



## FACING UP TO INEQUALITY AND EXCLUSION TO END POVERTY AND HUNGER IN LATIN AMERICA

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In the last two decades of the 20th century, recurring fiscal and financial crises, unsatisfactory growth, and deep and persistent inequality endangered development prospects in Latin America and the Caribbean (LAC). Since then, financial stability and growth have improved, but inequality and economic and social exclusion remain key areas of concern; they are, arguably, the main challenges to be addressed in designing strategies to end poverty and hunger.

Responding to high prices and demand for commodities, the region's economies have done well in recent years. After a long period of sluggish growth, the current upturn is in its fifth year and, thus, has lasted longer than other expansions in a generation. While growth in LAC has been lower than in the developing world overall—averaging 4.5 percent per year from 2002 to 2006 (or 3 percent per capita per year)—it is taking place in a context of low inflation, relatively balanced monetary and fiscal policies, dynamic capital markets, growing reserves, and declining foreign debt. Growth varies widely, as is to be expected, but most countries are participating in the boom. Growth, coupled with new poverty reduction programs, has begun to improve livelihoods and transform social conditions. But the fruits of growth are distributed unevenly within countries, and the media and academics are raising new concerns about two-speed, diverging national economies.

Deep and persistent inequality implies that the ability of some groups to take advantage of opportunities is consistently inferior to that of others. This is unfair and polarizing, and (as is explained below) it limits growth and the scope for sustainably reducing poverty. Growth and poverty reduction programs alone are unlikely to shift the region out of poverty and hunger. Both approaches are necessary and have tallied up impressive gains in recent years, but both also need to be supported and enhanced by policies and programs that create and distribute opportunities more widely; generate productive, well-remunerated jobs; raise the capabilities of potential job holders; foster inclusion; and reduce inequality. This calls for broad-based social policies with supportive and well-aligned public investment and economic and fiscal policies.

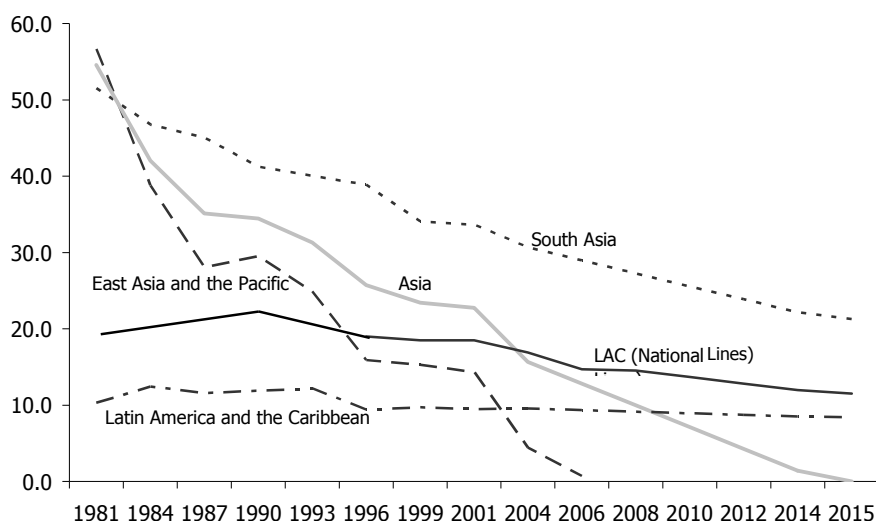
### Progress in Reducing Poverty and Hunger

Growth and new poverty reduction programs have measurably affected poverty in recent years, causing it to decline, albeit slowly. As a result, for the region as a whole, it now seems possible to halve the proportion of people living in extreme poverty by 2015, relative to the 1990 baseline. Country-specific projections by the United Nations' Economic Commission for Latin America and the Caribbean (ECLAC)—using national poverty lines—indicate that this target has been met today in Brazil and Chile and seems reachable in 7 more of 17 countries that are being tracked; prospects are less hopeful in the remaining countries, however. Progress toward the target is behind schedule in these countries, but the trajectories vary widely: in some of these countries, the reduction of the proportion of people in extreme poverty has recently accelerated.

Progress in reducing poverty is slower in LAC than in Asia—a region with lower inequality, higher rates of growth, and higher initial levels of poverty (Figure 1). Trends in LAC growth and poverty reduction point in the right direction, however, even though the share of poor people in the population today has changed little from the share reported in 1980, according to ECLAC. It took the better part of a generation after the transformations of the 1980s and the 1990s to recover gains once achieved.

Extreme poverty is defined internationally as incomes of less than US\$1 per capita per day. Figure 1 also shows trends for LAC based on definitions of extreme poverty or "indigence" using national poverty lines. The proportion of indigent people in the population is higher with the Latin American national lines than when the international definition is applied. Plausibly, as seen in the figure, the proportion based on these national lines diminishes more rapidly in a context of positive per capita growth. Trends beyond 2001 in the figure (2006 in the case of LAC for national lines) are extrapolations to 2015, the target year for the United Nations' Millennium Development Goals. Future actuals may vary. The curves portray averages for major world regions, which are not explicit about the true situation in individual countries in those regions.

**Figure 1—Evolution of Extreme Poverty: Share of Population below US\$1 per Capita per Day**



Sources: World Bank, PovcalNet Database <<http://iresearch.worldbank.org/PovcalNet/jsp/index.jsp>> and U.N. Economic Commission for Latin America and the Caribbean, *Social Panorama of Latin America 2006*, Santiago, 2007 <<http://www.cepal.org>>.

Today, 39 percent of the population in LAC (about 205 million people) is classified as poor, and 15 percent (about 80 million people) is classified as extremely poor or “indigent.” Poverty is worse in rural than in urban areas, and, while there are more poor people in the towns and cities of this heavily urbanized region than in the countryside, the absolute number of indigents in rural and urban areas is almost the same. Poverty is also an ethnic and racial phenomenon in many countries in that it disproportionately affects citizens who are of indigenous or African descent.

Lack of income (particularly in the case of the very poor) is strongly correlated with manifestations of hunger, although other factors (including access to health care, levels of education, and household and community variables) affect nutritional outcomes as well. ECLAC data indicate that between two multiyear periods ending in 1993 and 2003, respectively, the prevalence of underweight children under five years old decreased from 10.4 to 7.5 percent (varying from 0.7 percent for Chile to 22.7 percent for Guatemala more recently). This indicator and others therefore suggest that some manifestations of hunger may be subsiding—slowly—as poverty improves. At the same time, nutritional deficiencies affecting young children and their development potential remain prevalent in some countries or parts thereof—most notably in the rural areas of Central America and the Andean region.

### Growth, Poverty, and Inequality

Latin America is the world’s most unequal region, with a coefficient of inequality greater than 0.5 (Table 1). The distribution of income and wealth, and that of the underlying productive assets, is thus highly skewed and changes little over time. (Recently, income inequality has declined somewhat

in Brazil, Mexico, and Peru, but it has increased in Colombia, Costa Rica, and Ecuador, for example.) According to the literature, deep and persistent inequality harms growth, particularly in countries with per capita incomes up to about the LAC average. The paths through which this occurs include inefficient results from imperfect markets interacting with asset inequality; weak incentives to create accountable political and economic institutions and a meritocracy; and a fragmented society, which favors the emergence of a climate of distrust. Inequality also constrains demand (and therefore growth); keeps the poverty-reducing impact of growth low (thus lengthening the time required to meet specific poverty reduction targets); and is responsible for higher-than-expected levels of poverty in LAC, given the region’s middle-income status and economic development achievements.

**Table 1—Gini Coefficients by Region, 1997–2004**

Region	Gini Coefficient
Organisation for Economic Co-operation and Development	0.321
Eastern Europe and Central Asia	0.335
South Asia	0.374
Middle East and North Africa	0.385
East Asia and Pacific	0.399
Sub-Saharan Africa	0.420
Latin America and the Caribbean	0.521

Source: World Bank, World Development Indicators Database <<http://go.worldbank.org/6HAYAHG8H0>>.

Note: 2004 is the latest year for which data were available by country/region.

Deep inequality in LAC manifests itself in income distributions at the country level that are rather flat up to decile 8 (if not 9) and top-heavy, with the richest decile capturing 40 percent or

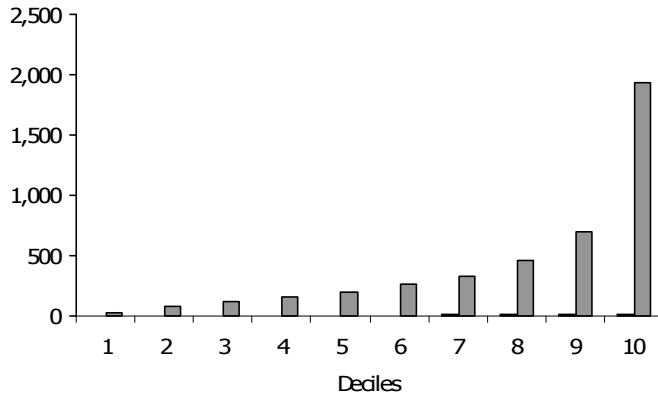
more of total income (Figure 2). This pattern implies that the differences in average absolute incomes among the deciles of the middle segment (here defined as deciles 3 to 8) are small, and that the mean income of this numerically and politically important group is low. Panel data point to a high

degree of income instability among the middle deciles over time. Structural, extreme poverty at the low end of the distribution (deciles 1 and 2) therefore coexists with a great deal of privilege, protection, and stability at the top (decile 10) and frequent cyclical adjustments in between.

**Figure 2—Income Distribution by Decile, Selected Countries**

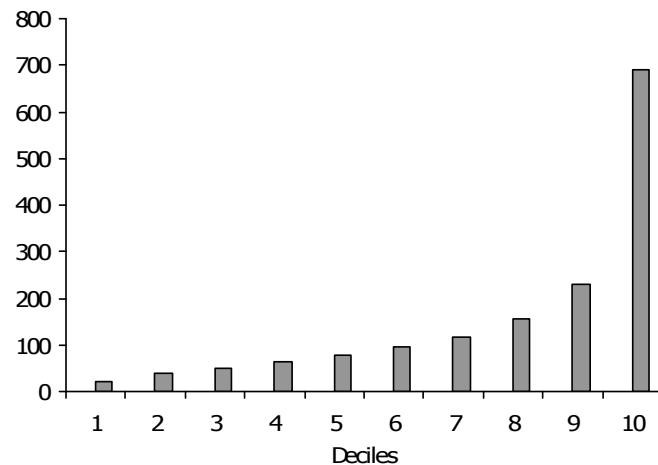
**a. Brazil, 2004**

Units of National Currency



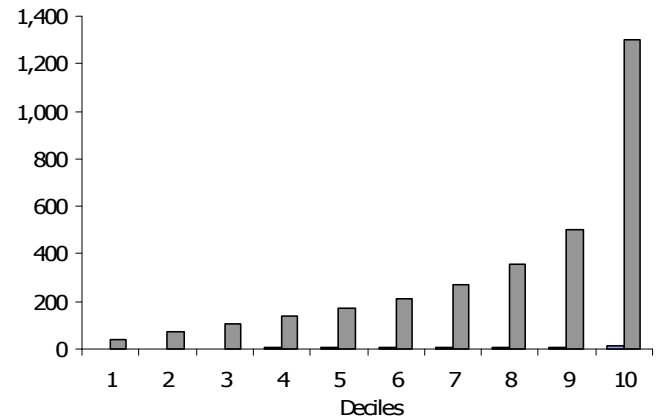
**b. Chile, 2003**

Units of National Currency



**c. Peru, 2003**

Units of National Currency



Source: Socio-Economic Database for Latin America and the Caribbean (CEDLAS and World Bank) <<http://www.depeco.econo.unlp.edu.ar/cedlas/sedlac/>> accessed 2007.

Households in the middle range may fall into poverty or near-poverty as a result of employment shocks or other contingencies, even as some of those officially classified as poor may exit poverty, with or without the help of government redistributive programs. The middle range of households, therefore, is not "middle class" by most criteria but rather relatively vulnerable and poor, with low health and education indicators, limited physical and financial assets, and limited capacity to help drive growth. Policies that benefit the middle range of households are therefore needed, in addition to policies targeting those classified as poor.

The challenge for LAC today, as in the past, is to accelerate lasting and poverty-reducing growth. Efforts to take advantage of the potential economic contribution of the majority (hence including the middle range) are central to this endeavor, as are measures and incentives encouraging productivity and innovation. The region needs reforms that go beyond those of the past; focus on microeconomic aspects, as well as institutions and the politics of change; and take a new, committed approach to broad-based social policy benefiting a wide spectrum of the population. The standard, poverty-targeted approach must be embedded in a comprehensive social strategy that focuses on job-based growth.

Growth and targeted poverty reduction programs are currently reducing poverty by creating employment (mostly in unskilled, informal-sector jobs) and through a range of programs, including conditional cash transfers to eligible beneficiaries. But such transfers are only effective in reducing poverty today; reducing poverty tomorrow, through gains in human capital acquired under the terms of the transfers, depends on the availability of good and stable jobs.

So far, the region's economies are not creating this category of jobs on the scale required. Poverty reduction programs cannot fulfill this need, so other efforts must be brought to bear. These revolve around the domestic determinants of growth, as opposed to foreign demand, and thus are largely in the realm of social policy: education and the quality of the workforce; equality (since inequality constrains how the "asset-poor" contribute to and share in the benefits of growth even in a context of good economic policies); labor markets, social security, and social protection; the amount, composition, spatial distribution, and productivity of public (and private) investment; law and order; regulations; and the state of infrastructure and finance. Labor markets deserve a special word.

### **Labor Markets and Exclusion**

Labor markets have been an increasingly important source of inequality and exclusion since the crisis in the 1980s. Unemployment grew from 6 percent in 1990 to 11 percent in 2002, especially in parts of

the Southern Cone, the Andean countries, and Central America, while average real wages tended to decline. Employment shifted to unstable, low-productive, and ill-remunerated activities in the informal sector, where workers lacked health care coverage, insurance, social security, and job protection, and where having a job was no longer a ticket out (and to staying out) of poverty. In addition, wage inequalities worsened as schooling improved (by about 1.1 years over the 12-year period to 2002), average returns to education slowed, and employers paid premiums to highly skilled workers, who became the main segment of the population deriving prosperity from trade liberalization and integration.

The relative inability of economies to create "good" jobs since the 1980s, and the attendant rise in the share of precarious, low-wage jobs in total employment, is therefore the core of the problem, which has been linked not only to the occurrence of crises and persistent low growth, but also to the rising importance of the services sector as the low-skilled workforce continued to expand. Further, the phenomenon has been linked to factors that vary widely in their scope and implications, including economic volatility; macroeconomic and financial imbalances; high interest rates; limited access to credit; deficiencies in governance, security, and law and order; rent-seeking behavior; the "natural resource curse"; and unmet demand for higher skilled workers prompted by shifts in technology and new equipment. Another set of factors that is sometimes invoked has to do with employers' and workers' incentives under the rules governing social security systems, which may militate against the formalization of the workforce under highly differentiated seasonal and year-round work and employment conditions on the ground.

Since the 1980s, markets and systemic forces have produced a situation very different from the postwar years of growth, where, at least for some, inclusion and social integration were promoted through the expansion of formal-sector jobs in government and manufacturing and solidified through "corporatist" arrangements for the benefit of given groups. Basic economic and social rights, including protection against contingencies, became attached to employment in the public and (formal) private sectors, but subsequent difficulties brought this route to inclusion to a halt. Stabilization ended the practice of inflationary financing of social services and systems of protection at about the time when trade opening and globalization began to pose new challenges to job growth and inclusion.

But markets are not, and have not historically been, the only force behind exclusion. Prejudice, discrimination, and biased rules, whereby access to resources, justice, jobs, and other goods becomes unequal among groups, are in effect and play important roles in furthering exclusion. One way to view the phenomenon is in terms of dysfunctional

political, economic, social, and cultural processes, by which the excluded are denied access to the opportunities and quality services that are needed for fulfilling, productive lives (Box 1).

#### **Box 1—Definitions of Economic and Social Exclusion**

- A multidimensional, multidirectional, multicausal process . . . affecting the *functionings* and well-being of individuals and groups.
- A group phenomenon rooted in culture and traditions (afrodescendants, indigenous, gender, disabled, stigmatized) . . . reproducing itself through discrimination, unresponsive institutions, and economic change.
- A moving target . . . operating through the labor market, differences in endowments, growing informality, and lack of social protection.
- An entrenched condition . . . effectively inhibiting upward mobility.

Some individuals and groups are excluded because of innate factors over which they have no control: ethno-racial factors are important determinants of exclusion, as can be traits such as gender, age, physical ability or disability, and other considerations. Ethno-racial correlates of exclusion potentially affect up to 40 percent of the region's population, including more than 40 million indigenous people and many of the region's approximately 150 million people of African descent. These groups are underrepresented politically and overrepresented among the poor.

Exclusion and entrenched inequality are at the center of the sense of dissatisfaction and disengagement that (as reported by opinion surveys and other sources) affects the region's population, despite the presence of good news on the economic front.

#### **Broad-Based Social Policies to Accelerate Inclusive Growth**

The *purpose* of the approach to broad-based social policies outlined and espoused here is ambitious but straightforward: to end both poverty and hunger, and the near-poverty affecting many in the middle range. This calls for strategies, investments, and the alignment of incentives to reduce inequality, advance inclusion, and foster job-based growth. On a different plane, the *ways and means* also include the generation of political support and agreement to start down the proposed road and to persist, shifting from a tradition of short-term policies to a culture of long-term action anchored in legal frameworks and a system of rights.

The *approach* will vary by country depending on local conditions and what can be learned from the past. There is nothing on the horizon to suggest that silver bullets will work. The operationalization, finally, will be country-specific, requiring solidarity and resources. For most countries (given their low tax burden) this in turn leads to a topic not fully discussed here for lack of

space—the need to reform fiscal and tax systems to raise revenue and progressivity, increasingly through direct taxes within appropriate bounds. In LAC, unlike other parts of the world such as the countries of the Organisation for Economic Co-operation and Development, the effect of taxes and transfers in lowering income inequality (and hence Gini coefficients) is very low.

In terms of policies, the espoused elements can be visualized as four interacting clusters, as follows.

#### ***Labor Market and Entrepreneurial Capability***

The first broad cluster, *labor market and entrepreneurial capability*, focuses on the supply-and-demand side of the task of creating productive, well-remunerated jobs. A key element, clearly, is education and training, where the region has made advances but with much more to be done. According to existing analyses and evaluations, furthermore, labor market policies and programs are a neglected area that could be promising in important respects, for example, job intermediation; training and competency accreditation; income protection mechanisms, which are vital for job flexibility; and policies to address exclusion and to facilitate upward mobility for less advantaged workers. Other aspects to be addressed in this cluster include basic services and infrastructure, which need to be improved; the many obstacles that hamper the establishment and functioning of businesses as sources of employment in the formal sector; and new areas such as guiding remittances to sustainable, productive use. As the analysis of poverty trends indicates, rural development continues to be relevant and needed, even though in many countries it does not receive the attention it deserves.

#### ***Social Protection and Tools for Risk Management***

The second cluster, *social protection and tools for risk management*, addresses the widespread lack of protection against contingencies, such as economic downturns and job losses, natural disasters (which are frequent in the region), violence and crime (also frequent), and personal and family-related events and risks (sickness, accidents, disability, old age). The lack of protection against these contingencies is not only a "social" problem, but a major economic one as well, inasmuch as it can generate paralyzing insecurity and prevent households from taking entrepreneurial risks that would support growth and increased job opportunities. The most ambitious reform agendas in the areas under this cluster include gradual moves toward universal guaranteed health services (Chile's Plan AUGE is a beginning) and the extension of pension coverage through contributory and noncontributory components. In both cases, challenging issues of financial viability need to be addressed.

## **Social Programs**

The third cluster, *social programs*, addresses structural poverty at the low end of the income distribution. Here, the best of the available experience with targeted programs requiring “co-responsibility” on the part of the beneficiaries should guide the agenda. The conditional cash transfer programs, in particular, represent an improvement over previous approaches, but they are too limited in scope to solve structural poverty by themselves and they also have an opportunity cost (with more or less “bite” depending on the level of resources available overall) in the sense that the corresponding funds could be spent on other aspects, such as infrastructure needed to create good jobs. There are reasons to argue that social programs as understood here, with accountability on the part of politicians, beneficiaries, and intermediary institutions and constant feedback from evaluation to operations, should be expanded thematically, and extended to all eligible groups. For example, nutrition programs are needed in many settings as evidenced by the analysis of poverty and hunger trends above, as are follow-on programs to the cash transfers to foster access to productive assets such as credit and other resources that can underpin a small-scale entrepreneurial push.

## **Affirmative Action**

The fourth cluster, *affirmative action*, is shorthand for public policy to advance inclusion. The task in this difficult area is to achieve equality in access and opportunities for excluded groups by bringing them into the political, institutional, and community structures that make the decisions affecting their prospects. The task is hampered by

a dearth of analysis and experience in constructing “inclusive” public policies, although some efforts toward inclusion have been made in the region (for example, in bilingual education). As suggested by the Inter-American Development Bank, the promotion of inclusion through public policy requires normative frameworks, institutions, and instruments, some of which currently exist (such as legislation proscribing discrimination based on ethnicity and race in some countries), but the application is often deficient and enforcement is lacking. Many incidences of exclusion are subtle, intangible, and hard to prove, and the real need—as argued by the Inter-American Development Bank—is to transform rights on paper into effective rights in practice.

## **Conclusion**

To conclude, the elements of the approach to broad-based social policies as advocated in this brief are far-reaching and ambitious, but so are the expected benefits in terms of more equal opportunities, jobs and upward mobility for the disadvantaged, cohesive social systems, and, in time, the end of poverty, near-poverty, and hunger. The current, favorable environment of growth provides an opportunity for a political and policy commitment along these lines.

**For Further Reading:** U.N. Economic Commission for Latin America and the Caribbean (ECLAC), *Social Panorama of Latin America 2006*, Santiago, 2007 <<http://www.cepal.org>>; N. Birdsall and R. Menezes, “Beyond the Washington Consensus: A New Job-Based Social Contract in Latin America,” *Foreign Affairs en Español* (July–September 2005) <<http://www.foreignaffairs.org>>; Inter-American Development Bank (IDB), *Outsiders? The Changing Patterns of Exclusion in Latin America and the Caribbean: Economic and Social Progress in Latin America 2008* (Washington, DC: IDB, 2007).

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