

Part Two

INTRODUCTION

Income inequalities in Latin American countries are the greatest in the world, primarily because of the huge gaps between families belonging to the highest-income decile and everyone else. Four features set the wealthiest families apart: the higher education levels of their heads of households, the type of work they do, their urban location, and the smaller size of their households. Although household incomes come from various sources, overall income inequality as measured in household surveys is closely related to unequal income from work. Such are the facts, but what are their causes?

To answer that question, this section begins with more specific explanations associated with immediate observation of inequalities between individuals, and moves toward more general explanations that take into account the economic, social and institutional context in which individuals operate. Although only a limited number of variables can be observed and measured, their explanatory power is high. At the most immediate level, gaps in income can be explained primarily by differences in education. But these differences are the result of a decisionmaking process taking place in families, in which the economic, social and cultural conditions of parents play a role. In this process, families decide not only how much education to give their children, but whether or not the mother can be involved in economic activities outside the home and how many children it is desirable to have. Families that are poor because their parents have little education tend to be larger, offer fewer possibilities for women, and educate their children less. Thus, education and family are the channels through which income inequality is perpetuated. On a third level of analysis stands the context in which this process takes place. Parents make decisions on the basis of the relative rewards and opportunities they perceive for themselves and for their children. These rewards and opportunities depend on the abundance or scarcity of work and human capital in relation to other productive factors, particu-

larly capital and natural resources, and to other economic, social and institutional development conditions in their countries. The endowments and characteristics of productive resources and the state of development are therefore the two dimensions of the context in which income inequality unfolds and is perpetuated.

LABOR INCOME INEQUALITY AND EDUCATION

Given the many manifestations of income inequality, its causes can be explored on different levels. Differences in labor income constitute the most immediate level of observation. Because income inequality is greatest in Latin America, it is no coincidence that the region has the widest wage gaps in the world between more highly trained personnel who handle managerial and administrative tasks and unskilled workers who do manual production work.

The main explanation for such income differences is found in education and the power of experience to further widen the income gaps between those with a great deal of education and those with little. From the standpoint of income equality, education in Latin America is problematic in several ways. The average education of the workforce has advanced more slowly than it has elsewhere in the world, and by the early 1990s it had not even reached five years of schooling. Although initial access to school is comparable to or higher than it is elsewhere, the children of lower strata families withdraw quickly, while those who are better off remain in the education system, and growing numbers are even reaching the university level. Thus, a high proportion of the population has some primary education, and the proportion of those who attend the university is also high in terms of the development level of countries in the region, while the proportion at intermediate levels of education is low. Hence, the accumulation of human capital is not only weak, but

its distribution is quite unequal (albeit increasingly less so for younger generations). This situation reflects problems of returns and of quality. The returns are low for the early years of schooling but high for university education, and are substantially less in the countryside than in the city. The quality is quite inferior for those who attend public school and have no access to higher quality private education. The result of this set of factors is highly stratified education that reproduces income inequality instead of helping to correct it.

Other factors help deepen differences of labor income between workers. Independent of education and experience, employers receive higher incomes than formal (subordinate) workers, and the latter earn substantially more than informal workers. Although Latin American women are reaching education levels similar to those of men, they do not receive equal pay, especially in informal sectors, where their numbers are increasing.

INEQUALITY AND THE FAMILY

Because decisions about education take place in the family, they are influenced by the same factors that affect other family decisions, such as the participation of women in the workforce and the number of children. Some of these factors are internal family matters. Aside from individual beliefs and values (which play a crucial role in all these decisions but are not observable), the most important internal factors are the educational level of the father and the mother, the time demands on the mother in the household (which depend primarily on the number of children), the presence of other adults in the home, and the availability of basic household services. Other factors are external, such as the pay that household members can earn given their education and experience, and their possibilities of being involved in formal and informal occupations.

As a result of this interaction, women in lower-strata families participate less in the workplace (and when they do so, usually in informal activities), and have more children and less education than women in the high-income strata. Inequalities are therefore reproduced in the next generation, although not in the same manner in all countries. Indeed, from the results of a model of estimated family behavior for 14 countries, it was found that two couples differing only in their educational level will make different decisions in countries that are currently more unequal than they will in more equal countries. Consequently, the family acts as a channel transmitting inequality between generations, and education is its basic mechanism. But the transmission of inequality operates with

varying strength from one country to another, depending on relative prices and other conditions of the economic and social context confronting individuals as they make key decisions. Higher pay for work and better facilities for performing household work induce women to participate more in the labor market and have fewer children. Better opportunities and more flexible employment conditions help bring women into formal rather than informal employment. High expected returns on the education of children, lower costs and better facilities for sending them to school encourage greater educational attainment, which translates into less inequality in future generations. All these price and cost signals coming from the context in which families operate are the result of aggregate economic and social conditions.

THE ROLE OF THE ECONOMIC AND SOCIAL CONTEXT

The last level of the causes of inequality is consequently of an aggregate character. What aspects of the economic and social environment tend to foster income inequality and facilitate its reproduction? The conclusion emerging from a comparative analysis for economies of all regions of the world is that inequality is connected both to a combination of aspects of the state of economic and social development, and to the more permanent conditions of countries associated with their natural resource endowment, geographical location, and other features of their productive resources (henceforth called “endowments”).

Through a relationship of mutual causality and reinforcement, economic development is associated with falling levels of inequality. Development is multidimensional, and many of those dimensions affect inequality in the same direction, at least after certain minimal levels of development have been attained. Consider first the accumulation of physical capital, which is essential to the development process. At the early stages of accumulation, scarcity of capital leads to high returns, which are a cause of income inequality. But as capital becomes more abundant, its returns fall vis-à-vis other productive factors, especially labor. Since labor capacity is an asset that is better distributed than physical capital, income distribution tends to improve.

A similar mechanism is at work in education: low levels of schooling entail high returns for the few who are educated. As average educational levels rise, not only is the return for those who are educated reduced, but differences between the educational levels of some individuals and others tend to decline. Differences between indi-

viduals in the same generation tend to narrow first, although differences with past generations that received less education remain in place for several decades more. Thus, the micro-level analysis is confirmed in the aggregate: over time educational progress tends to help reduce inequality.

The same can be said of demographic patterns. Rapid population growth rates entail greater diversity in family size, which leads to worse distribution of per capita income. In part this is simply because in larger families the average income of individual members is less, but it also happens that in larger families women are less involved in formal employment and children receive less education. Hence, in countries with greater demographic growth, participation in the workforce is lower, as is educational achievement—even after isolating the effect of economic development on these variables.

The countryside offers fewer economic opportunities than the city: markets are not well integrated, costs of providing education are higher and access to it lower, employment possibilities are limited, and access to financing is restricted. This translates into lower income, less education and larger families in the countryside than in the city. Early in the urbanization process, income differences between city and countryside help increase income inequality of all individuals. But when most workers are based in cities, the rural-urban income gap will affect only a small fraction of the population, and its contribution to overall inequality will be reduced.

Similar reasoning can be applied to the formalization process. The existence of an informal sector makes it difficult to properly take advantage of the possibilities of specialization, greater access to capital and the economies of scale of higher volume production. Hence, the informal sector tends to generate lower incomes than those offered by the formal sector. Initially, as labor relations become more formal, the privileges of some wage workers are a source of inequality, but if the process takes hold and continues to advance, they become an equalizing factor.

Latin America is at a midpoint in this multidimensional development process, which partly explains the region's poor income distribution and suggests that pros-

pects are good if policies conducive to economic growth and the consolidation of changes are adopted to hasten the accumulation of physical capital and the expansion of education, improve women's chances to be part of the labor force, deal with the challenges of urbanization, and make productive activities more formal (see Part Three).

But that is not the whole story. The current development situation of Latin American economies only explains a third of the extra inequality as compared with developed countries (6 points of the 18 point differences between their respective Gini indices). The rest reflects factors of a more permanent nature, which constitute "endowments." Their influence on income distribution has occurred historically through varying institutional and political channels. Extensive agricultural lands, dependence on primary exports, and the geographical location of these countries are three interrelated variables that reflect characteristics of resource endowment. High economic volatility, which is also connected to these variables, is a manifestation of the influence of these endowments on economic institutions.

In keeping with other studies of geography and economic history, the statistical analysis on a world scale carried out for this section confirms the influence of tropical conditions on the structure of property and use of natural resources and unskilled labor. The colonial institutions of land ownership, forced labor and income distribution that prospered in tropical regions, influenced by those very geographical reasons, left their imprint on the distribution of land and other assets and continue to weigh on income distribution in Latin America.

But that imprint is not immune to change. Several countries, especially the English-speaking Caribbean countries, overcame slavery's legacy of inequality and today are among the countries with the least income inequality in the region. Furthermore, broad differences in distribution and tendencies toward change are found among countries with a Spanish or Portuguese heritage in tropical areas, thereby demonstrating that there is room for policies to have an effect. That is true both for policies favoring more equal distribution and for those that may reinforce the mechanisms that perpetuate inequality.