Democratic Change and Income Inequality in Latin America during the Last Decade

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Abstract. This paper reviews the decline in income inequality that has taken place over 2002-2007 in several Latin American countries against the background of the gradual democratization of the region during the lat fifteen years. The paper analyzes the factors that could explain this decline in inequality (that may be in part reversed by the current crisis) focusing in particular on favorable changes in terms of trade, rises in migrant remittances, improvements in the level and distribution of educational achievements during the last 15 years, and changes in macroeconomic and social policies introduced by several countries, particularly by the new social democratic governments which have come to power during the last decade. The paper tests econometrically the above four hypotheses on the basis of a database including 19 countries over the period 1990-2007. While the jury is still out, there are indications that moderate but telling policy changes have occurred (including in countries with conservative governments), and that these generated a positive impact on the distribution of income. There are also indications also that interest groups affected by these reforms are opposing the new model of 'fiscally prudent social-democracy' which seems to be slowly emerging in parts of Latin America.

1. The social-democratization of Latin America during the last 15 years

Latin America has been for long a symbol of authoritarian political systems, highly unequal distribution of assets, income and social services, and regressive redistribution by the state. In the 1950s and 1960s most democratically elected regimes followed nationalist-interventionist policies inspired by the Import Substituting Industrialization (ISI) paradigm which, however, placed limited emphasis on inequality. Yet, even modest attempts at redistributing income, land and assets were often repressed by the military *juntas* which in the 1970s adopted an extreme version of the neoliberal model. In extreme cases, as in the civil wars fought between military *juntas* and revolutionary movements on the issue of land redistribution in El Salvador, Nicaragua and Guatemala hundreds of thousands of people were killed.

However, during the last twenty years, democratization has dominated the political landscape in Latin America, and today Latin American societies are – for sure - more open and democratic. Such drift towards democratization was accompanied, starting from the mid-late 1990s, by a clear shift in political orientation towards left-of–centre regimes. As documented by the results of different surveys of the Latino Barometro, such political shift was to a large extent due to growing frustration with the poor growth and distributive results achieved by the Washington Consensus policies of 1980s and 1990s which by the end of the century had lost intellectual credibility and political appeal. These policies lead to a shrinkage of the industrial working class, a weakening of the unions, rising unemployment, and a substantial enlargement of an underclass of informal and self-employed workers. This shift began with the election in 1990 of the moderate Christian Democrat Patricio Alwyn in Chile. It continued with the election of left of centre political figures in the late 1990s and early 2000s, as in the case of Chavez in Venezuela in 1998, Lula in Brazil in 2002, Kirchener in Argentina in 2003, Tabarè Vasquez in Uruguay in 2004, of Morales in Bolivia and Correa in Ecuador in 2006, Lugo in Paraguay in 2008, and with the return to power of Ortega in Nicaragua (Knack and Keefer….). At the moment, of the large Latin American countries, only Colombia and Mexico are run by centre right governments. And, as noted by Panizza (2005) left of centre parties are or have been in office also in a number of major capitals or federal districts including, the Federal District in Mexico, the Federal Capital in Argentina, Bogotá in Colombia, hundreds of municipalities in Brazil and the state capital of Montevideo in Uruguay.

Such left-of centre regimes tend to differ among each other. They include both the orthodox left and its reformist and national-populist versions. Several of the regimes now dominating the region (Chile, Brazil and Uruguay) can be defined as social-democratic, in the sense that the socialist parties discarded their

historical links with the Communists and forged alliances with centrist parties. As suggested by Panizza (2005), this is the case for instance of Chile's Partido Socialista (PS), Uruguay's Frente Amplio (FA) and Brazil's Partido dos Trabalhadores (PT). As their European counterparts, these parties have their roots in organizations of the working class and other popular sectors, but have evolved to become broad coalitions comprising sectors of business and the middle classes disillusioned with the failures of neoliberalism in the 1990s, the urban and rural poor, the unemployed and those working in the informal sector and para-legal activities. They have abandoned any notion of revolutionary rupture in favor of reform, electoral politics and respect for the institutions of liberal democracy. They are committed to reform capitalism through market friendly policies with social inclusion. Other countries (such as Argentina and Ecuador) have developed left-nationalist platform, while Venezuela, Bolivia and Nicaragua are characterized by a more radical left-populist approach entailing a redistribution of assets both nationally and internationally.

Matters of social justice and economic development have been at the core of left of centre parties' identity in Latin America. Historically, such objectives were to be achieved by redistributing wealth through progressive taxation, agrarian reform, the expansion of welfare services, the protection of workers' rights, a strong participation of the state in the process of industrialisation and hostility to foreign capital. However, in several cases the implementation of these policies was poor or was carried out along the line of ill-conceived heterodox-populist policies that had scant regard for matters such as fiscal deficits, productivity and inflation (Dornbusch and Edwards, 1991). The economic paradigm of the new left has avoided such mistakes and adjusted to the new conditions of democratization and liberalization. This has entailed the practical acceptance of some of the policies associated with the neoliberal model while attempting to make them more sensitive to the needs of the poor. The new model attaches more importance than in the past to sound fiscal policy and low inflation, an awareness of the inefficiencies associated with some forms of state intervention, the primacy of the market in setting up prices, the abandonment of economic protectionism in favor of at least relative economic opening and regional integration and a general welcoming of foreign investment. At the same time, the recognition market failures and the increasing importance assigned by the left of centre paradigm to strengthening state institutions are in sharp contrast with the neo-liberal emphasis on shrinking the state and the self-sustained role of the markets.

The new left of centre governments have developed a new social contract that binds together their traditional and emergent constituencies through a combination of macroeconomic stability, neo-corporatist and participatory institutions, redisytribution via taxation and targeted social programmes. Economic stability and low inflation are the overarching economic goal, as it benefits all sectors of society. The cross-social and political benefits of low inflation explain why it has become a public good that no government can afford to jeopardize (Panizza 2005a). There are, however, a number of different in-built tensions within the new social democratic contract, for instance between the fiscal and monetary constraints required to maintain macroeconomic stability in highly indebted countries with demands for higher public investment and social spending in areas such as health and education. In addition, the quest for macroeconomic stability was achieved by the Brazilian government via a policy of high interest rates and high primary surpluses, which dampens economic growth and favors financial rents over public investment.

2. The distribution of income in Latin America in historical perspective

2.1. A rise in inequality in the 1980s followed by a further rise or stagnation in the 1990s.

With the exception of Uruguay and Argentina, in the early-mid 1950s, Gini coefficients in Latin America ranged between 0.45 and 0.60, i.e. the highest in the world **(Altimir 1996)**. This acute income polarisation was rooted in a highly unequal distribution of land and educational opportunities, that benefited a tiny agrarian, mining and commercial oligarchy. The rapid growth which followed the adoption of 'import substitution strategy' in the 1950s had - on the whole - a

disequalizing impact. In the 1970s, however, inequality declined moderately in most of the region except for the Southern Cone (*ibid*) where an extreme form of neo-liberal reforms were implemented by the *juntas*. The combination of a rise in inequality over the 1950s-1960s and of a fall over the 1970s made that by 1980, all medium and large-sized Latin American countries had a greater concentration of income than in the early-mid 1950s.

In the 1980s (the 'lost decade'), inequality in the region was affected by exogenous shocks (the 1982-1984 world recession, the debt crisis, and a major decline in commodity prices), the recessionary adjustments introduced to respond to them, and widespread internal and external liberalization. Altogether, the 1980s were characterized by regressive distributive outcomes as income inequality declined in only three countries (Colombia, Uruguay and Costa Rica) out of 11 with available data (Altimir, 1996). Despite the return of the region to moderate growth and the liberalization of the external sector, income polarization did not decline during the 1990s and in half of the cases it worsened further, if at a slower pace than in the 1980s. A review of inequality changes over the 1990s based on 76 standardized and representative surveys for 17 countries covering 90 percent of the population of the region shows that inequality worsened in 10 countries and stagnated in seven (Székely 2003). The deterioration was particularly evident during the "half lost decade" of 1998-2002.

The income polarization of the 1980s and 1990s resulted from fast inequality rises during recessionary spells and slow inequality declines during periods of recovery. One of the features of these rises was a decline in the "labor share" in total income and a parallel rise in the "capital share". For instance, between 1980 and the late 1980s, the labor share declined by 5-6 percentage points in Argentina, Chile and Venezuela and by ten in Mexico while such trend was not reversed during the moderate recovery of 1991-98. In several countries – as in Chile during the military dictatorship – the fall in the labor share was due to policies that altered the normal play of market forces and market institutions, relaxed regulations on workers dismissals, restricted the power of trade unions, suspended wage indexation, cut public employment and reduced the coverage of the minimum wage while, at the same time, they eliminated or reduced wealth, capital gains and profit taxes and raised interest rates. The fall in the "labor share" can analytically be traced to five labor market trends. First, sluggish growth brought about a slowdown in jobs creation (Tokman 1986). Second, informal employment became much more common. Third, formal sector wages evolved less favorably than GDP per capita. Fourth, minimum wages mostly fell in relation to average wages. Fifth, wage differentials by skill level widened, particularly during the 1990s, in parallel with widespread trade liberalization (Székely 2003). This short review may be concluded by noting with Altimir (1996, p.59) that: "Under these new economic modalities (characterized by trade openness, fiscal austerity, a prudent management of monetary policy, less regulation of markets and more reliance on private initiative), the pattern of income distribution tends …to be unequal at the very least, and more unequal - in most cases, at least in urban areas - than those that prevailed during the last stages of the previous growth phase in the 1970s".

2.2. Income inequality changes since 2000.

In contrast to the trends observed during the prior two decades, and contrary to the expectations of many observers, since the beginning of this century income inequality began falling in part of the region. An analysis of CEPAL (2007) data indicates that during the current decade inequality fell in 11 of the 18 countries with available nationwide data. The inequality decline was observed more frequently in countries ruled by left of centre governments (see later), including Argentina, Brazil, Chile and several others (Table 1, Chart 1). The recent inequality decline was particularly pronounced over 2003-7, i.e. years of uninterrupted and robust growth.

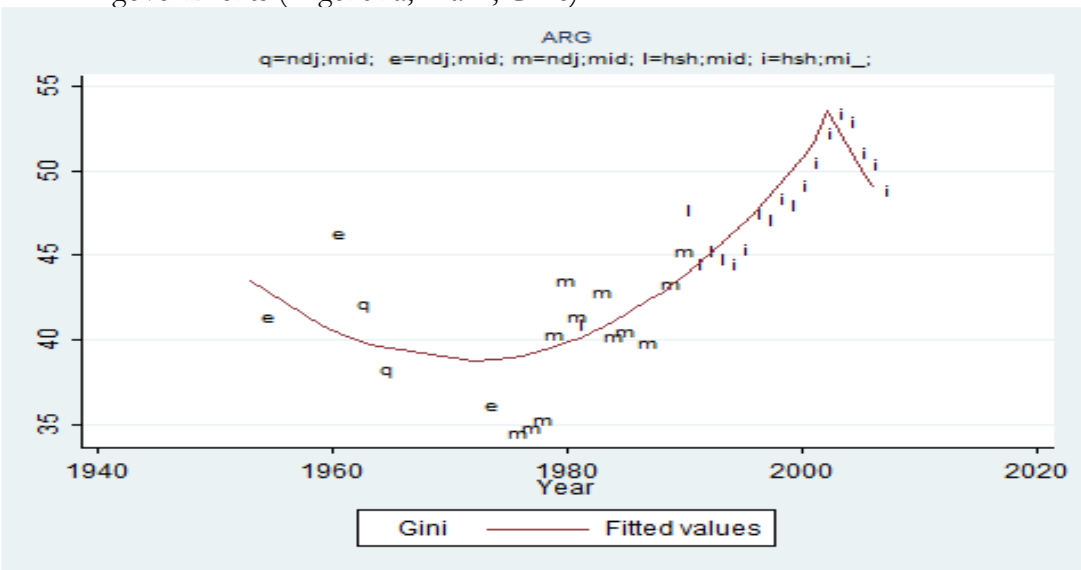
Table 1. Trends in Gini coefficients in countries with New Left vs. Conservative governments

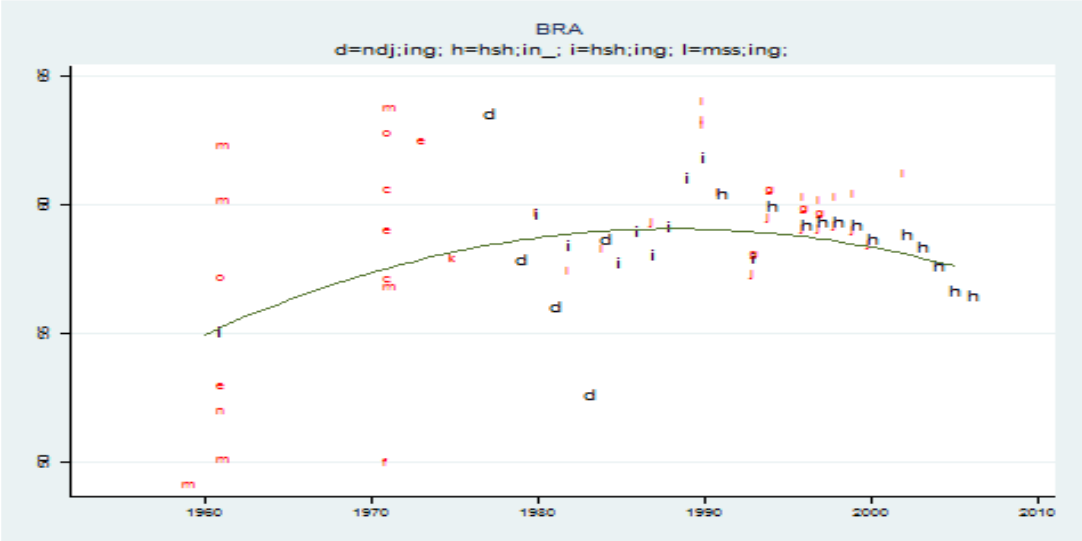
New Left Governments in the years 2000s*				Conservative Governments in the years 2000*			
	1990	**1999/2000**	**2006**		**1990**	**1999/2000**	**2005/6**
Argentina 1	**.501**	**.578^**	**.519 ↓**	Bolivia	.537	.586	.614^^ ↑
Argentina 2	**.450**	**.533^**	**.483 ↓**	Colombia	.601°	.572	.584 ↑
Brazil	.627	.640	.602 ↓	Dominican R.	…	.554	.578 ↑
Chile	.554	.559	.522 ↓	Ecuador	.461	.513	.513 =
Costarica	.438	.473	.478 =	Honduras	.615	.654	.587°°↓
Peru **? check**	.532	.545	.505 ↓	Mexico	.536	.542	.506 ↓
Salvador**?check**	.507**	.518	.493 ↓	Panama **?**	.560	.536	.548 ↑
Venezuela	.471	.498	.441 ↓	Paraguay	...	.565	.536 ↓
				Uruguay	.492	.440	.452***↑

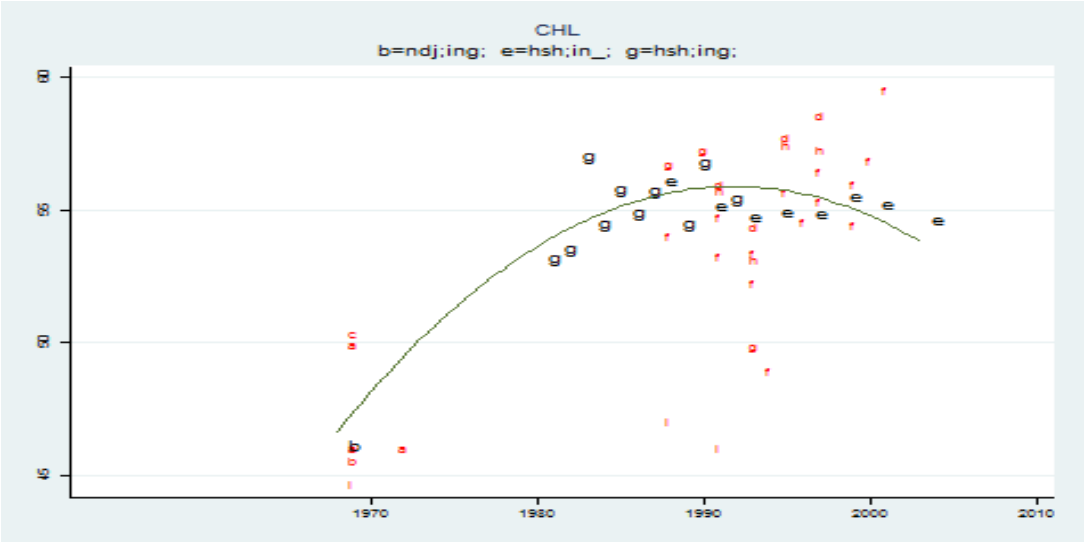
Source: CEPAL inequality database, CEPAL (2007) including for Argentina 1, Gasparini (2007) for Argentina2. Notes: *the assignment to the Left of Centre groups refers to the years 2000s. This decision is however arbitrary as some countries (e.g. Uruguay) experienced both a conservative and a progressive government during the 2000s; **=1995, *** = 2005, ° = 1994, °° = 2003, ^ =2002, ^^= 2002,

However, such decline was generally smaller than the increase recorded over 1980-2000 (Chart 1). For instance, in Argentina, the cumulative decline of 6 points in the Gini coefficient of the distribution of household income between 2002 and 2007 would appear more limited if assessed against its long term trend and not in relation to its value in the crisis-year 2002. In addition, in 2006-7 the Gini stagnated at around .48-.49, while the 2007-8 rise in export prices likely benefited more land rents and profits over wages. One wonders therefore if the redistributive gains recorded by some of the New Left regimes were mainly cyclical and are already running out of steam (even assuming a rapid return to normal global conditions) . Furthermore, the inequality gains recorded since 2002 were smaller than the inequality rises recorded during the 1980s and 1990s. As shown in Figure 1 (top panel) in Argentina the income inequality returned in 2007 to its 1998-9 level. To return to its 1990 level, the Gini coefficient must decline by two more points, while to return to the lowest value recorded during the post World War II period (i.e. 0.336 for Greater Buenos Aires, in 1974), the Gini coefficient ought to decline by another 13 points. A smaller decline than the prior increase is visible also for Chile and, to a lesser extent, in Brazil (Figure 1).

Figure 1. Declining Gini coefficient of the income distribution in countries run by New Left governments (Argentina, Brazil, Chile)







2.3. Other recent macro trends relevant to income inequality

From 2002 the region recorded a strong recovery in relation to the 1990s and, especially, the 1980s. The recovery was the result of a rebound from the 2001-2 recession, a favourable international environment and, possibly, better policies. Data in Table 2 indicate that growth of GDP/capita doubled between the 1990s and 2002-6 in South America and improved by a almost half a point in Central America. The improvement was even greater in relation to the 1980s. Only few countries (such as Chile, which introduced progressive policies since the election of the Alwyn's government in 1991 and recorded Tiger-like growth in the 1990s) did not do better during the recent period than in the 1990s.

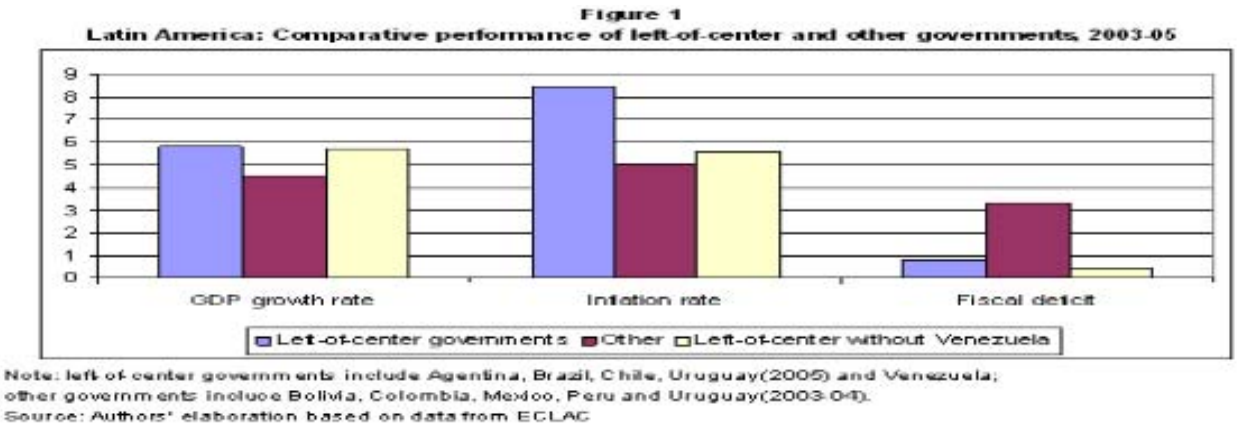
Table 2. Growth of GDP/capita in Latin, South and Central America and key countries

Regions/Countries	1960-1970	1971-1980	1981-1990	1991-2001	2002-2006
Latin America	2.6	3.2	-0.4	1.4	2.2
- South America	1.8	2.6	-0.7	1.4	2.8
- Central America	2.9	1.2	-1.3	1.8	2.2
Argentina	2.5	1,4	-2,8	2,6	3,9
Brazil	3.3	6	-0.4	0.9	1.8
Chile	1.8	1.5	2.2	4.6	3.2
Colombia	2.3	3.1	1.5	0.7	2.9
Ecuador	1.3	4	-0.5	0.4	3.5
Mexico	3.4	3.7	-0.2	1.6	1.7
Peru	2.4	0.9	-2.7	1.9	4.2
Uruguay	0.4	2.7	-0.5	1.9	3.3
Venezuela	1.5	-0.7	-1.8	0.2	2.7

Source: computations on World Bank (2008).

While all Latin American countries recorded a positive growth of GDP since 2002, such growth appears to have been higher by about one point, on average, in the countries ruled by New Left governments than in those ruled by more conservative regimes, at least for the 2003-5 period (Figure 2). A better performance is evident also in the field of budget deficit but not in the field of inflation. Differences shrink if Venezuela is excluded.

Figure 2. Macroeconomic and growth performance of New Left versus other governments, 2003-5



Source: Moreno-Brid and Paunovic (2006)

To conclude, since the early 2000s (more precisely since late 2002) the Latin American countries recorded an average improvement in GDP growth per capita, and a fairly widespread (if not universal) decline in inequality. Second, though the analysis still needs refinement, there is some evidence that countries administered by New Left regimes recorded greater improvements than countries administered by conservative regimes. What factors can explain these encouraging performance, with particular attention to the decline of income inequality? In the next sections we discuss the main factors which could explain this phenomenon.

3. Terms of trade effects and migrant remittances

3.1 Terms of trade effects

Since the beginning of the century, the rapid growth of China, India and other Asian countries has exerted a favourable impact on the exports and economic performance of Latin America. Already in

2006, China accounted for roughly one third of world coal, iron ore, and aluminum consumption and for one a quarter of world copper consumption. Similar increases were recorded in China's share of world imports of agricultural commodities such as soy and corn. The strong "pull effect" of the Asian growth has thus entailed a large increase in Latin America's exports, which have represented for years the most dynamic component of aggregate demand in much of the region.

An indication of this phenomenon is given by the trend in the export/GDP ratio which rose from 13 to 22 percent of GDP between the average of 1991-2001 and 2006 (imports rose from 14 to 20 percent of GDP). The rapid increase in exports was determined by significant improvements in both export prices and volumes. In 2007, the total index of commodity prices exported by Latin American and Caribbean countries rose for the sixth year running, with the highest recent increases recorded by energy and agricultural products (oils, flour and seeds). The price of soybean, an important product for the agricultural sectors of Argentina, Brazil and Paraguay, was a driving force behind this trend (CEPAL 2007). In practice, the prices of the leading commodities exported by Latin America more than doubled since 2002.

As a result, in 2007 the terms of trade index for the region as a whole rose exceeded by 33 percent its average level for the 1990s. However, the extent of such improvement varied substantially across the region (CEPAL 2007). While between the average of the 1990s and 2007 the terms of trade index rose by 52 percent in South America, 21 percent for Mexico, and 13 percent for Mercosur, it fell by 13 percent in Central America, a region which does not export oil or minerals and depends on imported energy. Of the countries adversely affected by terms of trade changes, a first subset (Paraguay, Uruguay, Panamá and Nicaragua) remained specialized in the export of traditional agricultural commodities (beef, soy, etc.). A second group of Central American countries (Costa Rica, El Salvador, Guatemala, Honduras) reduced its dependence on primary commodities, switched to the export of textiles and experienced a rise in emigration (Perez Caldentey and Vernengo 2007).

This positive terms of trade shock stimulated aggregate demand and economic growth in many South American countries (but not in the Central American ones). What was the impact on inequality of these changes in terms of trade and export volumes? A 'partial equilibrium analysis' would suggest that, given the high concentration of land and mine ownership (particularly by foreign TNCs[1]) prevailing in the region, the rise in terms of trade of agricultural and mineral exports likely generated – *ceteris paribus* - a disequalizing effects on the functional and size distribution of income. Indeed, production in these sectors is very land, capital and skilled-labour intensive, and not unskilled labour intensive, and their employment capacity is very small. For instance, in Argentina, agriculture accounts for a minuscule 0.8 percent of total employment. However, when the mineral rents accrue to the state (as now in Bolivia), or if private rents are adequately taxed (as in Botswana), and if the resources so obtained by the treasury are redistributed in a progressive way (as in), the current rise in land and mining rent could generate a favourable distributive effect.

In the absence of a CGE model the 'general equilibrium effects' of the commodity boom on income inequality are difficult to trace. Improvements of the balance of payments can relax the foreign-exchange constraint and stimulate growth in the labour intensive manufacturing and services sector by permitting the importation of equipment and spare parts. Likewise, an increase in

[1]An important part of the price increase of primary commodity left the region in the form of rising profit remittances sent by foreign companies to their headquarters, as the development of natural resources in Latin America is often entrusted to TNCs. Chile and Peru (copper and silver mining,) account for over half of the regional outflow of foreign exchange, even though they produce only 8% of the region's GDP. Another striking example is Costa Rica, which in 2007 saw profit repatriation increase six fold on the previous year, to reach US$915 million.

demand generated by the resource sector could generate some increase in domestic production (the extent of which depend on how much of this demand 'leaks out' to imports), with the possible effect of reducing income inequality at the margin. Indeed, both theory and empirical evidence suggest that in developing countries income inequality falls – *ceteris paribus* – in periods of growth as employment expands and wages may rise.[2] A second equalizing effect could occur via a reduction in the interest rates (due to money creation from abroad) which favours firms and households and penalized banks and rentiers. All in all, while it is plausible that the recent commodity bonanza had a favorable effect on growth, the impact on inequality was likely little pronounced or – in some cases – negative. It would be inappropriate, therefore, to attribute the decline in inequality to this factor.

3.2. Rising migrant remittances

In the new century, the Latin America macroeconomy enjoyed a second positive external shock, i.e. a steep increase in migrant remittances, particularly to Central America, Mexico and Ecuador. Official remittances to the region (which, likely, account for just over half of total remittances) increased from US$ 2 to 59 billion dollars between 1980 and 2005 or from 0.23% to 2% of regional GDP (Table 3). In 2007, remittances accounted for some 2.3% of the GDP of the region as a whole (CEPAL 2007), but for over 11% of GDP in Central America, 2.8% in Mexico and about 20% in the three English-speaking Caribbean countries (Grenada, Guyana and Jamaica). Interestingly, with the exception of Ecuador and Uruguay, (migration and) remittances appear to play a more important role in countries which did not experience terms of trade gains, meaning that the Latin American countries support their current balance by exporting either primary commodities or migrant labour (and – so far - only a modest amount of manufactured goods). In addition, the dynamic behaviour of the remittances/GDP ratio shows a sharp acceleration over 2002-2006, i.e. a period that recorded a drop in inequality in several countries of the region.

One may be tempted therefore to establish a causal link between these two phenomena (rising remittances and falling inequality). Yet, the literature on the inequality impact of migrant remittances (reference ?) suggests that their short and medium term impact tends to be disequalizing, as most migrants are comparatively well educated and belong to the middle-part of the income distribution, and that households in this group are able to finance the high costs of illegal migration. In addition, the migration of skilled workers tends to raise the wage rate of skilled workers in relation to that of unskilled workers in the countries of origin, thus affecting negatively the local income distribution. The final distributive effect depends on how the families of migrants receiving remittances pool them informally with other families. In addition, remittances may reduce inequality over long term, if the creation of migrant networks reduces 'migration costs' thus making migration accessible also to low income/unskilled people. The long term inequality impact of migration is mediated also by its effect on growth, i.e. whether migration leads to brain drain, brain gain (due to greater incentives to invest in human capital) or brain waste type. Most of the available evidence (IMF 2004) show that remittances raise current consumption, reduce volatility, and improve the creditworthiness of receiving countries, but have an insignificant effect on investment and the growth rate of GDP. In view of all his, it seems highly unlikely that migration and remittances have plaid – despite their fast increase

[2] There is empirical evidence to support these hypothesis (Altimir, 1993). In Costa Rica the urban and rural Gini coefficient of the income distribution rose by 7 and 14 percent respectively during the recession of 1981-88, but fell by 6 percent during the 1988-90 recovery. Likewise, in Uruguay the urban Gini rose by 7 percent during the recession of 1981-6 but it fell by 9 percent during the subsequent recovery. A similar phenomenon was observed in Chile. This decline in inequality following a return to growth is, of course, far than authomatic. It depends on whether the growth pattern is pro-poor, neutral or immiserizing. In Colombia, both the urban and rural Gini fell during during both the contractionary and expansionary phases of the 1980s cycle, while Brazil recorded the opposite phenomenon.

since 2000- an important role in reducing income inequality, either directly or indirectly via an acceleration of growth.

Table 3. Remittances/GDP in countries affected by positive and negative terms of trade

	1980-1990	1991-2001	2002-6
Countries that recently experienced favorable term -of-trade effects			
Argentina	0,07	0,22	0,38
Bolivia	1,98	2,17	2,51
Chile	0,58	0,68	1,25
Colombia	1,49	1,87	3,32
Ecuador	0,60	3,50	6,46
Peru	0,80	1,64	2,07
Venezuela	-0,42	-0,22	-0,06
Mexico	0,96	1,19	2,36
AVERAGE	0,69	1,26	2,12
Countries that recently experienced unfavourable terms-of-trade effects			
Costa Rica	2.57	1.20	1.23
Dominican Republic	4.40	8.67	11.37
El Salvador	8.85	14.01	15.86
Guatemala	1.51	1.95	10.47
Honduras	3.64	8.11	20.48
Nicaragua	5.48	10.05	14.84
Panama	2.13	2.08	1.70
Paraguay	…	1.77	2.91
Uruguay	0.17	0.29	0.77
AVERAGE	3.59	4.91	8.85
Source: Adapted from Perez Caldentey and Vernengo (2008)			

4.1. The rise of the New Left and its economic paradigm

Besides by changes in political orientation, the shift in economic and social approach was due to changes in the international environment. These include the slowdown of the US economy, the declining importance of foreign trade with North America, and the weakening of the dollar since 2002, improvements in terms of trade for all South American countries, a rise in migrant remittances, and two periods of "exuberance" in international financial markets (between mid-2004 and April 2006, and between mid-2006 and mid-2007) that facilitated access to foreign funds at low interest rates. In this New World, the old abhorred 'colonial-based international division of labour' proved to be a major source of medium term progress - though it is doubtful it can trigger, by itself, long term growth. These changes in international environment permitted to lessen the balance of payments constraint, reduce external borrowing, repay part of the international debt, accumulate considerable reserves, and drive interest rates down. Meanwhile, growing competition by the emerging Asian economies in the field of manufacturing exports encouraged many countries of the region to adopt competitive exchange rates which help protecting the domestic tradable sector without having to abandon the free trade regime inherited from the neoliberal era.

It is still debated whether the economic policies implemented by the New Left governments (and to an extent by some conservative governments) constitute a 'pragmatic correction of the earlier neoliberal model', or a genuine 'new model' combining macroeconomic stability, rapid growth, structural transformation à al Furtado, and explicit social and distributive objectives, or - as some suggest with particular reference to the case of Bolivia and Venezuela - a revamped version of the

'macroeconomic populism' experimented in Peru, Argentina and Brazil in the middle-late 1980s (Dornubush and Edwards 1991).

4.2 Policy approach of the New Left and some conservative governments

(i) Macroeconomic policies. Overall, the measures introduced in this areas are broadly inspired by the 'pro-poor macroeconomics' paradigm (Cornia 2006). Its key elements are:

- A fiscal policy aiming at budget balance in the context of expansionary expenditure policies. A decline in the budget deficit has been targeted in all countries despite an increase in public expenditure, with New Left countries achieving better results than the other countries (Figure 2). In practice, overall fiscal deficits have been typically reduced below 1 percent of GDP (much lower than in the EU and US) or have been turned into surpluses. Such results suggest a shift (still limited to few countries) towards a countercyclical fiscal management (Ocampo 2007). Traditionally, Latin America adopted pro-cyclical macroeconomic policies that boost growth during periods of external buoyancy but build up vulnerabilities which explode when favourable external conditions disappear. Countercyclical fiscal policies require in fact that during upturns the extra fiscal revenue is saved (as in Chile's Copper Stabilisation Fund or in a similar scheme in Peru) and is used to support public expenditure during bad years. Second, the improvement in the budget deficit was not achieved – as in the past – by cutting public expenditure but by increasing tax/GDP ratios (see next point). However, in some countries, such tightening of fiscal policy meant that the achievement of key social goals, such as poverty alleviation and income redistribution, had to be spread over the medium term.

- *Rising tax/GDP ratios*. For the region as a whole, the tax and non-tax revenue of the central government including social security contributions rose from 15 percent of GDP in 1990 to 17 in 2000, and 20.2 in 2007 (CEPAL, 2007). Very large revenue increases were recorded over 1990- 2004 in countries as different as Argentina (around 10 points of GDP), Colombia (8.5 points), Nicaragua and Bolivia (10 points), and Venezuela (6 points). Only Mexico experienced a small decline (Cetrangolo and Gomez-Sabaini 2006). Scattered evidence for 2004-8 indicates that the rise in tax/GDP ratios has not yet stabilized, as in Argentina where it rose by another 4.4 points (Ministerio de Economia, 2008).

The increase in tax revenue resulted from a widespread reduction in excises (due to efforts at administrative simplification) and tariffs (following trade liberalisation), a rise in general indirect taxes (VAT *in primis*), an increase in personal and corporate income tax, stagnation at low level of wealth taxes, and stagnation in social security contributions following growing informalization of employment (Table 4). Countries benefiting from large increases in the price of hydrocarbons, metals and agricultural commodities taxed part of this rent, by imposing special taxes on the operating revenues of mining companies. Argentina strengthened its tax base by appropriating some of the benefits accruing from the real exchange rate depreciation of 2002 by means of a selective *ad valorem* export tax on selected primary commodities (soy, corn). Furthermore, in view of the sharp increase in the world prices of these commodities, in November 2007 it rised the export tax rate from 27 to 35 percent.

Several countries introduced a "surrogate" tax on financial transactions. This tax is potentially distortive and can cause financial disintermediation and a shift to cash transactions (Cetrangolo and Sabaini 2006). Yet, this tax could be seen as a 'second best' tool to tax financial assets and rents which would otherwise remain untaxed. Considering that the distribution of financial assets (including current accounts and saving deposits) is more concentrated than that of income, such tax is likely to have a progressive incidence, though – as noted – its application may possibly cause inefficiencies.

Table 4. Revenue/GDP ratio of the central government in 1990, 2000 and 2004, and changes in tax structure in components in three groups of (high, medium and low taxation) countries

Revenue/GDP ratio revenue			**Country Group**	**Changes over 1990-2003 in percentage of total tax**				
1990	**2000**	**2004**		Trade	Excises + other indir Security	VAT	Direct Taxes	Social
23.0	25.9	28.7	**Group 1**	+ 0.1	- 6.3	+ 3.6	+ 6.5	- 3.9
12.0	15.7	16.7	**Group 2**	- 9.2	- 6.3	+ 9.9	+ 3.3	+ 2.3
8.5	10.5	11.5	**Group 3**	- 8.3	- 13.0	+ 20.6	+ 2.5	- 1.9

Source: Elaboration on Cetrangolo and Gomez Sabaini (2006); Notes: Group 1 includes Brazil, Argentina and Uruguay. Group 2 includes hile, Costarica, Honduras, Nicaragua, Panama, Dominican Republic, Peru, Bolivia and El Salvador. Group 3 includes Ecuador, Guatemala, Haiti, Mexico, Paraguay, and Venezuela. * the 1990-2003 changes in tax shares are estimates of the author, as the data from the main source do not tally with those of Ministerio de Economia (2008)

While practically all countries (particularly the New Left ones) raised their revenue/GDP ratio, its increase varied markedly across the region. By the mid 2000s, countries such as Brazil, Argentina, Uruguay and Costarica, reached levels of taxation similar to those of the US and Japan. In contrast, with tax/GDP ratios at around 10 percent, Group 3 countries remained mired in a 'low revenue development trap' which hampers growth due to their inability to fund 'pro-poor' and 'pro-growth' public goods, merit goods and goods with large externalities.

This increase the tax/GDP ratio represents an important achievement for both growth and equity, as inability or unwillingness to raise tax revenue was a major cause of the accumulation of public debt during the 1970s, the subsequent debt crisis of the 1980s, and the macro instability of the 1990s. Yet, for many countries of the region, both Left of Centre and conservatives, efforts in the field of taxation will have to continue for many years if the existing infrastructural, human capital and social gaps are to be filled.

It is still an open question whether the recent revenue increases are compatible with the distributional objectives set by New Left governments, or whether the recent rise in taxation exacerbated the regressive features of tax systems in the region. Table 1 suggests that while tax reform has still a long way to go in country groups 2 and 3, the recent increase in tax/GDP ratio was in part achieved by augmenting the weight of direct taxes. In addition, the selective export tax used in Argentina is likely progressive, as it captures part of the land rent and 'windfall profits' arising from growing world prices and accruing to a sector characterized by a high asset and income concentration.

- Monetary policy and inflation targeting. New Left governments have generally emphasized the need for macroeconomic policies to be guided by development goals and not merely by price stabilization. As a result, monetary policy has been accommodating and has generally accepted somewhat higher inflation rates than the 6-8 percent targeted by more conservative governments. Such position may be justified by the fact that, in economies that are (still) inflation-prone the 'inflation/GDP sacrifice ratio' (the loss of GDP required to reduced inflation by one percent) is quite high. Monetary policy has also aimed at reducing the extensive polarisation of financial systems In particular, there has been a tendency for foreign currency-denominated public-sector liabilities issued in local capital markets to dwindle. Argentina conducted a radical de-dollarization of its financial system during the crisis of 2002, and Peru adopted a policy of gradual de-dollarization, together with Bolivia and Uruguay. Finally, and contrary to what expected by many, there was a strengthening of Central Bank independence.

- ***Exchange rate regime***. With the exception of Venezuela since 2005, most New-Left (and other) governments abandoned the 'two corners' exchange rate regimes (free floats and fixed pegs) and opted instead for intermediary regimes characterized by a competitive exchange rate inspired by the Basket-Band-Crawl (BBC) approach (Williamson 2003) or by other managed "dirty floats" regimes which explicitly aim at avoiding an appreciation of the real exchange rate. As noted by Ocampo (2007), consistently with this approach, Central Banks reduced the supply of foreign exchange in the domestic market through frequent interventions in the currency market (made possible by a build up of external assets by central banks), adopted a tight fiscal-monetary policy and introduced when necessary capital controls, as done in Chile, Colombia and, more recently, Argentina. This policy recognizes that the exchange rate has an important influence on international competitiveness and growth, and not only on inflation. The clearest example of this policy is given by Argentina, where the maintenance of a competitive exchange rate is one of the cornerstones of the macroeconomic policy[3] .

Yet, during the last two years, the policy of adopting a competitive exchange rate come under pressure, owing to large increases in export prices and demand, capital inflows and remittances. The large current and capital account surplus realized in most of South America in 2006 and 2007 has lead to an appreciation of the extra-regional real exchange rate of 4.8 percent for the region as a whole, and in seven of the subregion's 10 countries, especially in Colombia, Brazil and Venezuela (CEPAL 2007). Given this new situation, one may wonder if the benefits of such exchange rate policy are as large as they were during the years of shortage of foreign exchange. Despite a huge accumulation of reserves through sterilisation, several economies are now showing symptoms of 'Dutch Disease' and accelerating inflation in the non-tradable sector which – if uncontrolled – could slow growth and generate adverse distributive impact (Taylor 2000). This trend is particularly dangerous when the exported commodities fetching high world prices are also consumed at home (as in the case of food exports). In this case, countries experience a 'double blow inflation' caused by rising non-tradable prices (Dutch Disease effect) and rising tradable prices.

- Less reliance on external funds and greater international autonomy in deciding policies. New Left governments attempted to broaden their policy space by strengthening the independence and scope of their economic policy which, in the past, had been subjected to the conditionality of foreign creditors. Existing short term stabilisation agreements with the IMF were generally not renewed. Second, Brazil (…. billion US$ in ….) and Argentina (9 billion US$ in 2006) prepaid their outstanding debt to the IMF. Third, a few countries restructured their foreign debt, as in the case of Argentina which – against the advice of the IMF – successfully renegotiated its private debt at a 70 percent discount. Fourth, New Left governments in mineral-rich countries renegotiated with transnational companies the distribution of rents from the exploitation of natural resources or, in Bolivia's radical move, nationalized the mines.

- ***Trade policies***. The free trade policies adopted in the past have not been reversed, including because the newly adopted exchange rate policies have often offered some protection to the tradable sector. In contrast, the trend towards international trade integration and trade agreements points to some reorientation. The Free Trade Area of the Americas seems to have stalled. And, particularly in the case of Mercosur, regional integration is seen as a more attractive option than a deepening of

[3] A policy of this type requires that the build-up of international reserves during upturns be matched by measures to sterilize their monetary impact. Sterilization of this type is easier when there is a fiscal surplus. Otherwise it will be necessary to sterilize via a mix of traditional open market operations, sales of central bank-issued bonds in the market, or higher reserve requirements. For this reason, in the Argentine model the fiscal surplus is an essential complement to the policy of maintaining a highly competitive exchange rate; the possible erosion of this surplus, if public spending continues its recent rate of increase, is a threat to the macroeconomic policy model adopted by Argentina.

trade agreements with the United States (Moreno-Brid and Paunovic 2006). In addition, in contrast with the passivity in previous rounds, New Left governments (particularly Brazil) plaid an increasingly active role in international trade negotiations.

(ii) Redistributive, income and social policies.

Changes in this area have been more limited than in the macroeconomic field. So far, measures to reduce the glaring wealth and income concentration existing in the region have seldom made their way to the New Left agenda, with the possible exception of Bolivia (which nationalized the mines and is planning a land reform) and Venezuela (which renegotiated oil royalties with the TNCs and nationalized key industries, including steel, electricity and telecommunications). This moderate stance may be justified by the fact that – in the absence of overwhelming political support – radical reforms unavoidably generate tensions and uncertainty which affect business climate, capital flights, and electoral support. Indeed, the advent of 'procedural democracy' in the region has not yet reduced the power and perception of self-interest of dominant interest groups which – though often numerically small – still control economic power and can sway the public opinion on controversial issues. Reluctance about redistributing assets may also be due to the fact that the main sectors involved (oil, mining and agriculture) are precisely those which have generated much of the recent growth, raising fears that such reforms would kill 'the goose which lays the golden eggs'. As a result, the New Left social policy model resembles more the 'Redistribution With Growth' model (Chenery et al 1978) - which revolves around the redistribution of a few GDP points via the budget - rather than the more radical 'Redistribution Before Growth' model which sees the redistribution of assets and opportunities as a way to overcome the under consumption trap and lack of human capital afflicting developing countries. Despite all this, changes have occurred in the coverage of formal employment, social expenditure, and the introduction of conditional transfers. Key features of the measures introduced recently:

- ***Absence of asset redistribution***. Over the last decade, land reform was considered in Brazil, Bolivia, El Salvador, Guatemala and so on. With the exception of El Salvador where a 'willing buyer-willing seller' land reform was implemented with financial support of USAID, in all other cases the execution of land reform was slowed down or postponed. In Brazil, the redistribution of land to one million families of *Sem Terra* labourers has dragged on for years, while it is now argued (as in India) that land reform is more a 'political' than an 'economic' issue – and that subsidies and workfare programs providing employment guarantees are better suited to handle the problem of rural poverty. In Bolivia, opposition to the planned land reform is mounting in the Western part of the country. And in Guatemala, the solution of the land issue is still far off, despite the fact that a 'willing buyer-willing seller' reform backed by EU funding was a key pillar of the UN brokered peace agreement of the late 1990s. Even surrogate measures – such as the taxation of land or unused land – have attracted little attention.

- ***Income policy: prudent rises in minimum wages and wage settlements.*** The New Left's policy agenda has differed from the previous approaches in terms of the extent to which the government interferes in wage settlements. Though to varying degrees, the New Left labour policies deliberately addressed the problems of rising unemployment, job informalisation and instability, falling unskilled wages, diminishing coverage of social security, and weakening of trade unions and institutions for wage setting and dispute settlements.

Argentina enacted income policy measures to strengthen the purchasing power of poor and middle income families, including a rise in minimum wages, a large scale public work program, a deliberate attempt to extend the coverage of formal employment, and the re-birth of trade-unions. In Uruguay the EP-FA administration has reinstated the so-called 'wage councils', i.e.tripartite collective bargaining bodies comprising representatives of the business sector, the unions and the government that negotiate wage settlements for sectors of economic activity. In Brazil the

government has set up an Economic and Social Development Council composed of representatives of business, labour and a wide variety of civil society organisations as an advisory body on economic and social issues. A number of social programmes are directed to the 'emergent constituency' of the urban and rural poor through targeted money transfers to families living in extreme poverty (such as Brazil's *Bolsa Familia,* Argentina's s Programma Jefas y Jefes de Hogares and Uruguay' PANES.

However, most of the New Left governments have decreed significant but far from excessive hikes in minimum wages, especially in view of the real worsening they suffered in the past. Such restraint may reflect the fact that policy makers are concerned more with creating jobs than improving earnings in formal labour markets. It also reflects the recognition that, unless backed by increases in productivity, nominal raises in minimum wages may fuel inflation with scant effect on real wages. In any case by 2005, with the exception of Chile, the real average earnings of workers in countries under Left-of-Center governments were still below their 2000 level.

- ***Rising public social expenditure and redistribution***. Public social expenditure started rising in the early-mid 1990s (before the election of most New Left governments) and accelerated since the early 2000s in most of the region (Table 5). Most of the rise concerned social security, social assistance and education (*ibid*). The rise was nearly universal and of the 21 countries of the region, only Ecuador had in 2004-5 a social expenditure/GDP ratio lower than in 1990-1 (CEPAL 2005). There is still a huge cross country variation[4] in social expenditures but it appears that low-income countries made proportionally greater efforts to increase social expenditures. What explains this rise? A first factor was the increase in tax/GDP ratios. But changes in the structure of public expenditure plaid also a role. For instance, the debt cancellation enjoyed by HIPC countries permitted reallocating to social activities monies used to service the foreign debt[5], while ODA-recipient countries increased rapidly their expenditures, possibly as a result of 'social conditionality' for the achievement of MDGs.

Table 5. Average public expenditure per capita and % of GDP in Latin America (21 countries).

	1990-11	1996-7	2002-3	2004-5	Δ 1990-2004-5
Total public social expenditure/capita (USD 2000)	220	440	525	610	660
Total public social expenditure/GDP	12.9	13.9	15.1	15.9	3.0
- public expenditure on education/GDP	3.3	3.6	4.1	4.3	1.0
- public expenditure on health	3.1	2.9	2.9	3.4	0.3
- public expenditure on social sec./assistance	5.3	6.6	7.1	7.0	1.7
- public expenditure on housing and 'others'	1.2	0.9	0.9	1.2	0.0

Source: CEPAL (2005), CEPAL (2007a)

[4] While in 2004-5, 7 countries (Cuba, Uruguay, Brazil, Argentina, Bolivia, Costa Rica, and Panama) public social expenditure ranged between 15-20 percent of GDP (i.e. close to that of OECD countries), most Carribean, Central American and Andean countries, as well as Paraguay, had ratios below 10 percent. This heterogeneity reflects not so much the low priority assigned to redistribution via the budget but low tax/GDP ratios. This highlights the need for 'a fiscal contract' which includes an increase in the tax/GDP ratio and in the revenue share assigned to progressive social programs.

[5] Since 1996-7, Bolivia, Honduras and Nicaragua benefitted from debt cancellations of 5, 6 and 2 percent of their GDP.

The rise in public social expenditure has generated positive redistributive effects. Analysis of different surveys and studies on public social expenditure by income quintile for 18 countries of the region between 1997 and 2003 in the region (CEPAL 2007, Gasparini et al 2007) suggest that: (i) all components of public social expenditure (including social security) are less concentrated than private incomes; (ii) expenditure on primary education and social assistance are strongly progressive, that on secondary education and health are mildly progressive or broadly proportional (in the case of health it depends on the approach to its financing), that on tertiary education is concentrated as the distribution of income. In turn, expenditure on social security (pensions, unemployment insurance) is slightly less concentrated than that of private income, as it focuses on formal sector workers, only seldom providing non-contributory benefits (such as social pensions and child allowances) to informal sector workers and their families. These are average regional data and things vary between the three main country groups in the region (Table 6). (iii) there are indications (CEPAL 2005) that the incidence of such public expenditure is becoming more progressive, though at different speeds across the region. A confirmation of this trend is provided by the increase in enrolments in secondary education (which have traditionally been low and which explain much of long term inequality in the region), greater access to health services, social assistance (see below) and integrated programs aiming at eliminating the intergenerational transmission of poverty and inequality. As an example, the probability that a boy/girl from the bottom decile completes secondary schools in relation to that of a child from the top decile rose from 36.7 to 50 percent between 1990 and 2005 (CEPAL 2007a)

Table 6.. Incidence of government expenditure by quintile (18 countries, years 1997-2004) and concentration coefficients of the public expenditure by three subgroups*

(Panel a) Shares of total public expenditure By sector and income quintile expenditure					**Expenditure Sector**	**(Panel b) Concentration coefficients of public**		
I quintile	II quintile	III quintile	IVquintile	V quintile		Group 1	Group 2	Group 3
7.4	6.5	6.3	5.9	5.6	**Education**	-0.067	0.116	-0.138
5.1	4.7	4.2	4.0	3.7	**Health**	0.074	-0.073	-0.192
2.0	2.8	4.3	**6.3**	**16.5**	**Soc Security**	**0.504**	**0.568**	**0.349**
3.3	2.1	1.6	1.3	1.1	**Soc Assist.**	-0.089	-0.154	-0.484
0.8	0.9	1.1	1.4	0.9	**Housing**	0.206	0.067	-0.026
19.6	17.0	17.5	18.9	27.8	**Total**	0.143	0.042	0.044

Source: Elaboration on CEPAL (2007a); Note: Group 1 includes Bolivia, El Salvador, Guatemala, Honduras, Ecuador, Nicaragua, Paraguay, Peru. Group 2 includes: Colombia, Dominican Republic, Mexico, Panama, Venezuela. Group 3 includes: Argentina, Brazil, Chile, Costarica, Uruguay.

As shown in Table 6, social security expenditure is not progressive. Yet, the room for manoeuvre that policy makers have for increasing its progressivity is limited, as these outlays (which absorbs 27-52 percent of total social expenditure) are the result of long-standing contractual commitments. This raises the question of how can government expand social security coverage, whether by actively extending the formal sector or by setting up solidarity-based, non-contributory, universal funds providing basic benefits (such as minimum pensions) to informal sector workers and their families. The latter seems to be – understandably – the approach followed in recent times. During the last years, in fact, a few New Left countries (Argentina, Bolivia, Brazil, Chile, Costarica) introduced non-contributory social pension which start addressing this problem. Yet, the public resources assigned to social pensions tend to be smaller than those of Southern Africa (Table 7).

Table 7. Coverage of non-contributory pensions in Latin America and Southern Africa

	Age of eligibility	Universal (U) Means tested (M)	Amount paid/month US $	% population over 60	% pop >60 receiving a pension	Cost of pension as % of GDP
Argentina	70+	M	88	14	6	0.23
Bolivia	65+	U	18	7	69	1.30
Brazil 1	67+	M	140	9	5	0.20
Brazil 2	60/55+	M	140	9	27	0.70
Chile	65+	M	75	12	51	0.38
Costa Rica	65+	M	26	8	20	0.18
Uruguay	70+	M	100	17	10	0.62
memo item						
Botswana	65+	U	27	5	85	0.40
Lesotho	70+	U	21	8	53	1.43
Mauritius	60+	U	60	10	100	2.00
Namibia	60+	M	28	5	87	0.80
South Africa	65/58+	M	109	7	60	1.40

Source: HelpAge International (2006b)
**includes women 55+; ****universal with a few exceptions, primarily people who are already receiving a substantial government pension (about
4% of those who would otherwise be eligible) , Brazil 1 = (Beneficio de Prestacao Continuada), Brazil 2 = (Previdencia Rural)

Despite the progressive nature of much of social expenditure, the redistributive effect of tax-and-transfer operations in Latin America remains much smaller than in the OECD (Table 8), with the exception of Argentina and Costa Rica. In Uruguay, limited redistribution is due to its low initial inequality and the dominance of social security. In most countries redistribution operates exclusively on the expenditure side. The redistributive effect of taxation is, at least till the late 1990s-early 2000s, nil or negative. An analysis by Cetrangolo and Gomez-Sabaini (2006) relying on studies on 11 Latin American countries concludes that the distribution of income after taxation (but before transfers) remained broadly unchanged or worsened (in Mexico and Nicaragua), as the tax system mainly relied on regressive or proportional taxes such as excises and VAT. Unless the tax system becomes more progressive, taxation will have a minimal redistributive effects. Yet, as noted above, the increase in income and asset taxation as a percentage of GDP recorded between the mid-late 1990s and 2006 in Argentina, Brazil, Chile, and Colombia but also Nicaragua, Bolivia and Mexico points to a gradual evolution of the tax system towards greater progressivity.

- A new approach to social assistance: conditional transfers to the poor. The last 10-15 years witnessed the introduction of targeted social assistance programs developed to offset the limited coverage of formal social security systems. Contrary to the Social Emergency Funds (SEF) and Social Investment Funds (SIF) introduced in the late 1980s which played a minor role in reducing the number of the poor and income inequality[6] , 'conditional transfer programmes' are better funded by the state (with programs absorbing upto 0.5-1 percent of GDP), and cover a greater share of the population at risk (Table 9). Such programs comprise temporary employment schemes for the construction of public infrastructure; training of unemployed workers and youth with the aim of placing them in formal sector jobs; subsidized formal sector employment for the youth; training for the promotion of SMEs; conditional subsidies aiming at reducing poverty and child labour, and ensuring that children remain in school, have access to health services and proper nutrition.

[6] SEFs and SIFs were mainly introduced to reduce the opposition encountered by the structural adjustment programs of the 1980s and 1990s. Such programs were generally small, poorly funded by domestic resources. Thye also suffered from donor dependence, limited coverage, and targeting, sequencing, and cost -effectivness problems (Cornia 2001).

Table 8. Redistributive impact of budget operations in OECD and Latin America, late 1990s – 2000s

	Tax/GDP ratio, incl. social security	Share of direct taxes in total	Public Social Expenditure* /GDP ()	Gini of the distribution of income before taxes and transfers	Gini of the distribution of income after taxes and transfers	% decline in Gini due to budget operations
Denmark				0.420	0.217	-48.3
Sweden				0.487	0.230	-52.8
Finland				0.392	0.231	-41.1
Holland				0.421	0.253	-39.9
Japan				0.340	0.265	-22.1
Germany				0.436	0.282	-35.3
Australia				0.463	0.306	-33.9
United States				0.455	0.344	-24.4
Italy				0.510	0.345	-32.4
Costa Rica '00		16.7	18.0	0.430	0.350	-18.6
Uruguay '98		8.9	23.6	0.415	0.390	-6.1
Argentina '98		13.5	21.5	0.510	0.400	-21.6
Bolivia '02		11.2	20.5	0.440	0.412	-6.4
Mexico '02		41.3	12.1	0.490	0.450	-8.2
Ecuador '99		14.6	11.6	0.485	0.460	-5.1
Brazil '97		16.8	29.8	0.561	0.490	-12.7
Colombia '03		29.6	17.2	0.530	0.500	-5.7
Guatemala'00		25.8	9.7	0.540	0.510	-5.5

Source: compilation on Cetrangolo and Gomez Sabaini (2006) for OECD, CEPAL (2005) for the L.American countries. Note: The Gini in the table refer to the distribution of 'private and public income in kind' (health and education).

Table 9. Summary of some main social programmes introduced in recent times in the region

PROGRAMA (starting year)	OBJETIVES	COMPONENTS	% WAP MONTHLY target or pop	EXPEN/GDP	BENEFIT/ SUBSIDY($ WAGE	N. BENE
PLAN JEFES Y JEFAS (Argentina, 2002)	Temporary unemployed heads of household -Preservation of human capital	Ceation-maintenance employment for Assistance to schools and basic health services in favour of children	10,7% WAP	0,8% GDP	1.85 millons in 2 years	45 (...) 150 (2007)	0,75 (2002 0,43 (2004
EMPLEOS EN ACCION (Colombia, 2002-4)	- Support the 84,66 poor -Temporary employment -infrastructure	rehab o creation of income of urban infrastructure in areas part of the poorest 40% of urban areas	1,8% WAP	0,22% GDP	300.000 (target)	labour- (June 2000)	Minimum wage
PLAN NAC. DE EMERGENCIA (Bolivia, 2002)	Temporary employment	Ceation-maintenance social infrastructure	of basic economic WAP		1,6%	63 0,86% GDP workers	.. W
PANES (Uruguay, 2005)	Temporary employment	Ceation-maintenance econ/ social infrastr.	7,2% WAP	0,5% GDP	..	55,2 (2005)	0,66
BOLSA Alimentação (Brasil, 1995)	Reduce poverty and inequality in the short/long term	- Education - Nutrition	- Health	n.a.	US$150mm	$ 6.3 - 18.7 2 millon families (2002)	per fan
BOLSA ESCOLA (Brazil, 1995)	Increase the permanence of children in 1ary ad 2ary education	Education	4.8 % of school population	US$762mm (2002) 0,13% GDP	5 millon children	$ 6.3 - 18.7 per family (2002)	…
BOLSA FAMILIA (Brazil, 2003)	Reduce poverty and inequality in the short/long term	- Education - Health - Nutrition (multidimensional)	16% families	of all GDP (2003)		0.28%	
PRO EMPLEO SOLIDARIO (Chile 2004/5)	Training of jobless and placement in formal sector	Subsidies to hiring and hiring of workers in firms .	1.8% of the employed				
OPORTUNIDADES (México, 1997)	Support families in extreme poverty through per family investments in human capital	Education Health Nutrition (1997- 2000)	25%	US $960 million population	4 million of the	$ 55 families	
BONO SOLIDARIO	Ensureminimum consumption to the poor (mother with children, 3rd		Health	....	Education US$ 146.4	Mothers: 1.3 US$ million 3rd	

age and (Ecuador, 1998)	handicaped: handicapped)	age,	Nutrition	millon	beneficiaries US$ 7

- ***Food subsidies and pricing policies***. Food subsidy schemes were in vogue before structural adjustment but were gradually replaced by income subsidy. Yet, confronted with the huge rises in food and energy prices, many countries in the region introduced price controls, food subsidies and other measures that can be implemented quick enough to compensate the adverse impact of high food prices. In Argentina, the government did not updated utility rates, and capped prices of some basic foods. At the moment, 'regulated prices' are in existence for a number of essential items. Yet, it is unclear whether these measures can be effective if the economy continues growing rapidly, unless new additional investment are made to ease supply-side bottlenecks in these sectors. The export tax on food also had the effect of reducing domestic prices of basic food items in relation to the world price.

(iii) New Left policies and sources of inequality decline

What explains the this fairly common (if not universal) decline in inequality, especially in New Left governments, observed since 2002? It is difficult to provide a general answer, but some common factors seem to have plaid a role.

Earlier on, this paper has argued that inequality rose during the 1980s and 1990s as slow growth and the weakening of labour institutions raised unemployment, depressed wages, eroded even faster minimum wages and increased the share of informal employment in low–productivity sectors lacking social security (Table 10). The 2002-2008 recovery and the labour policies briefly described above reversed these trends: urban unemployment dropped from 10.7 to 8 percent between 2002 and the third quarter of 2007 (Table 10). Over 5.3 million new jobs were created each year – a much higher rate than during the previous decade. The new jobs were mainly taken by low–income groups, thus contributing significantly to the reduction of inequality in the region. There is quantitative evidence, at least for Argentina, that the adoption of a competitive exchange rate shifted labour towards the unskilled labour intensive sectors (mainly manufacturing) with a strong equalizing effect.

At the same time, wage employment rose faster than self employment (i.e. by 17.5-31.2 percent in Mexico, Brazil, Peru, and Chile, and by almost 50 percent in Nicaragua and Argentina), suggesting that the policy drive at 'formalizing employment' scored some points. The increase in employment, however, was accompanied by a limited increase in real wages, except in Argentina. A third factor, was a decline in the wage premium of skilled workers, due to a growing supply of educated workers (see section on social expenditure on education), and a shift of production towards the more unskilled labour-intensive tradable sector. A guess-stimate is that a third of the 2002-7 decline in inequality was due to the increase in social transfers and targeted anti-poverty schemes (Tables 6, 7 and 9), following the extension of coverage of minimum pensions and health insurance, the introduction of conditional transfers and the decline in the concentration of social security given the greater weight assigned to social assistance transfers. This analysis is, however, incomplete as it was not possible documenting the trend in capital incomes and their concentration. The decline in interest rates and stagnation of financial rents should have reduced the remuneration of rentiers.

Table 10. Main labour market trends for Latin America as a whole, 1990-2005

	Participati $) on rate (%)	Unemploy ment Rate (%)	% wage workers on total	% formal sector workers	%workers paying social sec.	Wages (const 2000		
						Average	Formal Sector	
1990	63.8	6.2	71.0	46.7	63.3	384	372	278
2002	68.5	10.7	67.5	41.7	55.5	397	457	264
2005	70.1	9.7	68.5	42.6	56.7	405	449	267
2007		8.0	..	..	..	..	..	..

Source: author's compilation on different tables in CEPAL (2006)

Also the recovery of minimum wages had an equalizing effect. A recent study on minimum wages of the impact of minimum wages in 19 Latin American countries for the years 1997-2001 (Kristensen and Cunningham, 2006)[7] found in fact that minimum-wages raise pay at the bottom of the distribution and are generally associated with lower dispersion of earnings. The impact of minimum wage was found to be more far reaching than neoclassical theory would predict, as it lifted wages in both the formal and informal sector. Despite the fact that minimum wages are generally not binding in the informal sector, the study found that in 14 of the 19 countries analyzed they influence favourably the wage distribution in this sector, as well as in the formal sector. This might suggest that, especially for unskilled workers, the minimum wage represents a kind of (fair) 'reservation wage' below which labour supply falls. The minimum wage seems to benefit the low-skilled workers (no or primary education) in countries were the minimum/average wage ratio is low, while where this ratio is high the minwage affects the wage distribution of the skilled (secondary education) more than that of the unskilled.

An IPEA study (cited in CEPAL 2006) decomposed the four Gini points reduction in inequality observed in Brazil between 2000 and 2006 and concluded that falling unemployment accounted for only three percent of the decline, as the jobs created were taken by individuals from households that already had other employed members. Government transfers (pensions and *Bolsa Família*) explain another third, with the rest due to a fall in labour incomes inequality caused by a decline in educational inequality among workers and wage premium by education level.

8. Regression analysis

An initial test was carried out to test the relative importance of the factor discussed above in reducing income inequality in the region over 2002-2007. To this end, a database was built including a series of annual data from 18 Latin American countries (Argentina, Bolivia, Brazil, Chile, Colombia, CostRica, Dominican Republic, El Salvador, Ecuador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay, and Venezuela, which represent the near totality of the population and GDP of the region), and for the years 1990-2007. This gives rise to a theoretical number of 306 observations for each of the variables introduced in the database. In addition to the Gini coefficient of the distribution of income (standardized for all countries in the Gini of gross income). The explanatory variables included in regression are presented below in Table 11 belong to four groups: (i) initial conditions (proxied by Gini 1990, which is ecxpected to have a negative sign in regression as inequality can rise more easily in countries with low Gini's rather in countries with already high Gini), and the share of manufacturing in GDP in 1990 (expected with a negative sign as (ii) variables which reflect

[7] the minimum wage threshold, even where minimum wages are very low. Minimum wages varied between 20 and 143 percent of low-skilled wages, with the number of benficiaries varying betwetween 1 and 20 percent of the labour force. Minimum wage earners are concentrated among the young, informal sector employees, and low-educated workers. In the fomal sector, minimum wage legislation raises wages at around that level in ten of the 19 countries analyzed (and partuiculalrly in Brazil, Chile and Colombia). Variance in institutional factors does not explain why minimum wages have an impact in some countries but not in others. No impact was found instead for Argentina on 2000 data as the mininum/average wage ratio was low and most wage earners were well above the min wage.

the impact of the current business cycle (expected with a negative sign) (iii) Variables that express the current external conditions of the economy (i.e. the international terms of trade, and the volume of the migrant remittances), with uncertain expectations about the terms of trade and expectations of a negative sign for migrant remittances, (iv) current public policies. These include the Real Effective Exchange Rate (a proxy of macro policy), minimum wage and the ratio of workers paying social security on the total number of workers (as proxies of labor market policies), the ratio of direct and indirect taxes on GDP and the share of social security public expenditure on GDP and the coverage ratio between the top and bottom quintile (as redistributive policies) ; (v) Past educational efforts (proxied by the lagged Gini coefficient of education (Table 11).

Table 11. Definition and description of the variables used in regression analysis

variable name	*variable label*	*Source*	*Unit of Measure*
Gini	Gini index	WIID	
GDP/c gr	Per capita Gross Domestic Product at constant market prices, average annual growth rates	ECLAC	Percentage based on US dollar figures at constant 2000 prices
va manuf (%GDP)	Value Added Manufacturing (%GDP)	USAID	as a percentage of GDP
REER	Indices of Real Effective Exchange Rate	Economic Survey of Latin America and the Caribbean	Index, 2000=100
Mw	salario minimo	ECLAC	Index, 2000=1
Contributors/ Employed Persons	Contributors/ Employed Persons	SEDLAC	
Direct tax	(Taxes on income,profits and capital gains + Taxes on property) / GDP	ECLAC	as a percentage of GDP
Indirect tax	(General taxes on goods and services + Taxes on specific goods and services) / GDP	ECLAC	as a percentage of GDP
public expenditure in social security	Social public expenditure (social security) / GDP	ECLAC	as a percentage of GDP
Q5/Q1 Pensions	Ratio of Coverage by Quintile for the Elderly, Q5/Q1	Rofman, Lucchetti and Ourens (2008)	Q5/Q1
edu	Education gini index	SEDLAC	Age (25-64)
Remittances	Workers' remittances / GDP	UNCTAD	Percentage of GDP
tft_fob	Terms of trade, fob	ECLAC	Index, 2000=100

Table 12 hereafter presents the matrix of correlation coefficients between the variables to be included in the regression analysis. With only three exceptions, the table suggests that the explanatory variables are sufficiently independent among each other and that therefore there should be only a limited problem of multicollinearity.

Finally,Table 13 presents the initial results of the regression which was carried out with the Ordinary Least Square (OLS), Random Effect(RE), and Fixed Effect (FE) methodology. Given the macro-panel nature of the data used, the latter procedure is that which ought (at least in theory) yield the most reliable results. Comparison with the two other approaches allows tto test the stability of the estimates.

Table 12. Bilateral correlation coefficients between variables entering the regression analysis.

	gini	*gini 1990*	*GDP/c Gr*	*va manuf (%GDP)*	*reer*	*Real Interest Rate*	*Budget deficit*	*Informal*	*mw/aw*	*dirtax*	*intax*	*Social Contrib*	*Ssecurity*	*Q5/Q1 Pensions*
gini	1													
gini 1990	0.8174	1												
GDP/c gr	-0.0683	0.0211	1											
va manuf (%GDP)	-0.5199	-0.4556	0.2101	1										
reer	-0.3295	-0.3745	0.0585	0.403	1									
Real Interest Rate	-0.05	0.027	-0.1656	0.0485	-0.1252	1								
Budget deficit	-0.0284	0.0081	0.4228	0.2543	0.1356	-0.2197	1							
Informal	0.4245	0.1708	-0.0824	-0.1884	-0.3042	-0.08	-0.2144	1						
mw/aw	-0.1622	-0.1447	0.1604	0.2168	0.4964	-0.028	0.0229	-0.1238	1					
Dirtax	0.0444	0.19	0.012	0.1058	0.5241	0.0074	0.0801	-0.3008	0.354	1				
Intax	-0.0377	-0.0687	0.142	0.4154	0.1535	0.4439	0.0204	-0.0548	0.2322	0.2474	1			
Social contributions	-0.2907	-0.1265	0.0704	0.0891	-0.0126	0.5204	-0.1344	-0.5282	0.2239	0.0158	0.2946	1		
Ssecurity	-0.3548	-0.2219	0.0611	0.2766	0.2331	0.5695	0.0064	-0.5	0.2313	0.22	0.7039	0.6912	1	
Q5/Q1 Pensions	0.375	0.2603	-0.1328	-0.1998	-0.1426	0.0667	-0.4527	0.5154	-0.0756	-0.1363	0.0864	-0.1635	-0.1958	1
gini educ	0.4999	0.5013	-0.1559	-0.2736	-0.3392	0.108	-0.3158	0.5778	-0.0746	-0.0376	-0.228	-0.2201	-0.5407	0.437

Remittances	0.3961	0.2656	-0.006	-0.366	-0.3904	-0.3257	0.0092	0.4451	-0.0915	-0.3074	-0.2241	-0.2602	-0.4504	0.0623	
tft_fob	-0.0581	-0.0046	0.4161	0.0486	-0.1114	0.1996	0.2304	0.0424	0.0698	-0.0533	0.2482	0.2288	0.2647	-0.0198	-

The results of the regression analysis confirm the sign of the expected coefficient in practically all cases,, though in some cases the effect is weak. To start with, the share of value added in manufacturing (which measures the ability to diversify) has – as expected a negative effect ion inequality changes. In constrast, OLS and RE suggest that a high initial inequality is a striong predictor of further inequality increases.

The GDP growth rate correlates negatively with income inequality (though the effect is non significantly different from zero), suggesting that the rapid expansion of GDP of the 2002-7 period helped reducing inequality in the region. The real exchange rate (tested here in a non linear way) appears to reduce significantly inequality, at least up to a point. Also the social sector policy variables generate in regression the expected results: the minimum wages (multiplied by the eligible workers) reduces income inequality and so it does an increase in direct taxation relative to indirect taxation, and an increase in public expenditure on social security.

In turn, an increase in pension coverage among the top quintile, in relation to pension coverage increases income inequality in the region, as argued above. Also, as expected on the basis of the theory, migrant remittances are inequality increasing (and cannot be attributed the merit of the decline in inequality observed in the region. In contrast, the improvements in the terms of trade seems to have a significant effect in reducing income inequality, a result which is at variance with the expected results illustrated in the text. Finally, the improvements in educational inequality realized in part of the region seem to have reduced current inequality though the effect is limited.

All in all, it would appear that initial conditions, business cycle effects, most public policies and – against the expectations – the improvements in terms of trade have all contributed to reduce income inequality. These results seem broadly to confirm much of the theoretical arguments reviewed in the text. They also suggest that income inequality may deteriorate during the current financial crisis which is featuring a fall in terms of trade, a decline in GDP/c and in remittances, a moratoria on taxation and other measures. Whether inequality will offset during the current financial crisis the gains realize during the recent past, will depend on the governments' ability to sustain some of the tax, social expenditure, and growth policies they adopted during the recent past.

Table 13. Regression results (dependent variable current Gini Coefficient)

	OLS	*RE*	*FE*
Variable and (sign expected on the basis of theory)			
gini 1990 (+)	0.7287***	0.7565***	0 [
gdp per capita (rate of change) (-)	-0.0324	-0.0514	-0.0504 ok
va manuf (%GDP) 1990 (-)	-0.2792***	-0.1333	-0.0758 ok
REER (-)	-0.0741*	-0.0941***	-0.1185***
REER^2	0.0003***	0.0004***	0.0005***
Minimum wage x % formal workers (-)	-0.0006***	-0.0007***	-0.0005**
Direct Tax / Indirect Tax (-)	-1.986 ***	-1.4928***	-1.3672***
public expenditure in social security (-)	-0.1748***	-0.1533***	-0.0945 ok
Q5/Q1 Pensions (+)	0.0013	-0.0009	-0.0015 ?
Remittances (+)	-0.2295***	-0.0688	0.2742 ok
Tft_fob (uncertain)	-0.0153	-0.0185**	-0.0216**
edu_1 (-)	-0.041	-0.1136	- 0.0722 ok [
Constant	32.7066***	32.6128***	68.4082***
Observations	161	161	161
R-squared	0.82		0.22

Robust standard errors in brackets
* significant at 10%; ** significant at 5%; *** significant at 1%

8. Tentative conclusions: is 'prudent redistribution with growth' spreading to Latin America?

How can one then explain the recovery and – even more – the improvement in inequality observed in several countries of the region since 2002 (earlier in some cases)? As for growth, there is no doubt that changes in terms of trade and, to a lesser degree, in migrant remittances lessened the balance of payments constraint of many Latin American countries, provided a strong demand stimulus, and increased the rate of return in key economic sectors, strengthening in this way the incentives to invest in these sectors. Yet, it is difficult to share the view (Perez Caldentey and Vernengo, 2008) that the recent growth acceleration has nothing to do with the policy changes introduced by New Left governments (and some conservative governments) in the field of exchange rate, taxation, interest rate and so on. This does not detract from their critique about the dangers of a long term development model still heavily dependent on the primary sector.

As for the recent decline in income inequality, this paper has argued that the terms of trade gains and rise in remittances generated offsetting effects (negative in partial equilibrium analysis, somewhat more positive in general equilibrium analysis), though it is likely that the net effect on income inequality was regressive, as demonstrated by the literature on the 'curse of natural resources'. The paper has argued, in contrast, that the recent macroeconomic and social policies

implemented since early this century have affected favourably income inequality.

The recent reforms seem to be inspired by a 'prudent social-democracy' committed to reducing the 'social debt' inherited from the colonial past and exacerbated during the 1980s and 1990s. With few exceptions, such objectives were not pursued through radical measures such as asset redistribution. Rather, the new model emphasises orthodox objectives such as macro-stability, fiscal prudence, and the preservation of free trade and capital flows. Yet, in a clear departure from the recent past, New Left governments opted for competitive and stable real exchange rates, greater independence in international affairs, and the right of the state to intervene in the economy.

As in European social democracies, New Left governments effected some redistribution in two ways. First, by increasing taxes and transfers, a trend facilitated by favourable terms of trade. This approach entailed an increase in tax/GDP ratio, greater public spending on education, conditional transfers, and other forms of social assistance but less so on health and infrastructure. There is some indication that higher public (and private) spending is starting to reduce inequality in education and the educational disadvantage of the children of the poor. If confirmed, this trend – which plaid a central role in equalizing incomes in Europe during the last century –could have a major effect on the future distribution of opportunities, wages and incomes. Redistribution was also pursued via changes in labour market policies and institutions. Also in this case, the changes introduced (rises in minimum wages, lump sum wage increases, reduction of informal employment, and active and passive labour market policies) have been moderate. And yet they have raised labour participation, reduced unemployment and augmented the proportion of workers covered by formal contracts.

For sure, the New Left model cannot be likened to the 'macroeconomic populism' of the 1980s, as suggested in some quarters. Its macroeconomic sustainability does not seem to be, in fact, a major problem, though the current inflationary pressures require a robust response. Yet, the constraints faced by Latin American governments in deepening this experiment are formidable. First, the trend towards rising taxation and social expenditure need to continue (if to different extents in various parts of the region) with the objective of building a lean but equitable welfare state that avoids the high costs of the European model but aims at universal coverage. Second, while the financing of the reforms have come mainly from gains in terms of trade, the resources to sustain future public expenditure will depend on the diversification of the economy into new sectors[8] . There are no signs that the terms of trade of the region are about to worsen significantly, but longer term growth and the fiscal capacity of the state depend on the diversification towards skill-intensive sectors. In fact, an hypothetical reversal of terms of trade might abort the prudent 'redistribution with growth' reforms underway. In this regard, public choices in the field of investment, industrial policy and innovation will be crucial.

The main problems faced by the New Left policies are essentially of political economic nature. As shown by the case of Bolivia and Argentina, interest groups are trying to stall even moderate attempts at redistribution. Meanwhile, a growing gap between the changes expected from New Left governments and what they can actually do risks derailing the entire exercise. Failure to stay the course may cause a credibility gap, undermine support for New Left governments, and push the region towards its traditional path of slow-unequal development or towards more radical solutions.

[8] As noted by CEPAL (2007, p.31) governments developed a variety of fiscal mechanisms for appropriating part o the increase in commodity prices. Argentina has financed much of its spending from resources generated by export duties. Likewise, Venezuela, Bolivia and Chile have created new taxes to increase the revenue generater from their non- renewable resources. As a result, the share of total fiscal resources represented by such revenue in Bolivia, Chile, Colombia and Mexico rose from of 27.8, 7.6, 9.9 and 29.4 percent in the 1990s to 34.8, 20, 14.2 and 37.5 in 2006-2007.

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