

Development, Inequality and Democracy:

Elements of a case study from the new “social contract” in Latin America

Francisco H.G. Ferreira
The World Bank

Development and Democracy Promotion Workshop
SAIS, Washington, DC: 24 March 2010

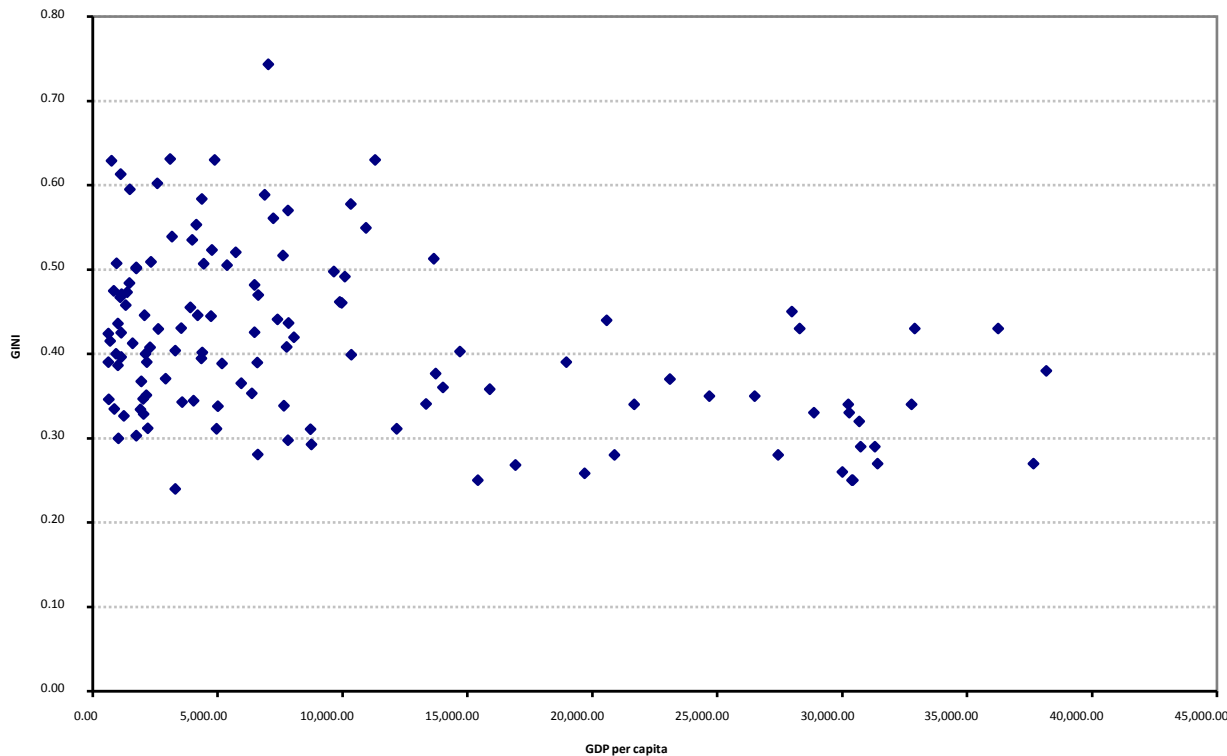
Two introductory hypotheses

1. Successful economic development is inconsistent with “extreme” inequality (say, Gini > 0.45).
 - a) When combined with imperfect capital markets, wealth inequality leads to inefficiency in resource allocation.
 - b) Inequality leads to “elite capture” of institutions, and thus to weak rule of law and property rights (except for the elite...)
(WDR, 2006)

2. The “natural” process by which development brings about a reduction in inequality usually involves a redistributive role for the State.
 - a) Redistribution need not be of incomes (XIX century US: education and land).
 - b) An interesting example that is unfolding today is the renegotiation of LAC’s “social contract”. In key countries, this process started with the re-democratization of the 1980s.

There are no “extremely unequal” rich countries

Figure 1: Income levels and inequality around the world

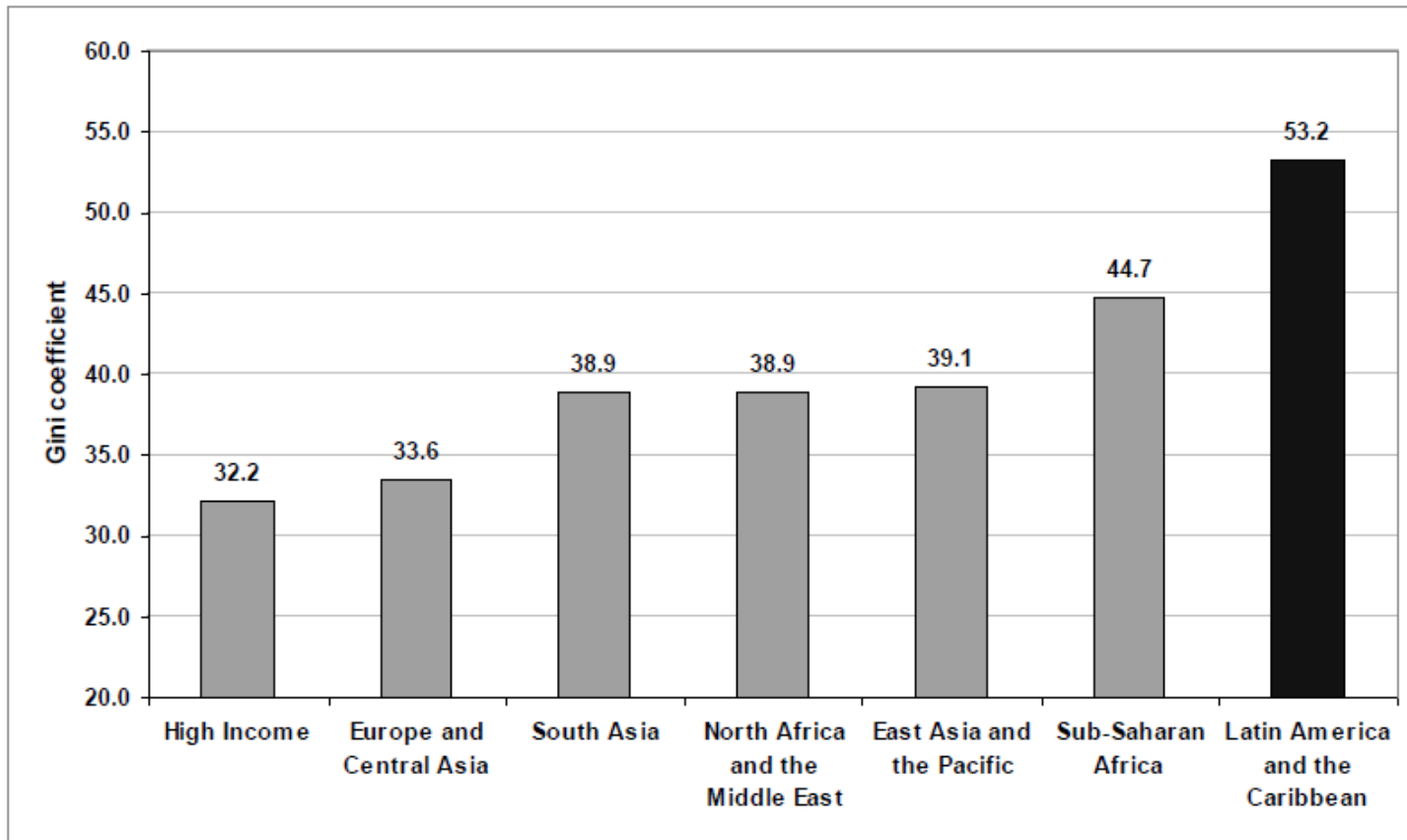


Source: Ferreira and Ravallion (2009)

1. Above a (PPP) GDP per capita of \$20,000 p.a., all Gini coefficients in (0.25, 0.45)
2. Correlation between GDP per capita and Gini = -0.44

Latin America and Africa are real outliers

Figure 1. *Gini Coefficient by Region (in %), 2004*

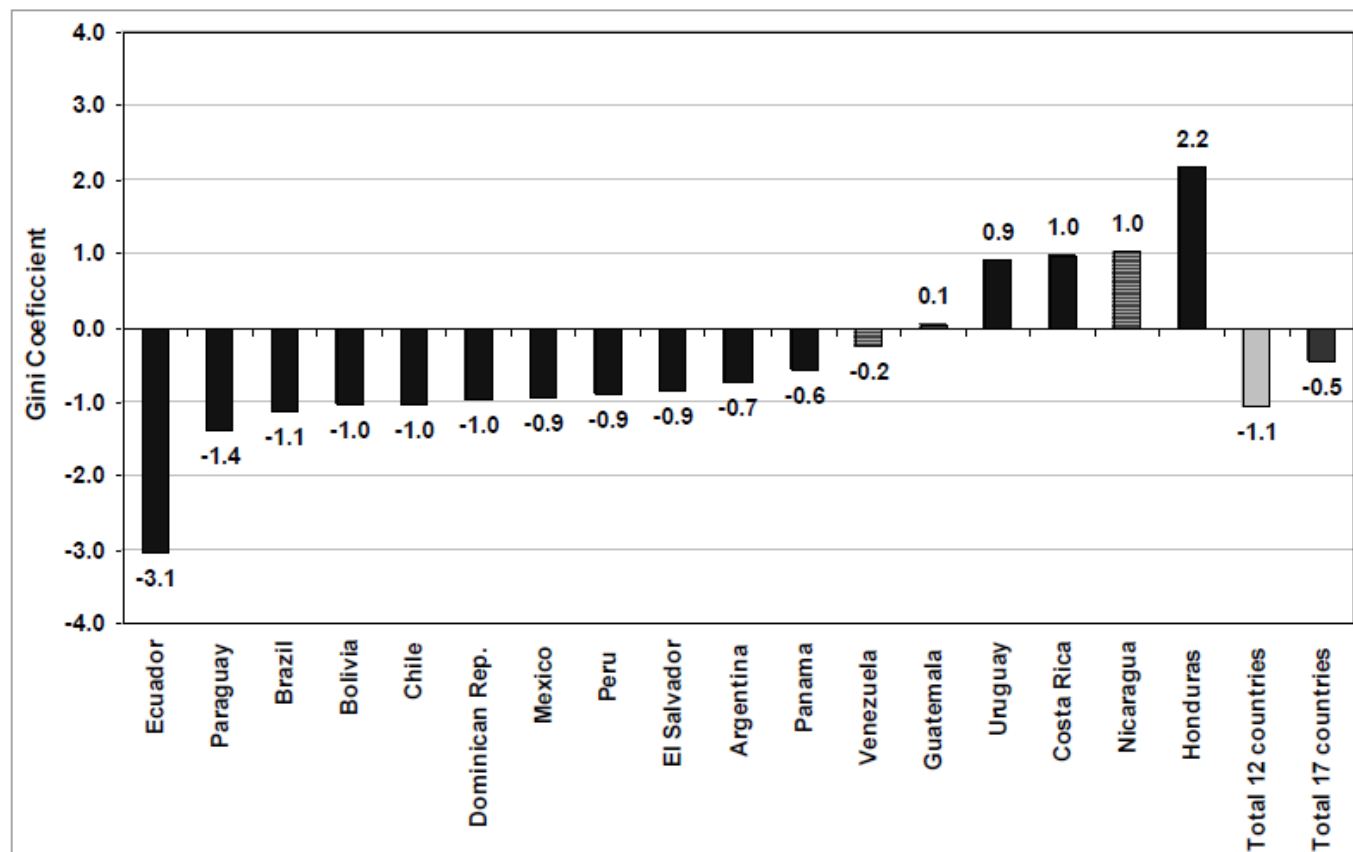


Source: Author's calculations based on Ferreira and Ravallion (2008).

Source: Lustig and López-Calva (forthcoming)

In the 2000s, inequality fell in 12 out of 17 LAC countries for which data is available.

Figure 2. *Change in Gini Coefficient by Country: circa 2000-2006; in percent*



Source: Authors' calculation with data from SEDLAC (July, 2009),

Average annual rates. Source: Lustig and López-Calva (forthcoming)

In Brazil, part of this decline in inequality – and of the fall in poverty that accompanied it – is due to **growth** (and **improvements**) in social protection spending.

Note: graphs plot a decomposition of the change in poverty based on the regression:

$$\Delta \ln P_{it} = \beta_B^P s_{it}^P - 1 l_t \Delta \ln Y_{it}^P + \beta_A^P s_{it}^P - 1 (1 - l_t) \Delta \ln Y_{it}^P + \sum_i \beta_i^S s_{it}^S - 1 \Delta \ln Y_{it}^S \quad (4)$$

$$+ \beta^T s_{it}^T - 1 \Delta \ln Y_{it}^T + \gamma_1 \Delta \ln \text{SOC}_{it-1} + \gamma_2 \Delta \ln \text{INV}_{it-1} + \gamma_3 \Delta \ln \text{SSA}_{it-1}$$

$$+ \gamma_4 \Delta^2 \ln \text{CPI}_t + \pi_i + \gamma_5 l_t + u_{it}.$$

estimated on a panel of Brazilian states, 1985-2004. Each line denotes the predicted evolution of poverty when a specific coefficient is set to zero.

Social security and social assistance expenditures

F.H.G. Ferreira et al. / Journal of Development Economics xxx (2009) xxx–xxx

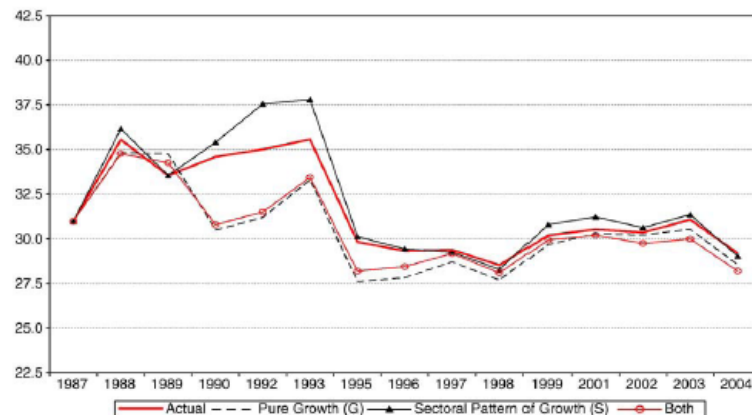


Fig. 5. Poverty measures with and without growth effects.

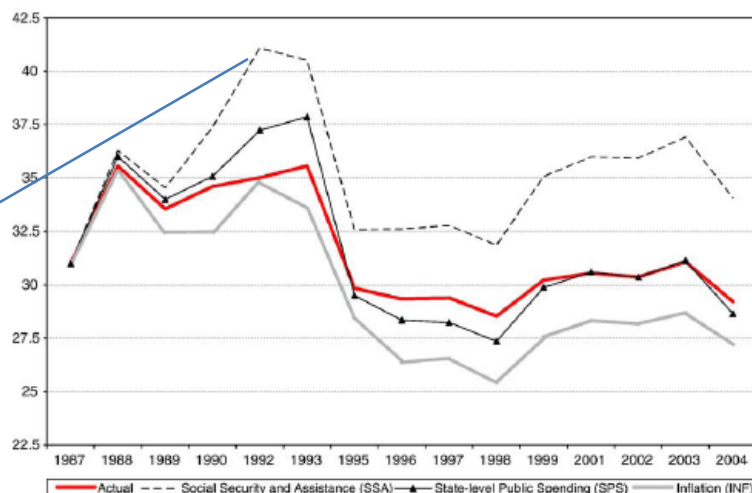
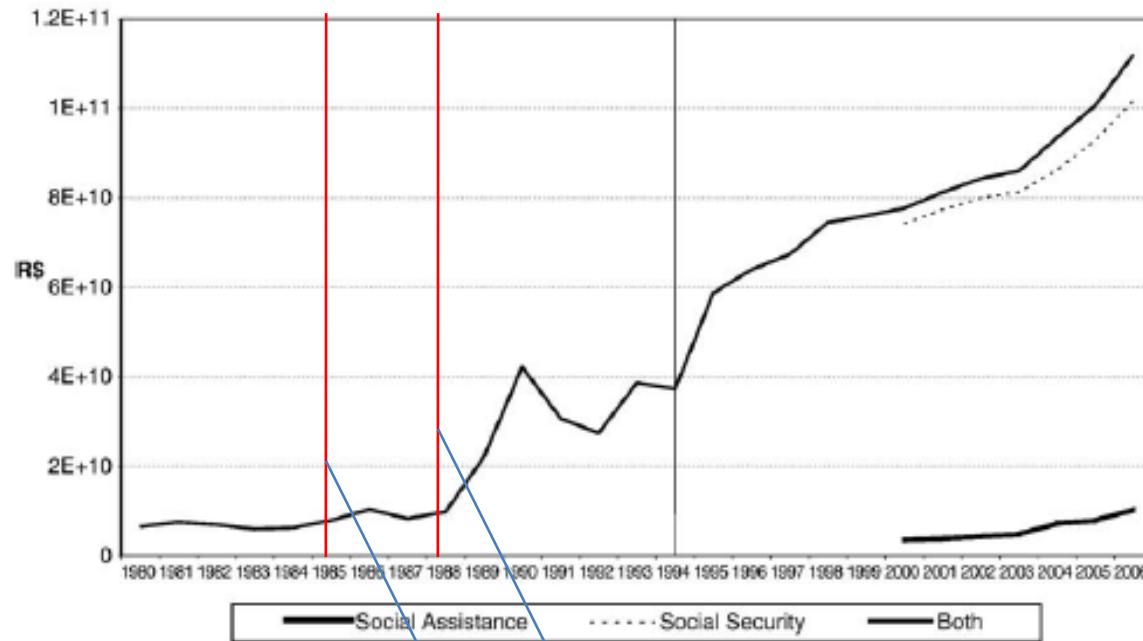


Fig. 6. Poverty measures with and without the changes in social assistance spending, state-level public spending and inflation.

Source: Ferreira, Leite and Ravallion, forthcoming.

Growth in social spending in Brazil since democratization was substantial.

F.H.G. Ferreira et al. / Journal of Development Economics xxx (2009) xxx-xxx



Source: Authors' calculation.

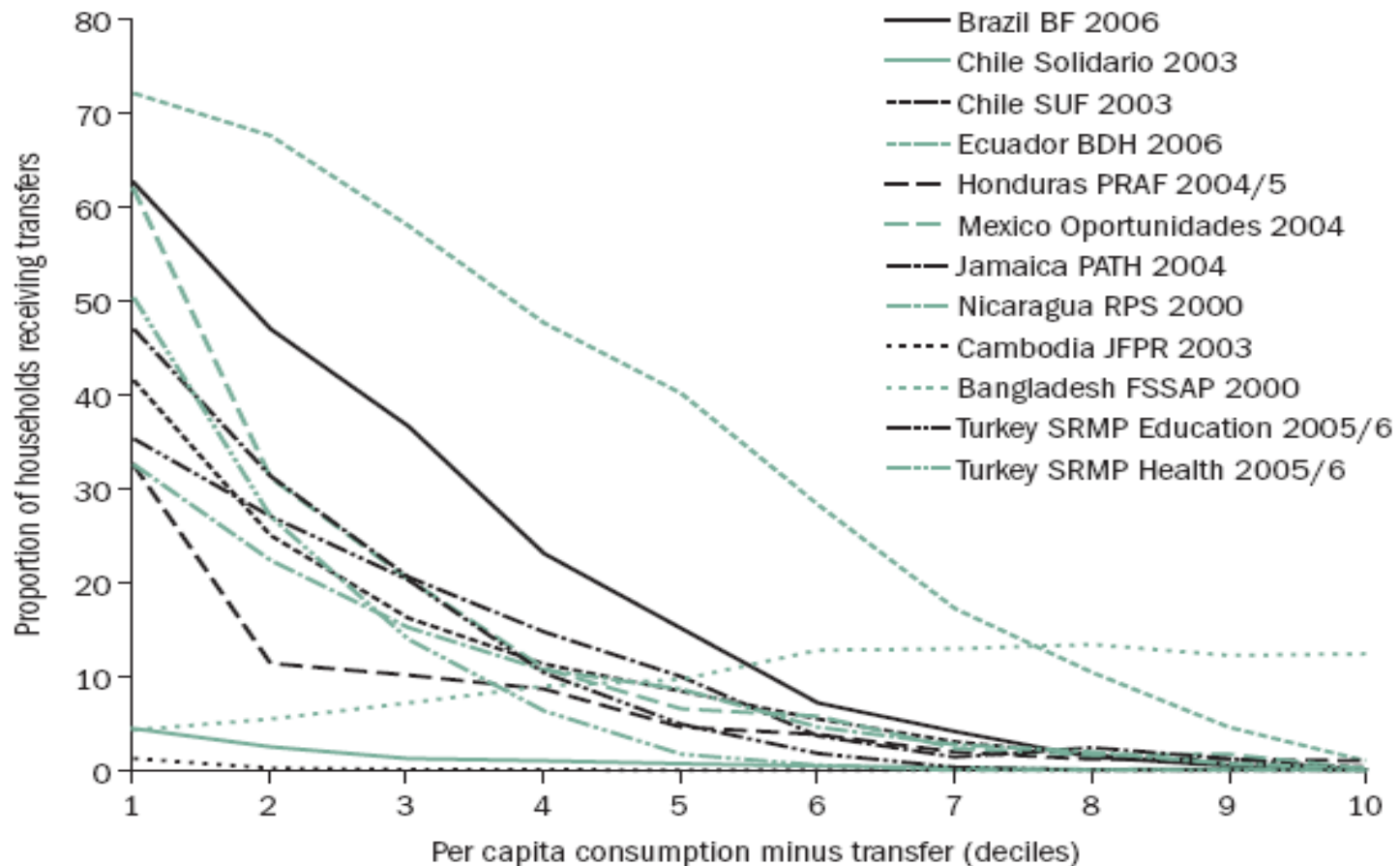
Fig. 1. Evolution of federal expenditure in social security and assistance.

End of military dictatorship
New constitution.

Source: Ferreira, Leite and Ravallion, forthcoming.

A substantial part of the improvement in targeting and coverage comes from the CCT revolution.

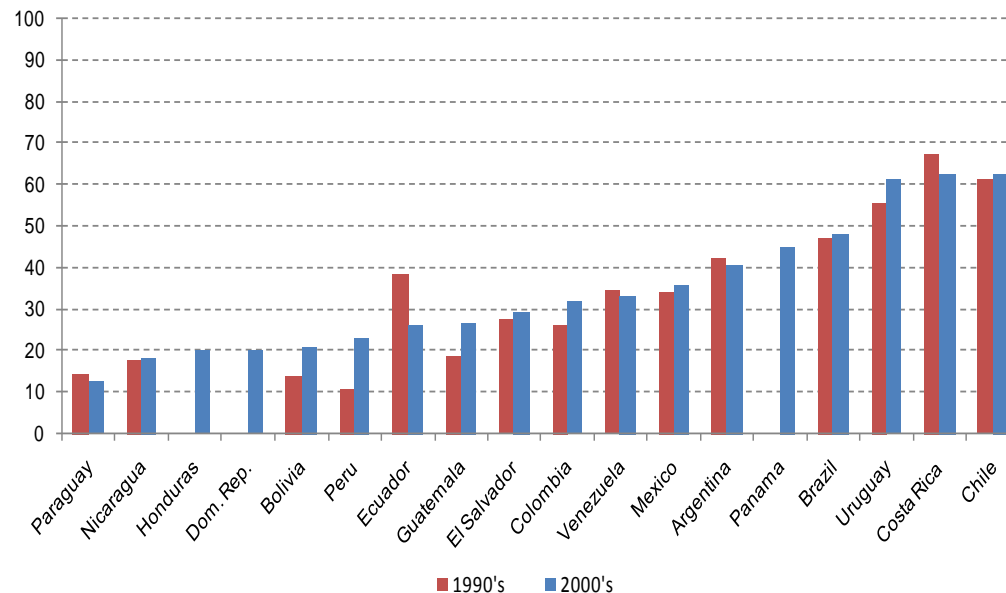
Figure 3.1 Coverage of CCT Programs, by Decile, Various Years



Source: Fiszbein and Schady (2009)

But CCTs are only part of the story. The Bismarckian approach to social security that Latin America adopted in the first half of the XX Century spawned a *truncated welfare state*: with coverage rates for pensions and health insurance that were both limited...

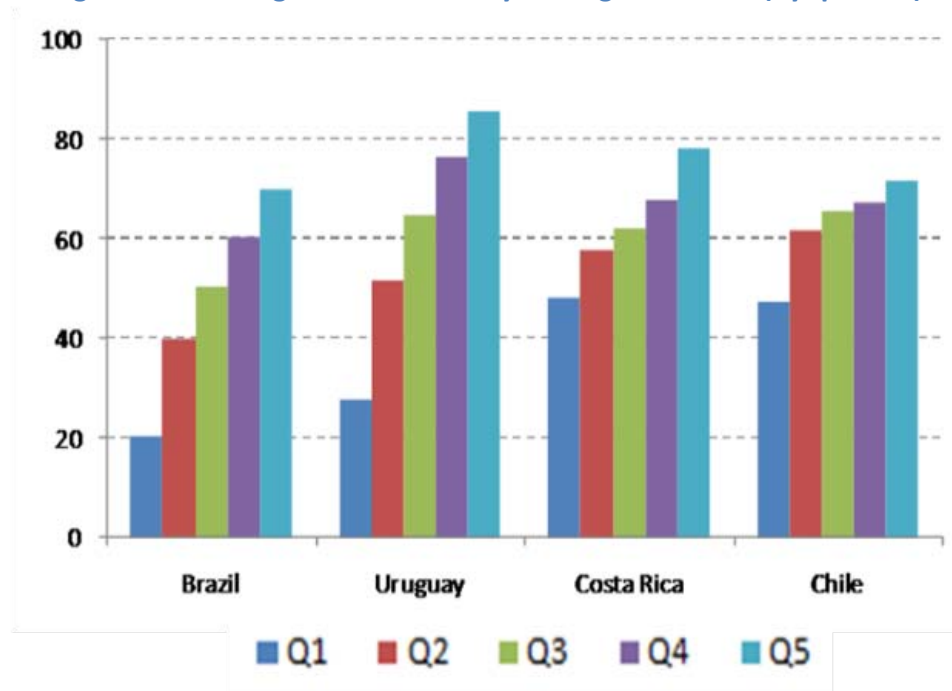
Figure 1: Coverage of Contributory Old-Age Pensions in the 1990s and 2000s (share of labor force)



Source: Robalino, Ribe and Walker (2010).

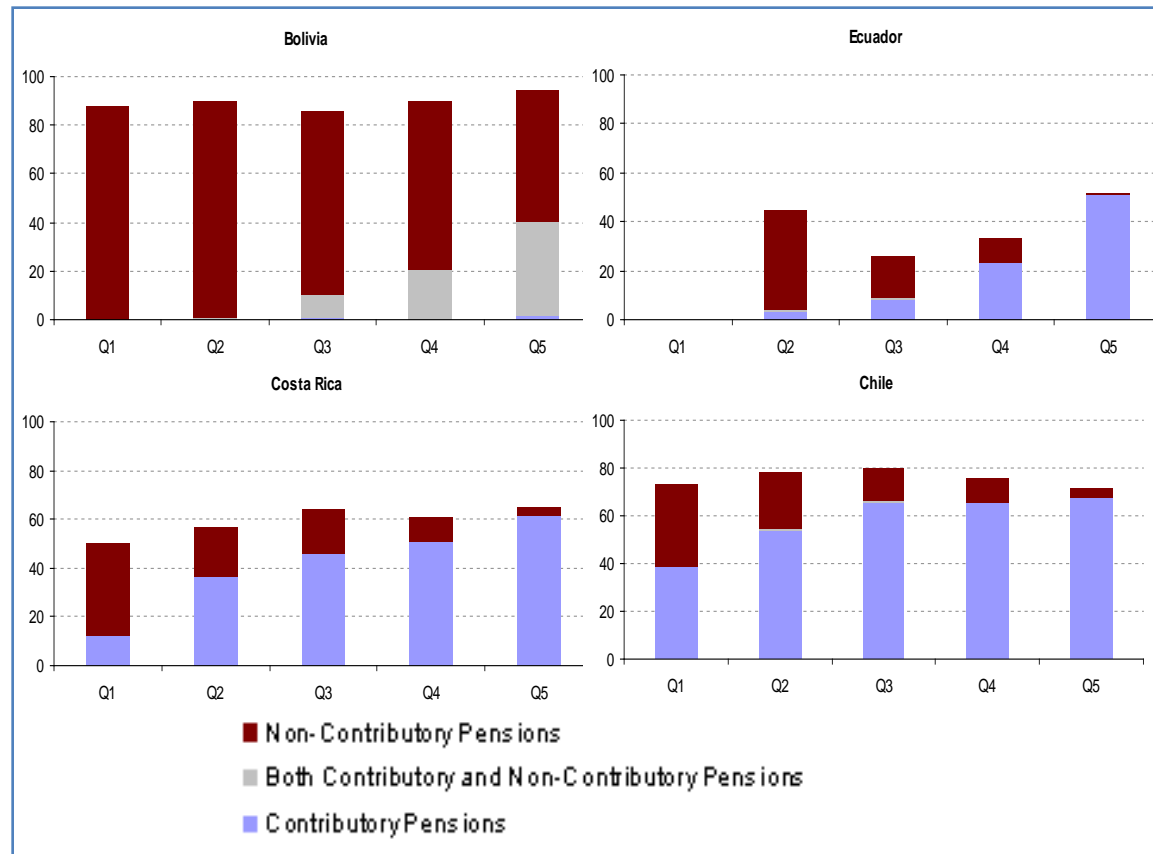
... and regressive.

Figure 3: Coverage of Contributory Old-Age Pensions (by quintile)



Source: Robalino, Ribe and Walker (2010).

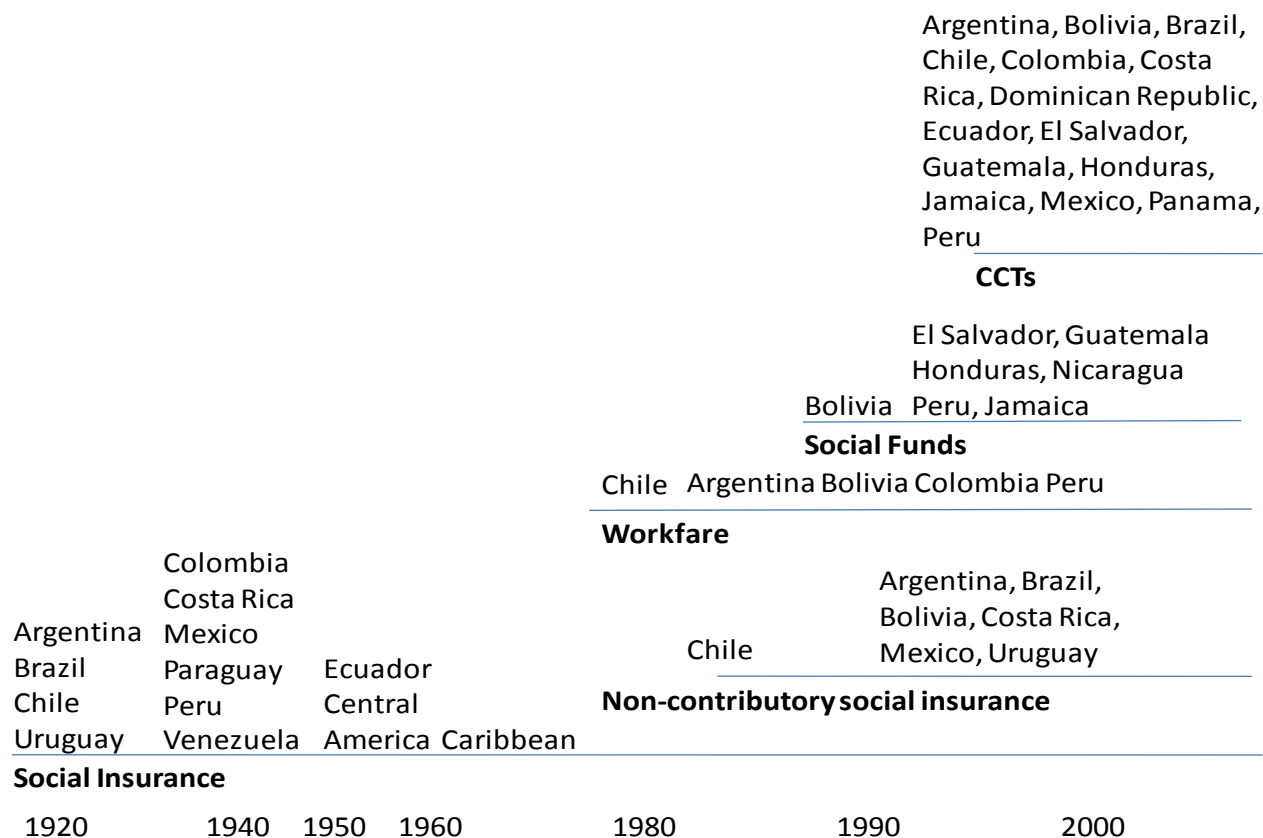
Since the late 1980s and early 1990s, a range of non-contributory instruments, such as “*social pensions*” have “deepened the reach” of social spending in LAC.



Source: Robalino, Ribe and Walker (2010)

In the last two decades, Latin America has proved fertile ground for new ideas on inclusive social assistance that seek to reach the poor without creating a “culture of dependence”.

Figure 1: Chronology of Major Innovations in Social Protection in LAC



Source: Ferreira and Robalino (forthcoming)

Parting thoughts

- I don't want to convey the impression that the social protection system in LAC is ideal in any sense. Far from it: substantial design challenges remain in terms of both efficiency and equity. There is great need for reform, and a couple of proposals are on the table.
- But the recent episode of “organic growth” in social protection in LAC strikes me as a good example of positive “feedback loops” between democracy and development.
 - Democratization shifted the “pivotal voter” downwards along the distribution of income.
 - And that pivotal voter appears to buy into the transfers to the real poor, so long as these are not seen as “just handouts”.
 - It is not **only** about growing the middle classes. Latin America polities seem to place some value on eradicating extreme poverty.