers or have to train the necessary personnel in-house, which leads to high non-recoverable costs, if trained employees leave the company.</p>	<p>Increase unemployment and competitiveness loss.</p> <p>Public or private resources are invested in skills development with the assumption that achieved qualifications will yield positive results in terms of employment insertion or wages. Yet, if skills mismatch imply that people are not employed at their full productivity potential.</p>

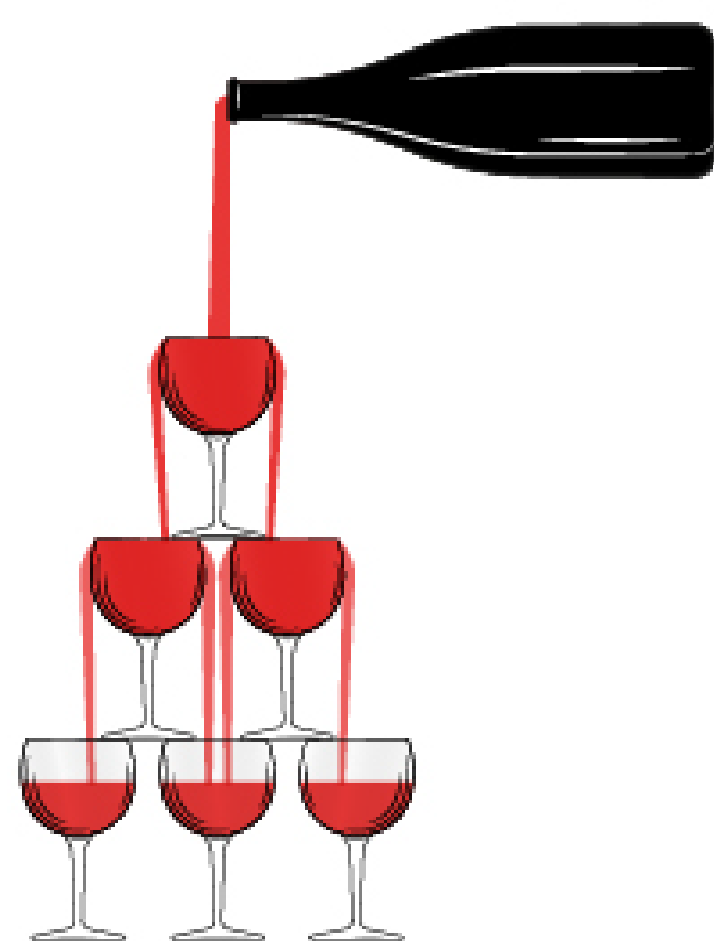
# The high cost of inequality... for society as a whole

## The Collapsing Pyramid

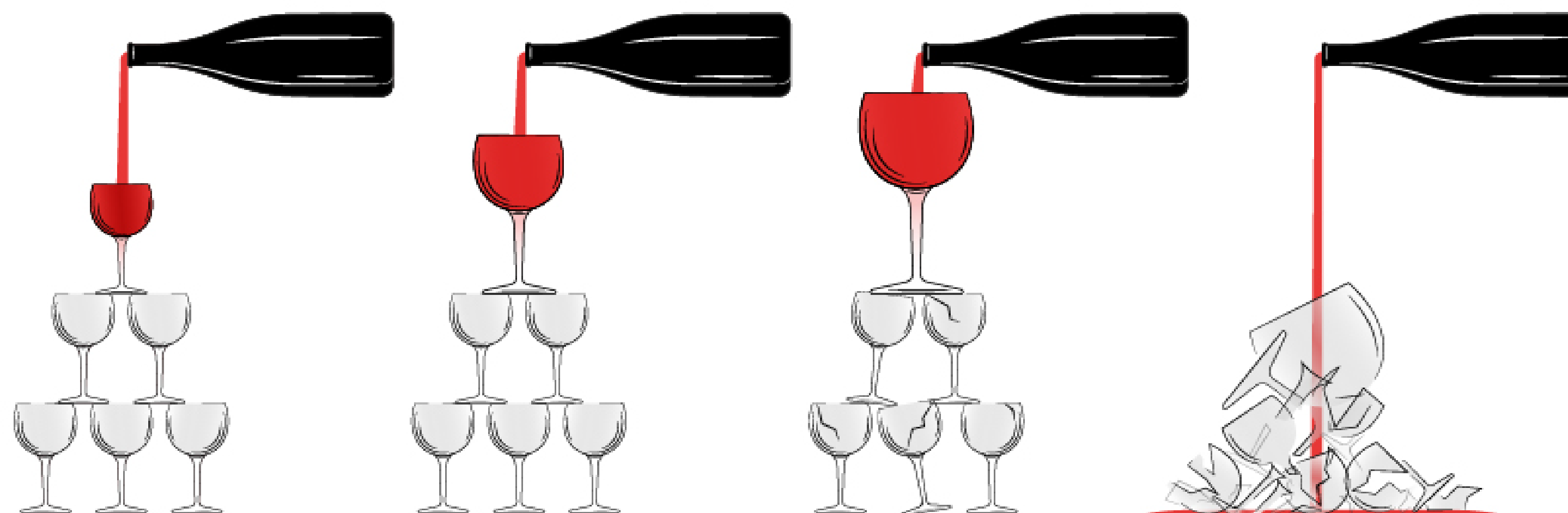
Trickle-down economics suggest that when rich people get richer, everyone benefits because wealth trickles down through consumption and the investment effects, like wine overflowing a pyramid of glasses. This belief justifies lower taxes on wealthier groups to stimulate economic growth that benefits the rest of society.

However, such policies tend to exacerbate inequalities that can crush the very foundations of society.

The Idea of Trickle Down



What usually happens...



It starts with the idea that when rich people have a lower tax burden, everyone benefits because wealth trickles down.

▶ Wealth rarely trickles down and often remains concentrated at the top.

▶ Perceptions of inequality increase, leading to a feeling of unfairness and injustice.

▶ If the bottom of the wine glass pyramid is too unstable, the whole pyramid crumbles and even the top glasses spill.



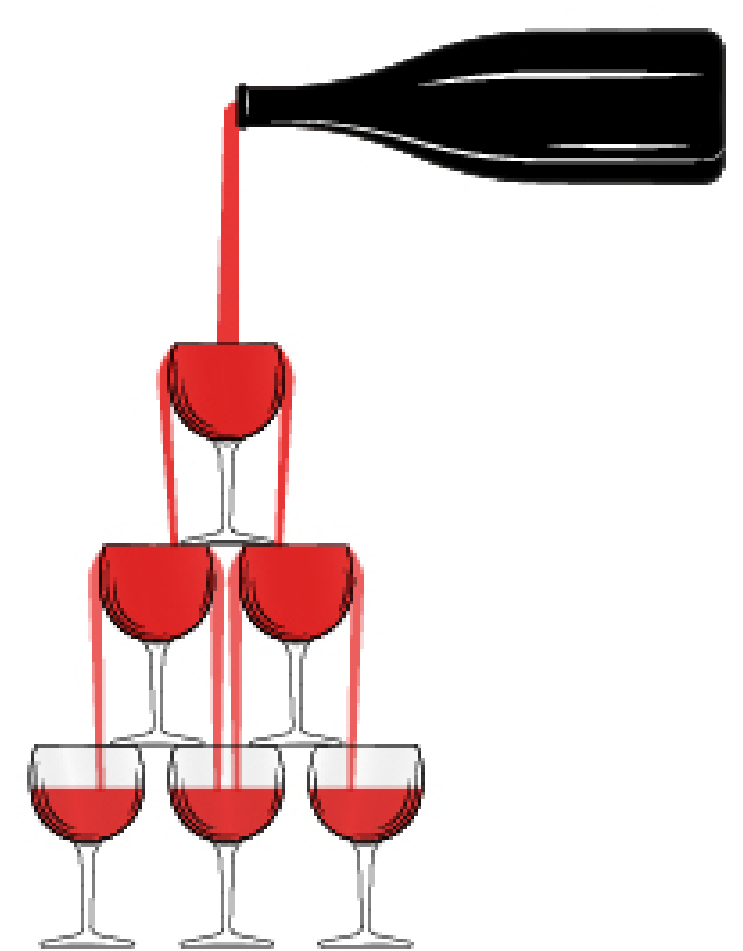
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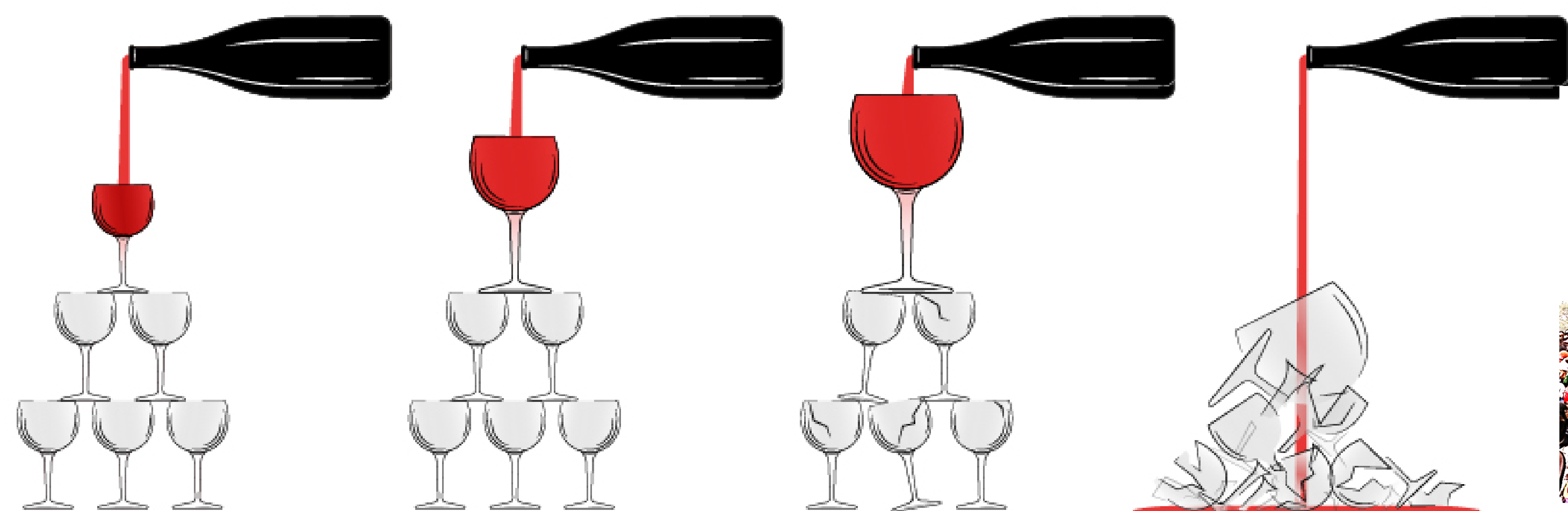
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Chile's 2019 inequality-induced protest, which led to economic instability, damage in public property and loss of income.



# Concluding remarks

- The ability of states to redistribute taxes or facilitate consumption amongst low-income groups may not be enough to sustainably reduce income inequality. These moves leave untouched the greater obstacles: **limited productive capabilities** and **weak absorption of labour in value-added sectors**.
- Rather than only redistributing existing wealth, reformers should implement **policies to generate new wealth that** will be more evenly distributed. Policy
  - Focus on combining diversification to increase labour demand with improved employability for lower income groups.
  - Sophisticated and coherent industrial, education innovation policies are needed.
- The COVID-19 crisis also represents a critical juncture **for rethinking industrial policy** in the region. The disruptions of global supply chains in 2020/2021 have further shown the vulnerability of many Latin American countries that overly depend on commodity exports, tourism, and the imports of manufactured goods.
- Against this backdrop, urgent need to rethink the importance of diversification and strengthen productive capacities in strategic sectors to achieve both resilience, competitiveness, and productive employment that can reshape the inequality mould for the years to come, and break free from a model that fosters inequalities and that focuses on sectors making use of unskilled labour and raw material exports) rather than 'knowledge-intensive' and complex activities



# Thank you for your attention

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