

Fair Growth:

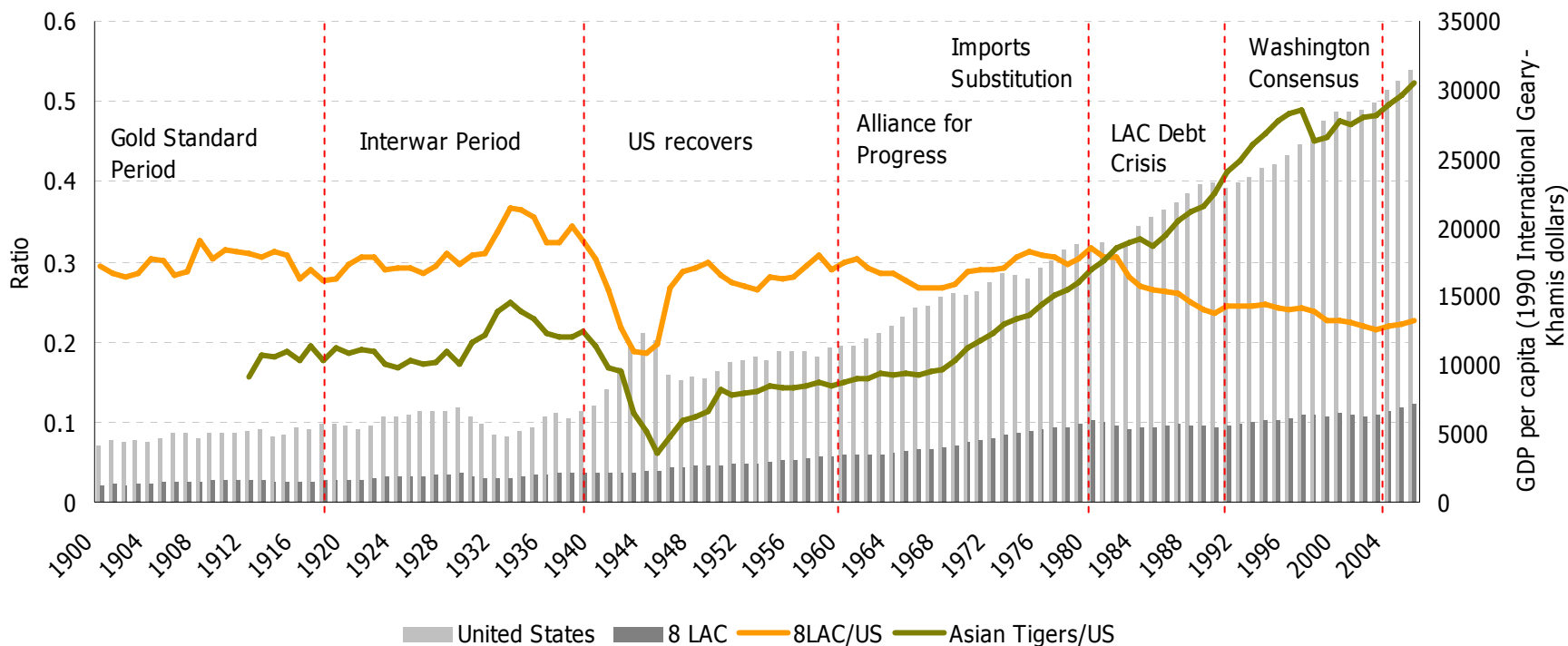
Economic Policies for Latin America's Poor and Middle-Income Majority

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Washington, DC
12 March 2008**

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Average per capita income in Latin America has not been on a converging trend over the past century

GDP per capita: LAC/US

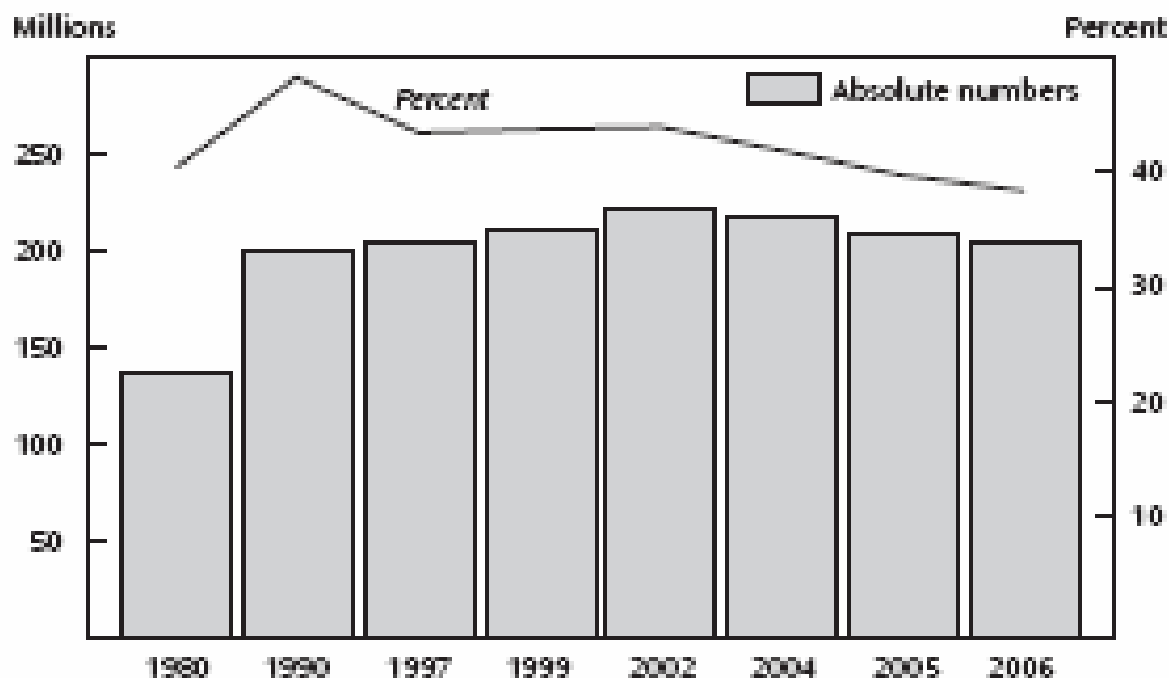


Source: Angus Maddison Historical Statistics for the World Economy. The unit is 1990 International Geary-Khamis dollars

Note: The aggregated GDP per capita is a simple average of the countries in the region. GDP per capita for the United States and Latin America are in levels. 8 LAC: Argentina, Brazil, Chile, Colombia, Mexico, Peru, Uruguay and Venezuela; Asian Tigers: Hong Kong (China), Indonesia, Malaysia, Singapore, South Korea, Taiwan (China), Thailand. Before 1950, the Asian Tigers sample varies. From 1950 on, Asian Tigers comprise all the seven countries.

Poverty in LAC remains stubbornly high

FIGURE 4. Latin American Population Living under the Poverty Line, 1980–2006^a

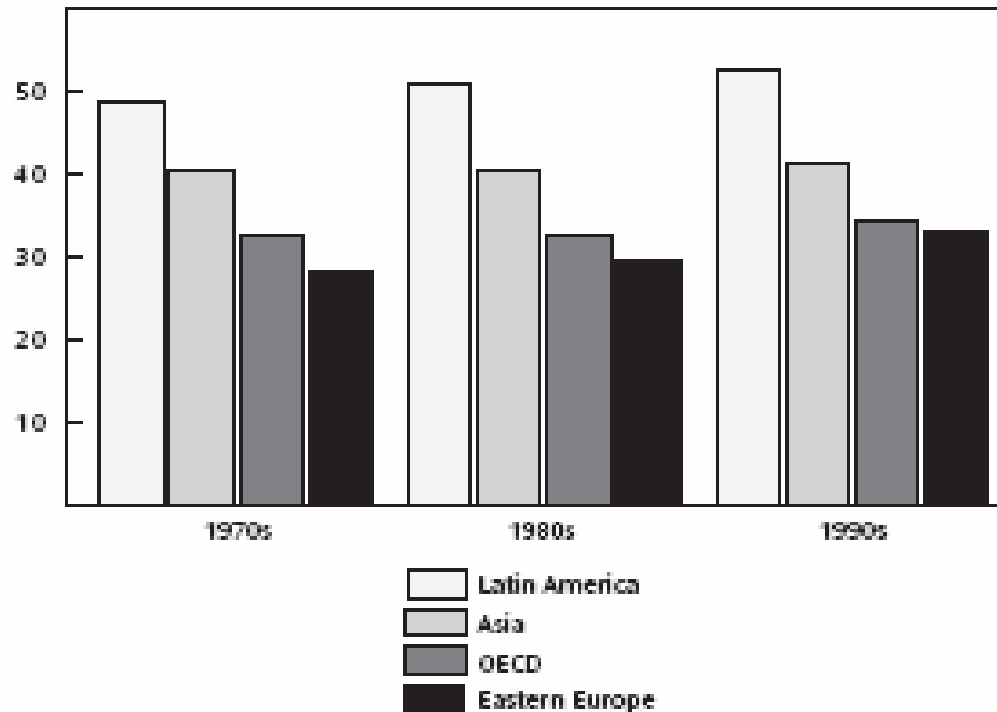


Sources: ECLAC (2006a).

a. Based on special tabulations of household surveys in eighteen countries in the region, plus Haiti.

High income inequality is a LAC trademark

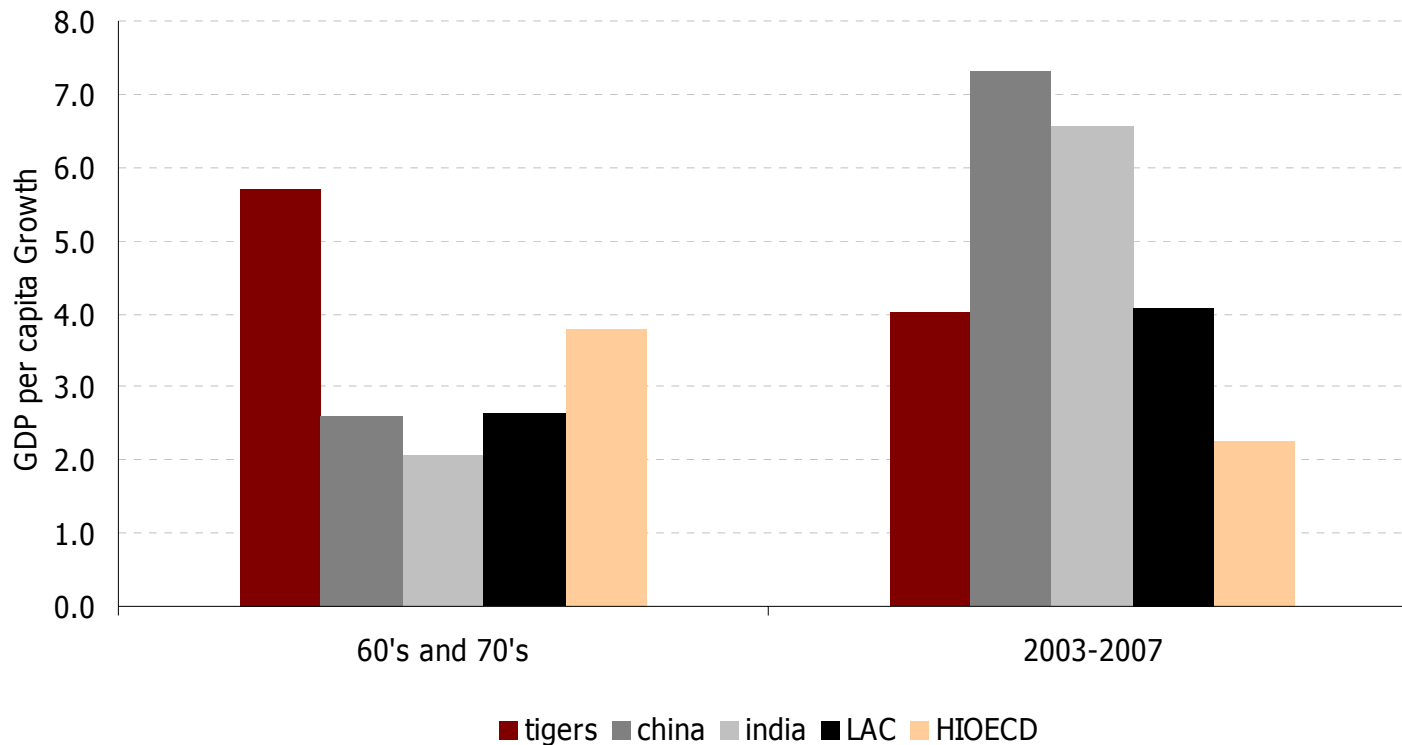
FIGURE 5. Gini Coefficients of the Distribution of Household Per Capita Income, Various Regions and Years^a



Source: De Ferranti and others (2004).

a. Africa is not included because not enough observations on income inequality in that region are available.

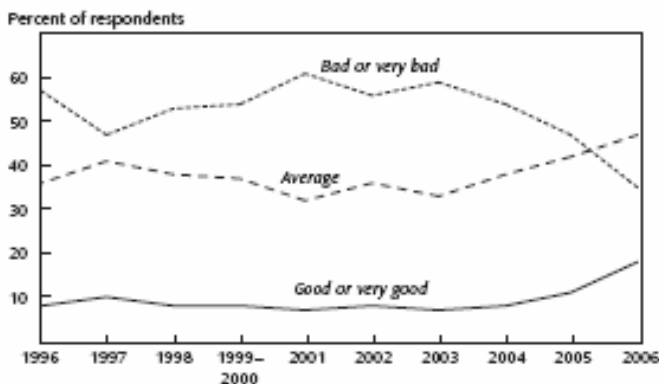
Although recent growth in LAC has been the best in decades...



Note: The aggregated growth is a simple average of the GDP per capita growth of the countries in the region. GDP per capita is PPP adjusted from Penn World Tables. From 2004 on, the data is from International Monetary Fund, World Economic Outlook Database 2007

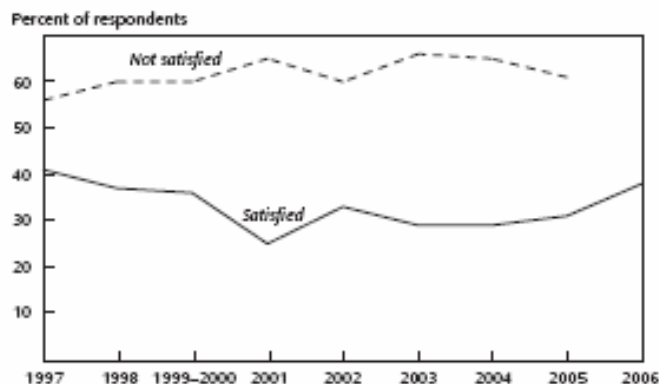
...Latin Americans remain dissatisfied with their democracies and market economies

FIGURE 10 a. How would you describe your country's present economic situation?



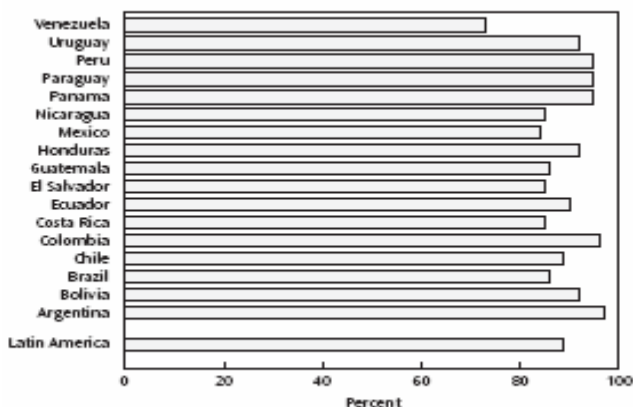
Source: Latinobarómetro (2006).

FIGURE 10 b. How satisfied are you with the way that democracy works in your country?



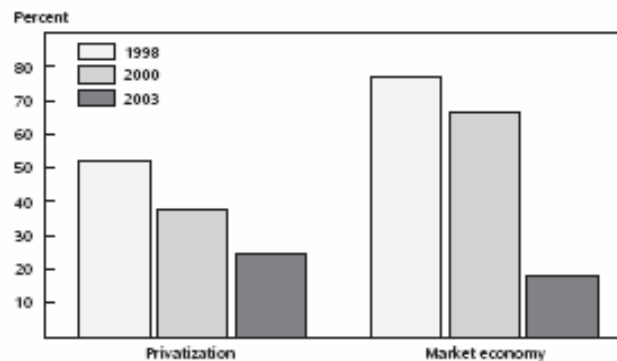
Source: Latinobarómetro (2006).

FIGURE 10 d. Do you think that the income distribution in your country is very fair, fair, unfair, or very unfair?*



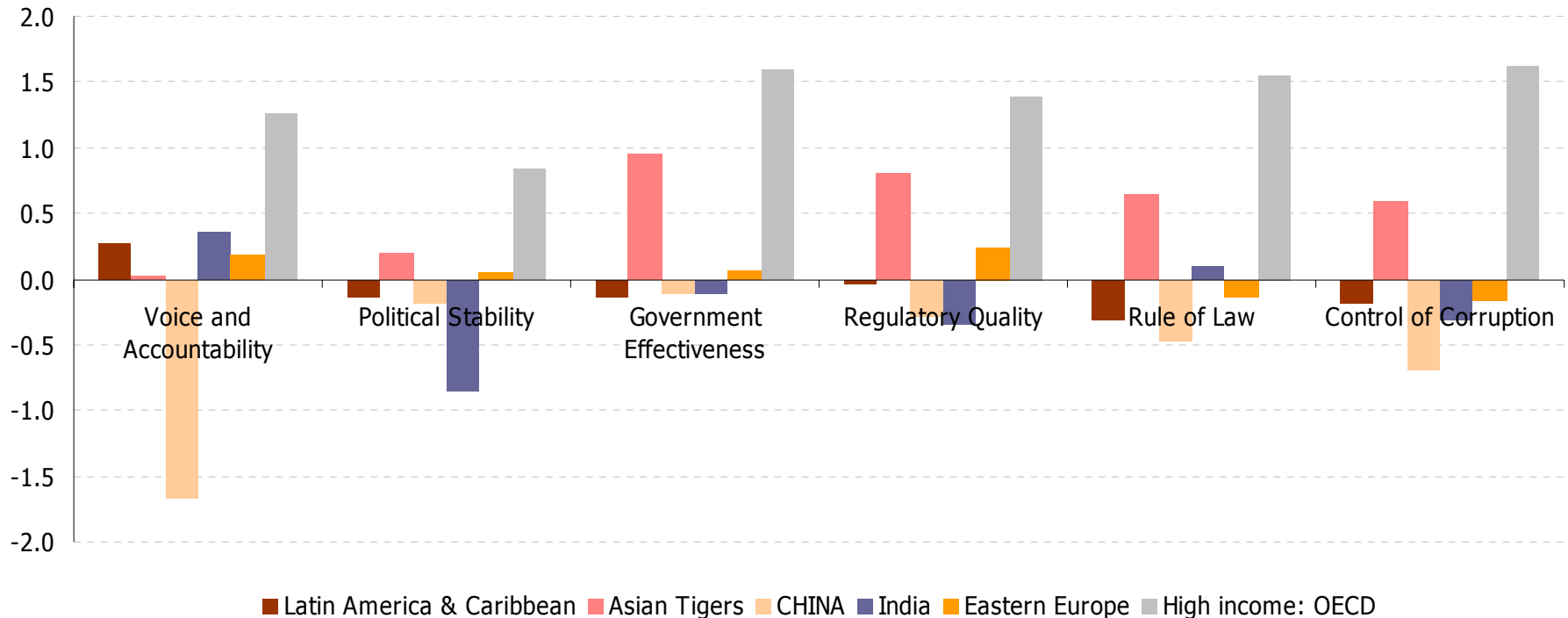
Source: Latinobarómetro (2001).
a. Percent responding unfair and very unfair, 2001.

FIGURE 10 e. Support for Privatization and the Market Economy in Latin America, 1998-2003*



Source: Panizza and Yañez (2006) based on Latinobarómetro surveys.
a. Percent of respondents who think that the privatization process was beneficial for the country; percent of respondents who think that a market economy is good for the country. Note that Latinobarómetro surveys from 1998 and 2000 ask "Do you think that a market economy is good for the country?" For the year 2003 the question was "Are you satisfied with the functioning of the market economy?"

...which is related to significant weaknesses in basic institutions relative to other emerging markets



Source: Governance Matters V. All indicators are simple averages for the region. The units in which governance is measured follow a normal distribution with a mean of zero and a standard deviation of one in each period. This implies that virtually all scores lie between -2.5 and 2.5, with higher scores corresponding to better outcomes.

Fairness

- ✚ A more elusive but more useful concept for the legitimacy of market economies
- ✚ Related but not reducible to inequality outcomes, and more congenial to equality of opportunities
- ✚ Perceived fairness of *process* is more important than perceived fairness of outcomes

What is the book about

- ✚ Policy suggestions for governments concerned with promoting fairness as a fundamental goal, without sacrificing efficiency and growth
 - ✚ In consultation with policy makers and reformers
 - ✚ Idea supported by recent empirical work on feedback loops between inequality, poverty and growth
 - ✚ Suggestions based on actual experiences and items in the debate
- ✚ A report to facilitate dialogue and build bridges with non-economists
 - ✚ Covers issues that, although intensively discussed among economists, are largely ignored or misunderstood by politicians, civil society leaders, and the press in Latin America

What it is not about

- ✚ Not a substitute for rigorous, case-by-case diagnosis – policy suggestions don't offer guidance on what is wrong
 - ✚ What the problems are, which problems are more important, where are the binding constraints
- ✚ Not a guide for reform packages and policy strategy
 - ✚ No suggestions on sequencing, prioritization, complementarities
 - ✚ No discussion on political economy of reform
- ✚ Does not pretend to understand the precise links from policy to outcomes
- ✚ Does not necessarily reflect a consensus on the contents of the toolkit not any magical features of the tools

What is left out

- ✚ Political institutions and governance
 - ✚ Tangential coverage – taxes, corruption, public services
- ✚ Health policy
- ✚ Crime and violence
- ✚ Etc. (choice of policy areas is ultimately arbitrary)

A Dozen Equity Policy Areas

1. Rule-based fiscal discipline
2. Smoothing booms and busts
3. Social safety nets that trigger automatically
4. More taxes on the rich and better spending on the rest
5. Giving small business a chance
6. Protecting job mobility and workers' rights
7. Repairing rural markets
8. Tackling corruption head on
9. Schools for the poor, too
10. Dealing openly with discrimination
11. Consumer-driven public services
12. How can the United States help: opening markets and more

2. Smoothing Booms and Busts

- ✚ Create buffers ex-ante

- ✚ Fiscal

- ✚ Structural budget target à la Chile
- ✚ Stabilization funds (politically sustainable?)

- ✚ Monetary

- ✚ Inflation targeting cum exchange rate flexibility (where feasible)

- ✚ Financial

- ✚ Solvency buffers (e.g., countercyclical loan-loss provisions)
- ✚ Liquidity buffers
- ✚ Local currency debt markets

- ✚ Other

- ✚ Catastrophe insurance

LAC ranks highest in recurrence of financial crises

TABLE 1.5 | RECURRING BANKING CRISES, 1974–2003

Region	Average number of crises per country	Countries with recurrent crises (percent)
Latin America (excluding the Caribbean)	1.25	35
Latin America and the Caribbean	0.90	27
High-income OECD countries	0.21	0
High-income non-OECD countries	0.09	0
Eastern Europe and Central Asia	0.89	11
East Asia and the Pacific	0.38	8
South Asia	0.38	0
Middle East and North Africa	0.40	0
Sub-Saharan Africa	0.83	13

Source: IDB calculations based on Caprio and Klingebiel (2003).

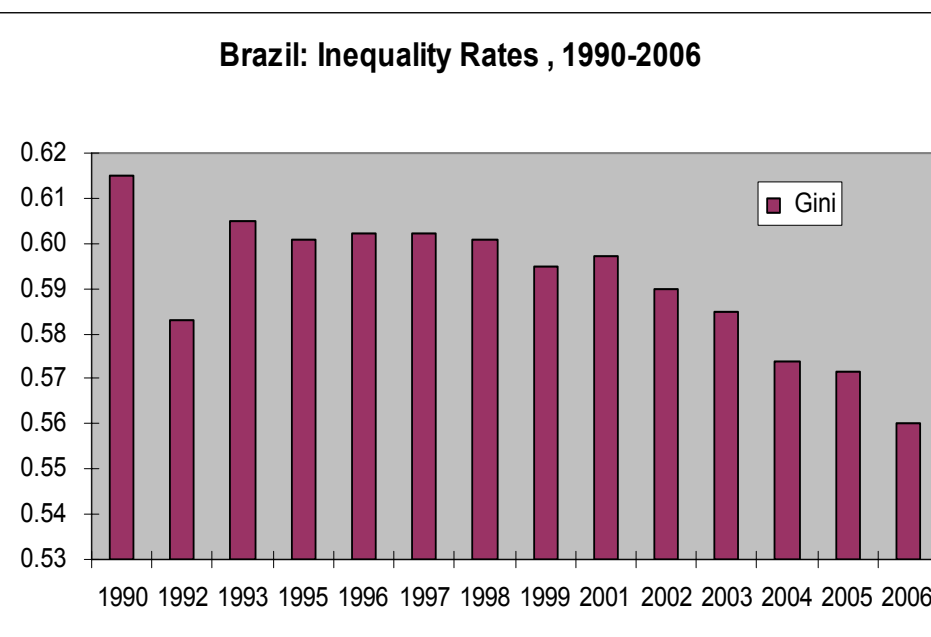
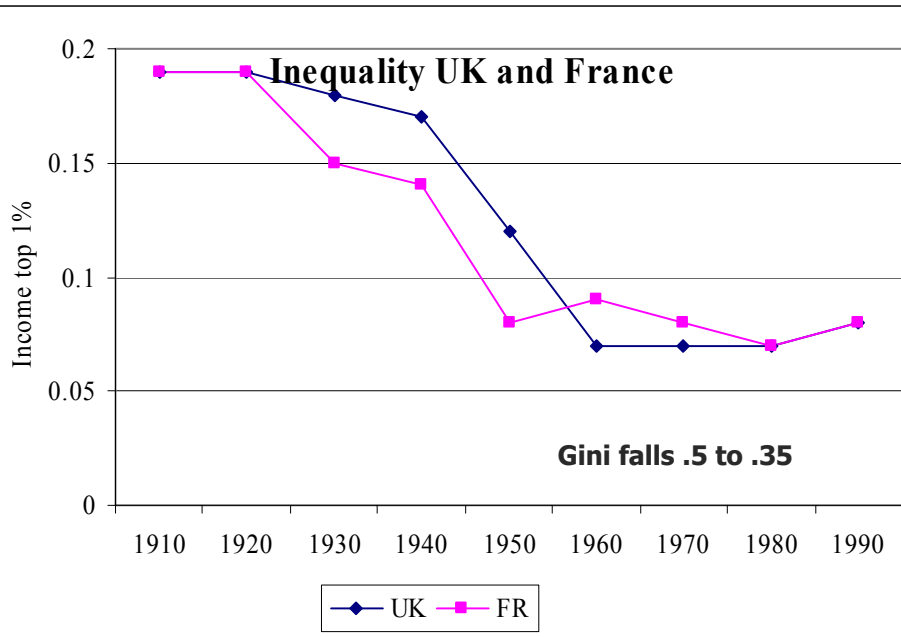
3. Social Safety Nets

- ✚ Focus on targeted social assistance nets (as opposed to social insurance – social security, unemployment, health)
 - ✚ Due to complexity of social insurance issues, but a loss!
- ✚ Permanent programs
 - ✚ Conditional cash transfers (align incentives better)
 - Bolsa Familia (Brazil); Oportunidades (Mexico)
 - Links to savings that can be leveraged
 - Demand empowerment leads to improved services supply
- ✚ Emergency programs – automatic triggering and sunset
 - ✚ Temporary work programs at slightly below lowest market wage
- ✚ Community involvement and independent evaluation

4. More Taxes on Rich & Better Spending on the Rest

- + Equity concerns shouldn't be restricted to expenditure side
- + Progressivity in income taxes
 - * Clearer link between tax payments and citizenship
 - * Simplification to reduce evasion and de facto regressivity
 - * Income tax rebates rather than exempting low incomes
- + Other progressive taxes: property taxes, gross assets tax, taxation of global income (?)
- + PAYG pensions – key to greater progressivity of spending
 - * Reform overly generous, inequitable public employee systems
 - * Set income floor with broad coverage to address poverty in old age

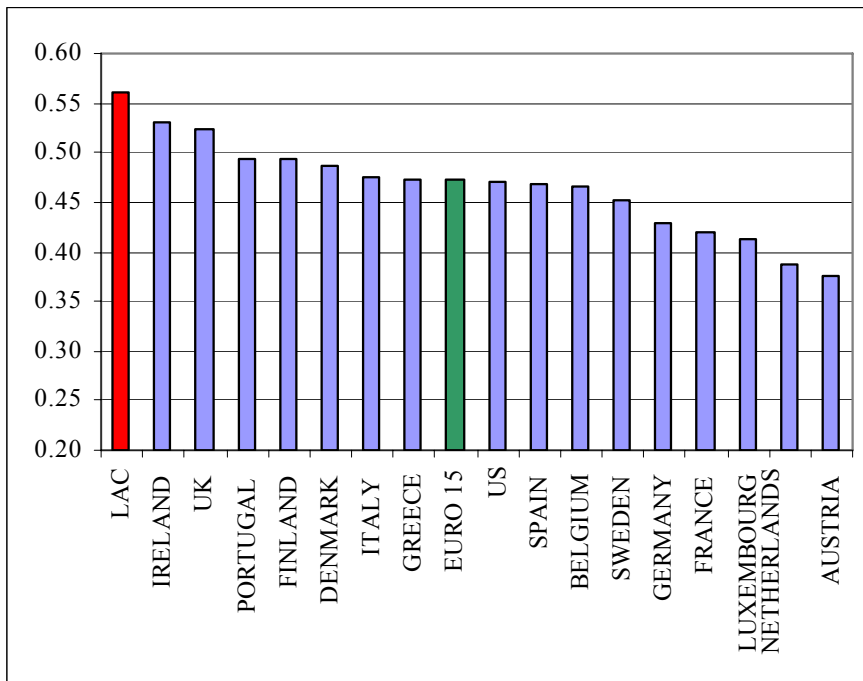
History suggests that income concentration can be reduced...



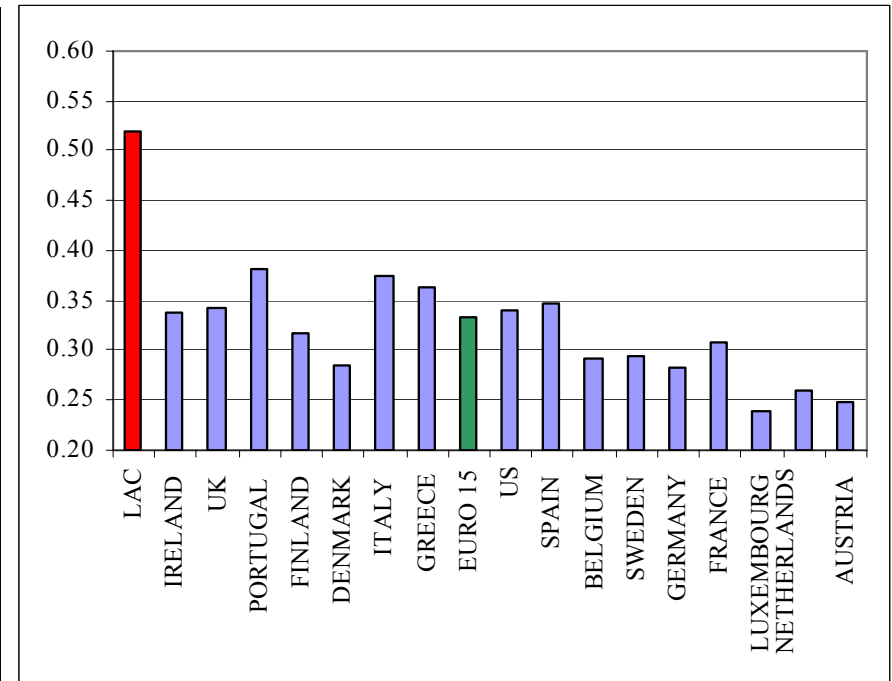
Sources: World Bank, *Poverty Reduction and Growth: Virtuous and Vicious Circles*. 2006; and IPEA, based on IBGE PNAD data

... but it generally requires a strongly redistributive fiscal process

Gini of Market Incomes



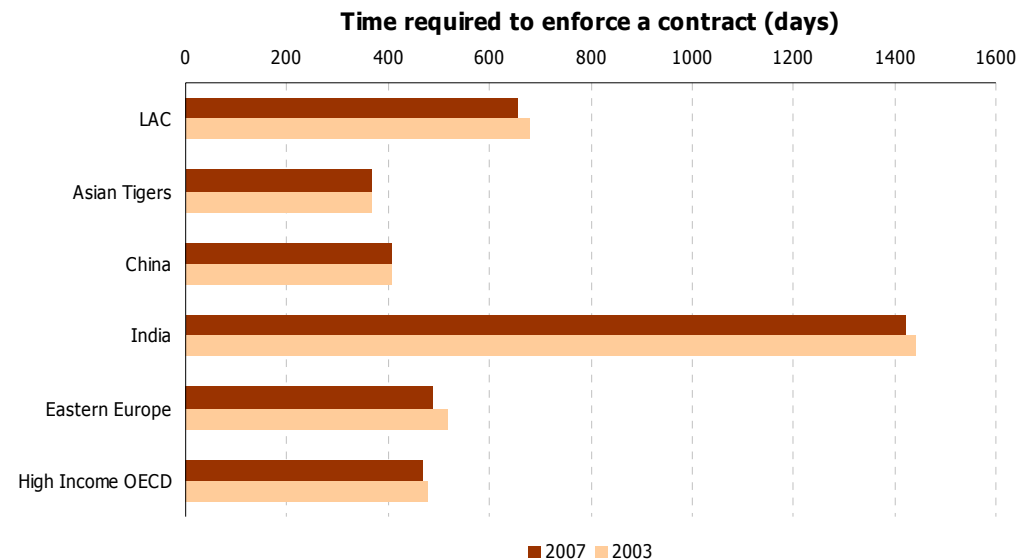
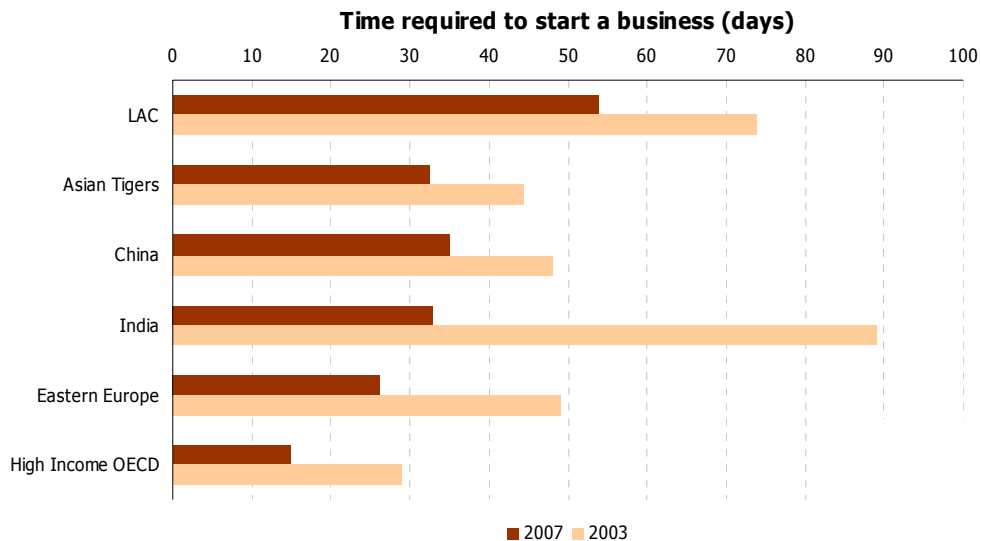
Gini of Disposable Incomes



5. Giving Small Businesses a Chance

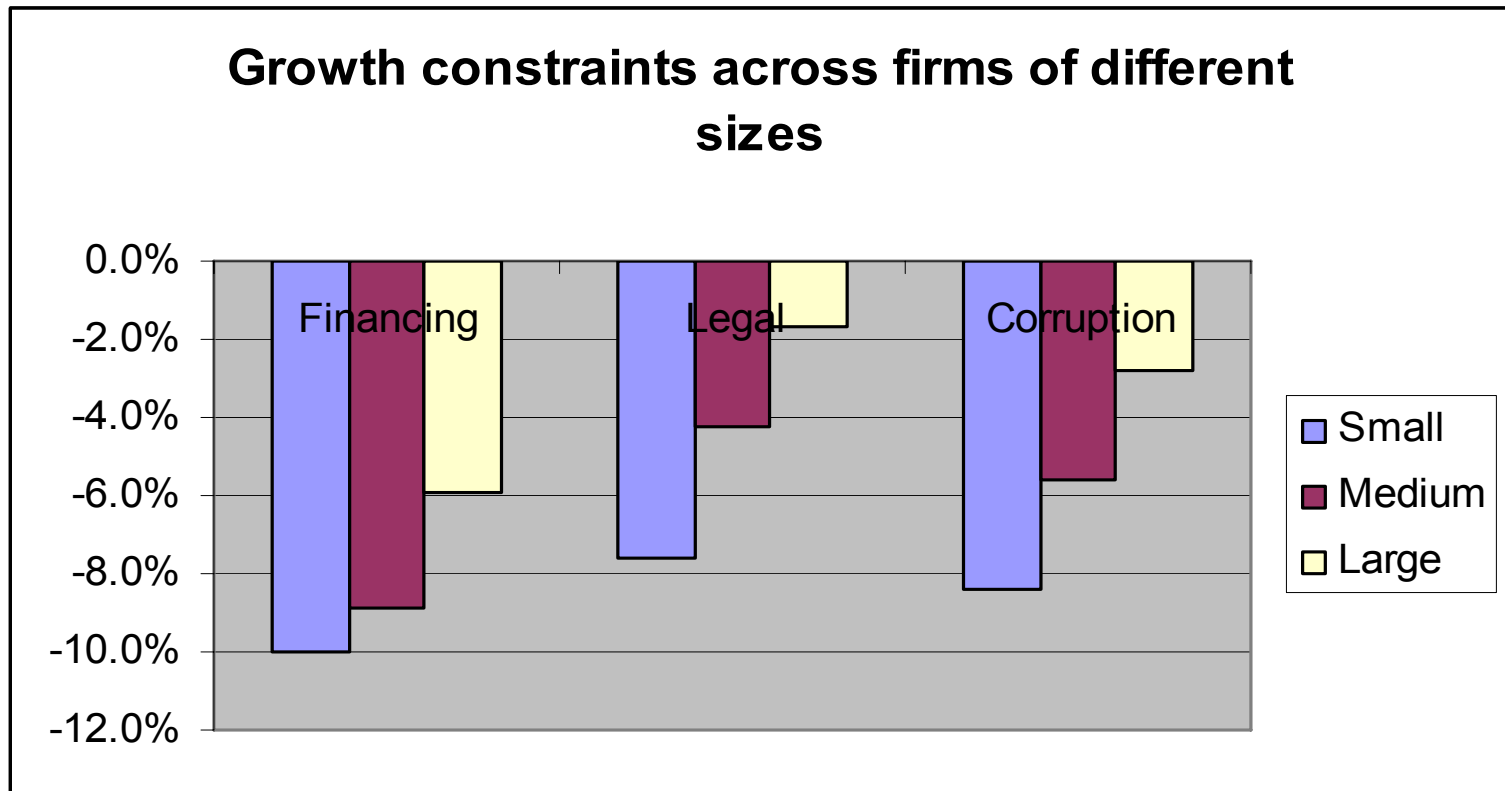
- ✚ Address obstacles to access to finance
 - ✦ Microfinance: credit bureaus; diffusion of scoring technologies
 - ✦ SME finance: contractual environment (collateral, bankruptcy)
 - ✦ Foster diversification of financial intermediaries and products
 - ✦ New strategy for development banks
 - Eliminate, rationalize, and consolidate where needed
 - Move towards development agencies charged with promoting the sustainable broadening of access to financial services markets
- ✚ Reduce other costs of doing business (e.g. red tape, burdensome taxes and labor legislation)
- ✚ Promote clusters and productive chains where comparative advantages are obvious
 - ✦ Potentially useful role of matching grants

LAC's environment for small businesses is improving but remains comparatively unfriendly



Source: World Bank Doing Business Indicators. Asian Tigers: Hong Kong (China), Indonesia, Malaysia, Singapore, South Korea, Taiwan (China), Thailand.

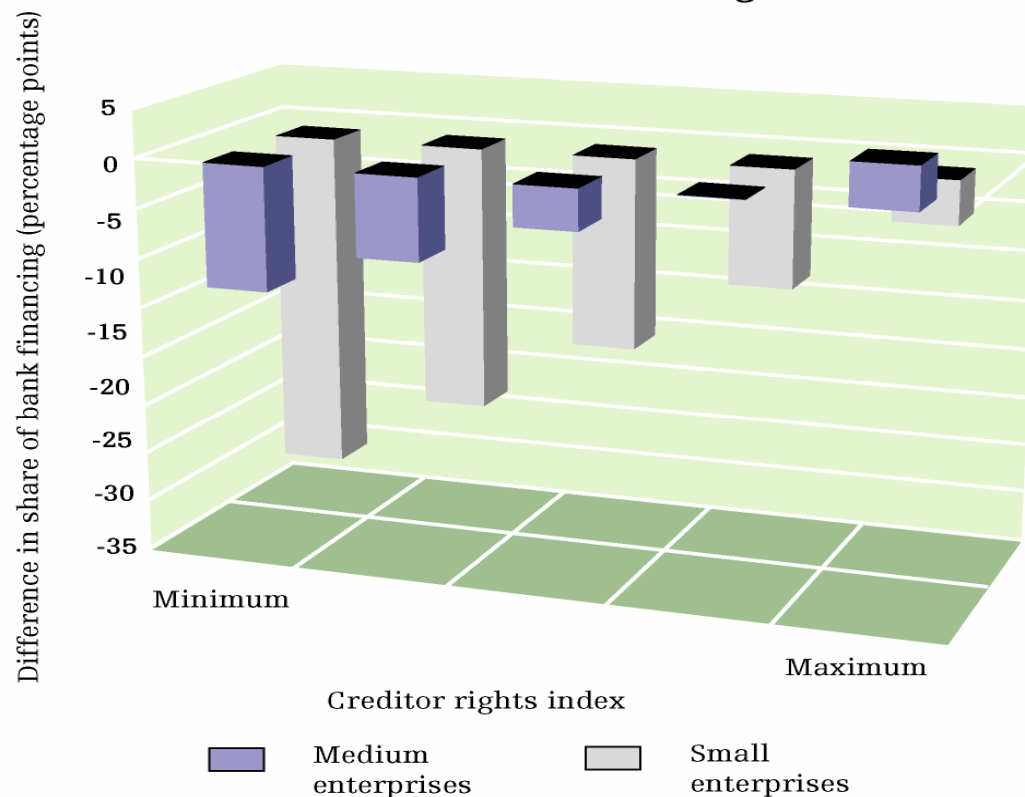
Small firms are disproportionately hurt by financing, legal, and corruption problems



Source: Beck, Demirguc-Kunt and Maksimovic (JF, 2005), Use firm level survey data (WBES) for 4000 firms in 54 countries.

Creditor rights improvements can narrow gap in bank financing between SMEs and larger firms

FIGURE 12.3 Gap in Bank Financing of Small and Medium-Size Enterprises and Effective Creditor Rights



Note: Values are differences in share of bank financing compared with large enterprises.

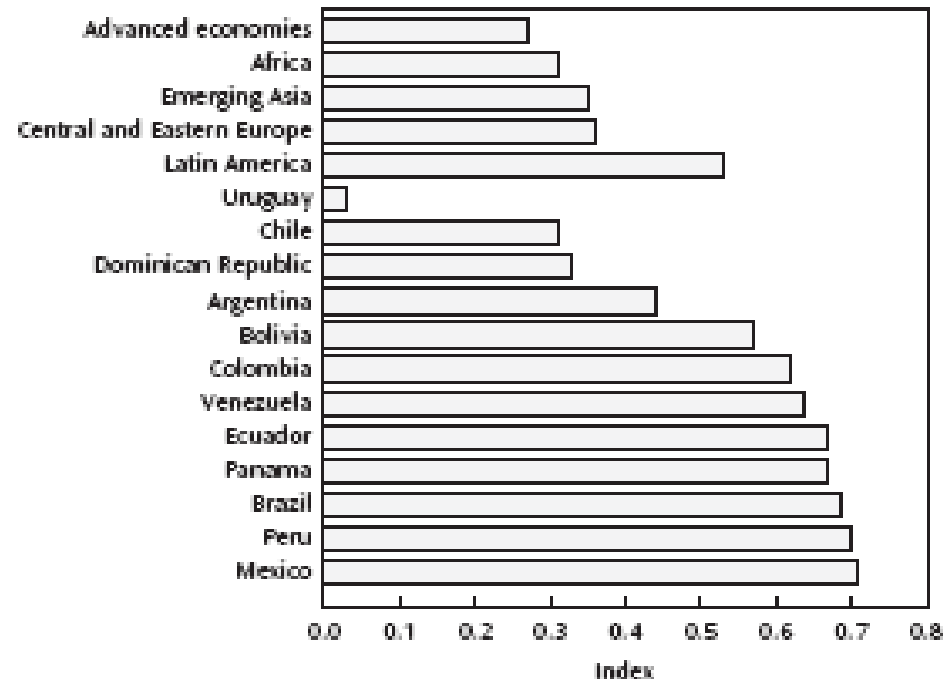
Source: Galindo and Micco (2004b).

6. Protecting Job Mobility & Workers Rights

- ✚ Globalization intensifies “creative destruction” and dislocation
- ✚ Protect rights of association and encourage collective bargaining at the firm level
- ✚ More democratic unions – transparency and accountability
- ✚ Allow flexible hiring arrangements with minimum social protection
- ✚ Life-long opportunities for education, training & re-training
- ✚ Portability of pensions, healthcare and other benefits
- ✚ Eventually, unemployment insurance
- ✚ Extend minimum social insurance coverage to informal sector (contributory or noncontributory?)

LAC has a legacy of high labor market rigidity

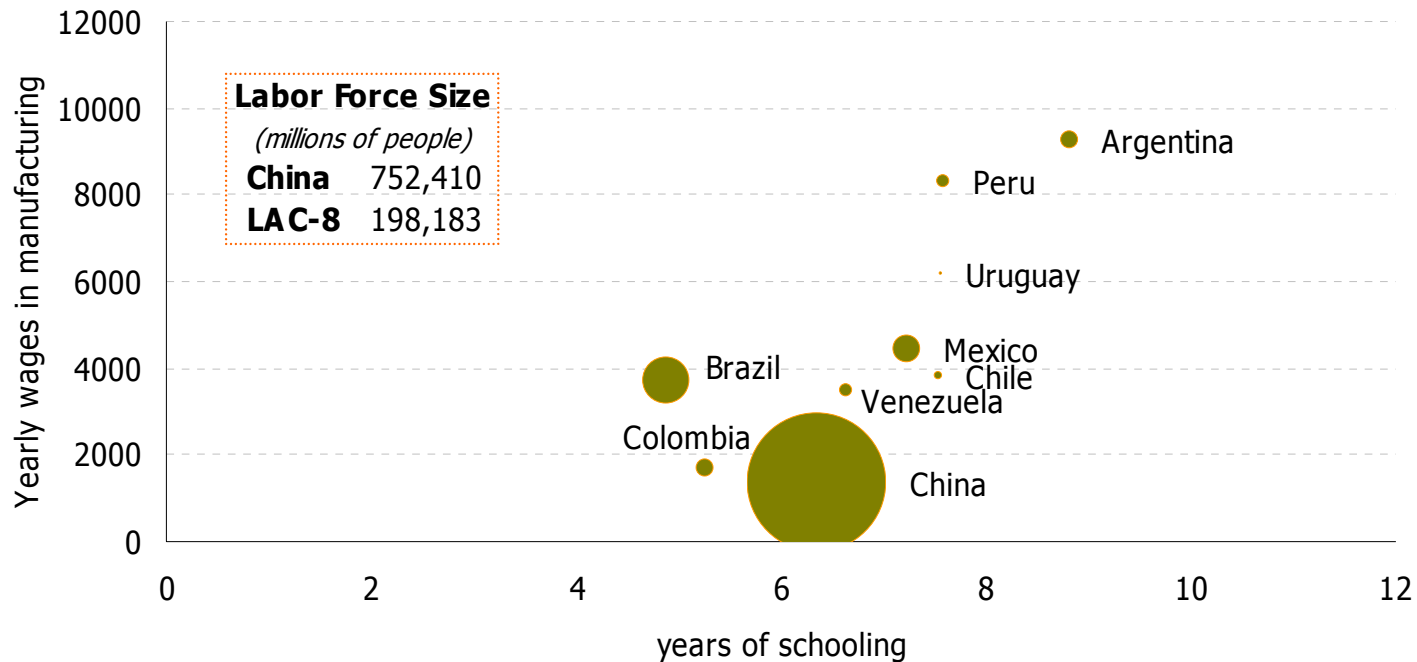
FIGURE 6-2. Index of Labor Market Rigidity^a



Source: Bobaro and others (2003).

a. 0 = low level of labor market rigidities; 1 = high level of labor market rigidities.

LAC not positioned to compete with abundant, low-wage labor – it must do it through productivity



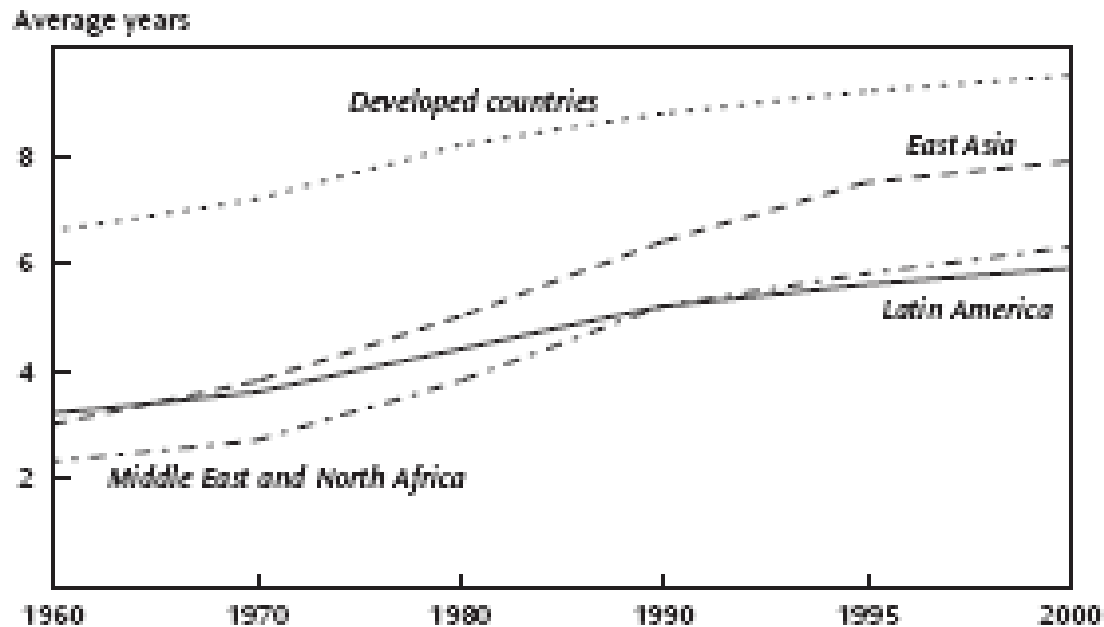
Notes: Yearly wages are manufacturing wages from LABORSTA (ILO) in 2002. Uruguay and Argentina are in 2001 and Venezuela in 1997. Labor force size is from WDI 2002. Years of schooling is the average number of years of school attainment of the population with 25 years or more from Barro and Lee 2000.

9. Schools for the Poor, Too

- ✚ Returns to tertiary education and skill premium rising
- ✚ Design of reform should incorporate voice, choice (vouchers!), information, and accountability
- ✚ Performance-based school reform (tests!) to enhance quality
- ✚ Investment in early childhood (child care, pre-school, parenting programs)
- ✚ But beware of excessive supply-driven approach – demand matters and beware of crowding out effects

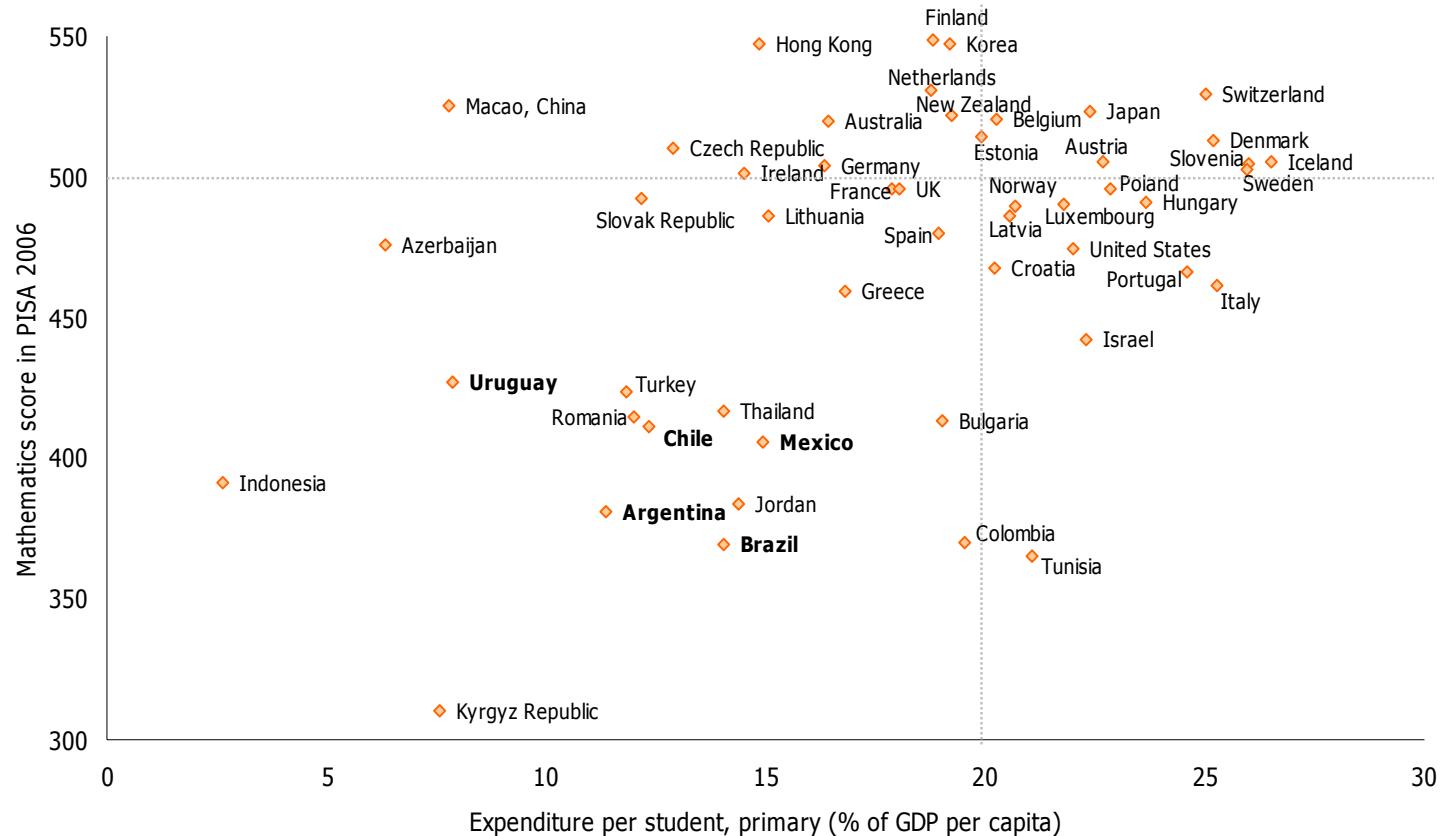
LAC is lagging in average years of school...

FIGURE 9-1. Average Years of Schooling of the Labor Force, 1960–2000^a



Source: Adapted from PREAL (2006), with data from Barro and Lee (2000).
a. Simple averages. Labor force is defined as those age twenty-five and over.

... and has a particularly pronounced gap with respect to the *quality* of education



Source: Mathematics score from Pisa (2006). Expenditure per Student, primary (% GDP) is the most recent data available in WDI (2004 for most of the countries). Public expenditure per student is the public current spending on education divided by the total number of students in the primary level.

11. Consumer-Driven Public Services

- ✦ Privatization and concession contracts that maximize competition (if exclusivity unavoidable, shorten period)
- ✦ Compensate laid-off workers of privatized companies
- ✦ Enhance transparency in privatization process and privatized operations
- ✦ Build in obligation in privatization and concession contracts to extend access to services for the poor
- ✦ Use connection subsidies targeted to the poor
- ✦ Incorporate the labor of poor users in service operation (can attract private operators while benefiting the poor)
- ✦ NB: user participation is not a substitute for well-run public agencies in service provision

END