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DECLINING INEQUALITY IN LATIN AMERICA:

Policy Changes and Lessons

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Giovanni Andrea Cornia (ed)

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Extrême inequality is one of South Africa's most persistent afflictions. While there is some consensus that poverty rates have declined, partly due to the large-scale rollout of social grants, it is equally clear that there has been no significant decline in inequality. Over the past 20 years, South Africa has had reasonable economic growth rates and the issue of inequality has been near the top of government's agenda. So the burning question is: why has there been so little progress in addressing this fundamental problem?

Since the early 2000s, Latin America – another developing region with a history of deep inequality – has seen a significant reduction in inequality. This collection of studies is therefore of considerable interest to policymakers and researchers in South Africa.

Part I is a series of overview chapters, including two by editor Giovanni Andrea Cornia. The second part contains chapter case studies on Ecuador, Chile, Uruguay, Mexico, El Salvador and Honduras. These are countries with quite different economic conditions and also encompass a range of government ideologies. The chapters in Part III have crosscutting themes that assess the impact of macroeconomic, trade, labour market, education and social protection policy changes on income inequality.

Many Latin American countries have similar per capita income levels to South Africa's and also rely on resources. The underlying causes of inequality in Latin

America also resonate with the South African case. These include colonial histories and the concentration of land, assets and human capital. In Latin America in the 1980s and 1990s, policies of stabilisation and liberal reform had a regressive effect on income distribution. The share of labour fell and the share of capital rose sharply. Skill-biased technical change was one factor. Rising demand for skills coupled with limited supply led to rapidly growing incomes at the top end. Cornia also attributes increased inequality to liberalisation as a result of competition from low-cost imports and the immobility of production factors in declining sectors. Another outcome was a significant shift into the informal sector.

The Gini index, a commonly used measure of inequality, measures the degree to which the distribution of income deviates from a perfectly equal distribution. The higher the Gini, the higher the level of inequality. According to World Bank tables, the Gini index in Brazil declined from 59.3 in 2001 to 52.7 in 2012. In South Africa, the index increased from 57.8 to 65.0 over a similar period (2000 to 2011), although there is some debate about these numbers. While the case of Brazil has received much attention, it is less well known that inequality declined across the region over the period from 2002 to 2010, with the exceptions of Nicaragua and Costa Rica. The average Gini index among Latin American countries was 54.1 in 2002. By 2010, it had declined to 48.6. This represents a sharp

break in the previous trend of rising inequality since the early 1980s.

According to Cornia, these trends cannot be explained by high growth or favourable external conditions. Growth was much lower than in Asia, for instance, and in any event, the growth of commodity-based sectors can have an unequalising effect on the pre-tax distribution of income because of the high concentration of mine and land ownership.

So what explains the decline in inequality? As usual, there is no silver bullet and a combination of factors has been important. A large part of the explanation is a reduction in labour market inequality resulting in part from a declining skill premium, which is itself a function of declining educational inequality due to large educational investments in many countries. Also, the demand for skilled workers grew relatively more slowly in the 2000s compared to the rapid increase in previous decades. It is also striking that in nearly all countries the urban-rural wage gap fell, a process helped by the adoption of more competitive exchange rates and rising prices for agricultural commodities. Rising levels of social assistance were a significant but lesser factor, according to Cornia.

As Roberts' chapter on the politics of inequality points out, inequality declined in countries of diverse ideological orientation, but the biggest declines were generally in those with more left-leaning governments. However, even more conservative governments felt the pressure to reform and improve redistributive outcomes, as in the case of Mexico or Colombia's health programmes. Left-oriented governments were more likely to introduce progressive taxation and transfer policies as well as minimum wages.

Like Latin America, South Africa has liberalised trade. In their chapter, Székely and Sámano-Robles argue that, while trade liberalisation during the 1980s and 1990s led to increased inequality,

this is not a permanent obstacle to improvements in income distribution. Once the economy has adjusted, other measures can be effective in reducing inequality. For instance, tariffs in Latin America have stabilised at quite low levels but, as we have noted, income distribution has improved substantially during since 2000.

The chapter by Cruces, Domench and Gasparini assesses the patterns of education inequality in Latin America and their links to income distribution. They find that the gap in years of education widened in all Latin American countries in the 1980s and 1990s. But from 2000 to 2010, it declined on average. Importantly, this has had a more equalising effect on the income distribution because of the increased relative demand for low-skilled labour – in contrast to the 1990s, when the demand for unskilled labour fell following market-oriented reforms, technological changes and weak labour policies. This is in sharp contrast to South Africa, where reductions in schooling inequality have not led to reduced income inequality. Lam, Leibbrandt and Finn (2014) attribute this to the increased returns to education in grade 12 and above since 1994.

Many of the policies being pursued in Latin America have also been adopted in South Africa. Progressive taxation and a large-scale programme of social grants have been in place for some time. Public works programmes have been rolled out on a fairly large scale and both the coverage and level of minimum wages has increased. So why the contrast in terms of distribution outcomes? The big difference is South Africa's extraordinarily high rate of unemployment, especially for those with limited skills. Labour-intensive sectors such as agriculture and mining have seen large declines in employment, as have the labour-intensive branches of manufacturing. In countries like Brazil, employment grew rapidly, including of low-skilled workers. Linked to this was a reduction in the skills premium and greater labour market equality.

Another issue has been the poor quality of education, health and other services delivered to low-income earners in South Africa. Poor delivery impacts directly on inequality and poverty and, in the case of education, has long lasting effects.

More rapid economic expansion in South Africa is an important objective, but, at any given level of growth, the economy needs to become more labour absorbing. In fact, it is not only incremental growth that needs to become more employment intensive: the economy as a whole needs to become more labour absorbing. A central question, therefore, is how to bring about changes in the economic structure and the pattern of development that would lead to the attainment of this objective.

The Latin American experience carries many important parallels and lessons for South Africa and this book warrants close study. It is sharply critical of orthodox structural adjustment as it was applied in Latin America from the 1980s and provides voluminous evidence to support the reforms introduced since the late 1990s. According to Cornia, these together represent the "surfacing of a new policy model" that responds to the perceived limitations of Washington Consensus policies as well as the steady move towards greater democratisation.

The overall conclusion is that policies need to be redistributive and that redistributive policies can work. Simply pursuing growth and hoping for the best is not the route to reducing inequality; the right policies need to be selected and they need to be well implemented. While South Africa can definitely draw on the Latin American experience, it will need to find its own route to a more equal society.

REFERENCE

Lam, D, M Leibbrandt and A Finn. 2014. "Schooling inequality, returns to schooling, and earnings inequality: Evidence from Brazil and South Africa", *UNU-WIDER Conference on Inequality – Measurement, Trends, Impacts and Policies*. Helsinki. ➤