Nota: este documento ha servido de insumo principal para el discurso ofrecido por la Secretaria General Iberoamericana, y no representa necesariamente su intervención en el evento. Se pone a disposición para consulta.

"Latin America's Challenges: growing middle classes, declining commodity prices"

Oxford, UK – Latin American Centre

February 20, 2016 – 14:30h

Talking points for Rebeca Grynspan

Ibero-American Secretary General

Introduction

Thank you, Diego, and thanks to the Latin American Centre for this wonderful opportunity.

First all, I want to begin by stating that, although I will refer to Latin America as a whole, there are many Latin Americas. The region is plural and diverse. I will attempt to make the necessary precisions but one must always bear in mind the immense variation across countries and within countries.

Latin America is not what it used to be

Latin America has changed dramatically in the last couple of decades. It has become rather stable in terms of its economic growth (even in light of the current slowdown), its macroeconomics and even its politics. Since the turn of the century, it is the only region in the world that managed to grow while reducing both poverty AND inequality. 60 million people climbed out of poverty – though many remain vulnerable. I will get to that later.

During the 1990s, Latin America registered an annual average growth of around 1%. This changed with the rise in commodity prices and better terms of trade: between the year 2000 and the year 2014, the region managed to grow at an average annual rate of 3.3% -it would have been 4%, were it not for the financial crisis of 2008/2009.

Per capita GDP in the region went from $700 in 2000 to a little over $1.000 in 2012, which is to say that it grew at a faster pace than the economy, thanks to the "demographic bonus" (the larger per capita share on account of falling fertility rates).

Alongside this economic growth and macroeconomic stability, social spending also grew – in relative and not just absolute terms.

(Figure 1)

Between the years 2000 and the years 2012, social spending grew almost 4 percentage points. As you can see in Figure 1, social spending as a percentage of GDP grew from 14.5% to 18.4%. Spending grew most in education (the red bar), health (the grey bar) and social security (the black bar).

This increase in social security includes conditional cash transfers, which amount to 1% of social spending, built into this black bar.

Other items grew a little less than social security, but they all grew. So we can see there was a significant effort on the side of governments to increase social spending during the economic boom.

What was the impact of all this? We can see how Latin America reaped the benefits in areas where it spent the most. Enrolment in primary education reached 94% in 2014. It was a significant expansion, though we are still not covering 100% of our children.

Secondary school enrolment went from about 60% of the relevant population to 73%. This is fundamental, since it is a big bottleneck for Latin America's productivity.

Mean years of schooling for people over 15 years of age grew about one year, this despite those who dropped out of the educational system before the economic expansion. Latin American adults now have, on average, 9.5 years of schooling.

Here I am not referring to the quality of social spending, only to coverage. I will refer to quality later on.

(Figure 2)

Now, on the issue of social security spending, you can see how conditional cash transfers grew to benefit 135 million people. I am sure you have heard of these programs. The largest are the ones in Brazil and Mexico, but most countries have some version of these systems where the state provides cash transfers to families, conditional upon their children staying in school or receiving medical attention. In some countries, they include child nutrition components.

The new demographics

(Figure 3)

The combination of economic growth and welfare programs changed Latin America’s social architecture. In this figure, the poor are the black line, the middle classes are the red line, and the white line represents those who are somewhat in between (above the poverty measure – 4 dollars per person per day –, even though they are still vulnerable and at risk of falling back into poverty).

You can see that in the year 2008, and for the first time in Latin America’s history, the middle classes –that is people living with 10 to 50 dollars per person per day–, surpassed the poor. So we are not talking about people living with 5 dollars a day, but people living with two times or more than two times that amount – there are many more middle class Latin Americans today than poor Latin Americans.

Of course, this is not true for several countries in the region (like Honduras, El Salvador or Guatemala), but overall Latin America has now more people in the middle of the income ladder than at the very bottom.

It is also true, however, that the largest group is this vulnerable sector that is “nominally” not poor but is still dangerously close to the line. Now that the region is experiencing an economic slowdown, people living in these circumstances lack sufficient social protection, are oftentimes not covered by social security, and are therefore at risk of falling back into poverty, which is something we are beginning to see.

We are also witnessing stagnation in the reduction of income inequality.

Despite this, Latin America's social structure today is very different from what it was in the 1990s. This has enormous consequences: economic, social, cultural, environmental and political consequences.

Some claim these gains in the reduction of poverty and inequality were entirely due to economic growth, brought about by favorable external conditions. Yet research shows that growth explains about 3/4 of the average reduction in poverty. 1/4 is explained by redistribution through social spending.

Even if we only talk about the 3/4 that can be explained by economic expansion, a big part of it had to do with the entry into the labor market of a generation of workers that was healthier and much more educated and could therefore aspire to higher wages. I want to highlight this because we often talk about economic growth and job creation as if social policies had no effect on economic performance, but they do! We saw the biggest increases in salaries precisely in the lower-earning sectors, where young people who had received a better education started earning more than their predecessors did. Investment in human capital, in health and education paid off.

Finally, some of the reduction in poverty and inequality can also be explained by the demographic bonus. Roughly put, this means you have more siblings than children. Latin America’s population growth rates have come down quite a bit, which has contributed to a better standard of living.

(Figure 4)

Here is the breakdown of poverty shifts in the region between the years 2003 and 2013. The red bars reflect job creation and the grey bars represent redistribution. On the right side, we have the regional average, with the 3/4 – 1/4 ratio I explained before.

But if you see countries on the left, like Nicaragua, Panama, Dominican Republic, Honduras – poverty reduction is mainly the consequence of redistribution. As we move to the other end of the spectrum, we have countries where poverty reduction was mostly due to economic expansion.

(Figure 5)

Here you have the Gini coefficient, which as gone down in all subregions.

(Figure 5b)

And here it is broken down by country. Though income inequality is not the only inequality in the region, you can see the average reduction of about 1% per year between the years 2000 and 2013. 16 out of 18 Latin American countries managed to reduce inequality in this period.

Again, Latin America is the only region in the world where, during this period, both poverty and inequality went down. Countries like China and India made significant reductions in poverty, but inequality in those countries and elsewhere has gone up. However, Latin America continues to be the most unequal region in the world.

Meeting rising demands with slower growth

This brings us up to date. As you know, Latin America has entered a period of slower economic growth – though with important differences across countries. The region as a whole contracted in 2015 by about 0.3% though this was hugely influenced by negative growth rates in two large economies, Brazil and Venezuela. The rest of the region grew at a modest though relatively acceptable pace. 16 countries grew above 2%; eight countries grew more than 3%, surpassing the world average. Projections for 2016 are similar.

(Figures 6 and 7)

It is against this backdrop that Latin American governments are now tasked with a triple challenge:

to preserve and deepen the social gains, protecting the most vulnerable sectors of society;

to meet the demands of the new middle classes, providing better public services, raising the quality of education, health, transport, etc.; and,

to enhance productivity through innovation, investing in science and technology, promoting an ambitious digital agenda to transition towards knowledge-based economies, and improving public sector transparency and efficiency.

(Figure 8)

First off, there are pending items on the social agenda. As you can see in this graph, the poor and the vulnerable largely lack social protection. They lack job stability, social security, pensions, health coverage. More than 70% of those living with less than 4 dollars a day work in the informal sector and lack any means of social protection. They are completely exposed to adverse shocks.

In vulnerable sectors, about half of people are also completely at the margin. They can very easily fall back into poverty. Even in the middle-class, more than a third lack social security.

(Figure 9)

Here we can see the stagnation in poverty reduction at levels that are still too high. Latin America has an excess in poverty and an excess in inequality, which are eating away its economic prospects.

How will we finance the pending social agenda? There is less fiscal space than before and tax reform – although badly needed – seems unlikely.

At the same time, we know that public policies that were very successful in the past are not what is needed for the future. We did a good job but we need second-generation social policies.

Over the course of the next few years, Latin American countries will have to increase significantly the quality of public services, in particular the quality of education. If the poor attend bad schools and the rich attend great schools, we will never close the income gap and the intergenerational transmission not just of poverty but also inequality. The same goes for health.

We must strive to overcome that false dichotomy that says: "first comes access and then comes quality." We need both! Especially when it comes to higher education, where we often hear people arguing that tertiary education is somehow a luxury investment that countries need to wait to make after achieving universal primary and secondary schooling. We need better education in all levels. 70% of university students in Latin America are first generation in their families to attend college. Tertiary education enrollment in the region doubled over the last decade. How will we ensure that those students are well trained to enter the labor market? They will expect good wages. They will expect good working conditions. We must see that they are able to find them.

A productivity revolution

Latin America's challenges are not just economic – they are also political. Will governments, will public institutions keep up with growing expectations while still pushing forth the necessary reforms to compete in the globalized economy?

The region needs a productivity revolution. It needs to do the microeconomic homework that it neglected in the past. This will require a broad and dynamic dialogue between the public sector and the private sector, in all areas. For example, Latin American needs to double current investment in infrastructure and logistics to close the gap with Asian countries. This will require public-private partnerships of great scale, which cannot happen unless both the general public and economic actors trust the government.

We also need better communication between the private sector and academia, ensuring that universities and technical schools are providing students with the skills that are needed in the labor market.

I remain cautiously optimistic. A young, empowered, educated middle class is demanding transparency and accountability, efficiency and efficacy, better policies and better public services. Institutions must heed these demands through innovation, knowledge, research, science and technology, and education.

Thank you very much.