

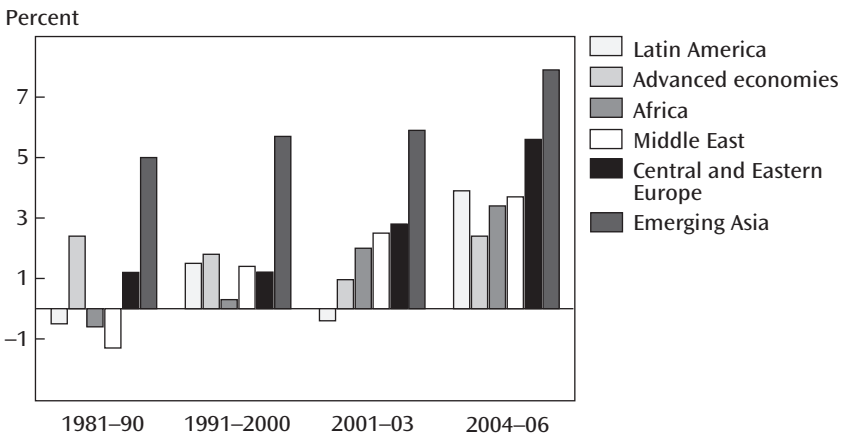
INTRODUCTION

Giving Latin America's Majority a Fair Chance

In the 1990s, most countries of Latin America firmly embraced the economic reform package that has come to be called the Washington Consensus.¹ The policies included in the package emphasized price stabilization and structural adjustment measures such as privatization, reduction of import tariffs, liberalization of local financial markets, and opening of economies to foreign investment—all with the objective of making the economies more efficient and competitive, in the hope that the resulting growth would trickle down. But more than a decade of such open market economic reforms in Latin America failed to deliver much in the way of growth or social progress. Per capita income growth in the region during the 1990s lagged behind that of the advanced economies and emerging economies in Asia (figure 1). That lag has led to anxiety and frustration—with market reforms, with the political process, and with the way democracy is working.

The early part of the new century did nothing to bring a new sense of promise. Latin American economies continued to suffer from the wave of financial turbulence that started in the late 1990s, with several countries falling into crippling banking and currency crises—for example, Ecuador

1. See Williamson (1990) for the original set of reforms associated with the Washington Consensus. General statements about Latin America in this book refer to continental Latin America excluding Belize, French Guyana, and Suriname (Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay, and Venezuela), plus the Dominican Republic.

FIGURE 1. Real Per Capita Growth, Various Years

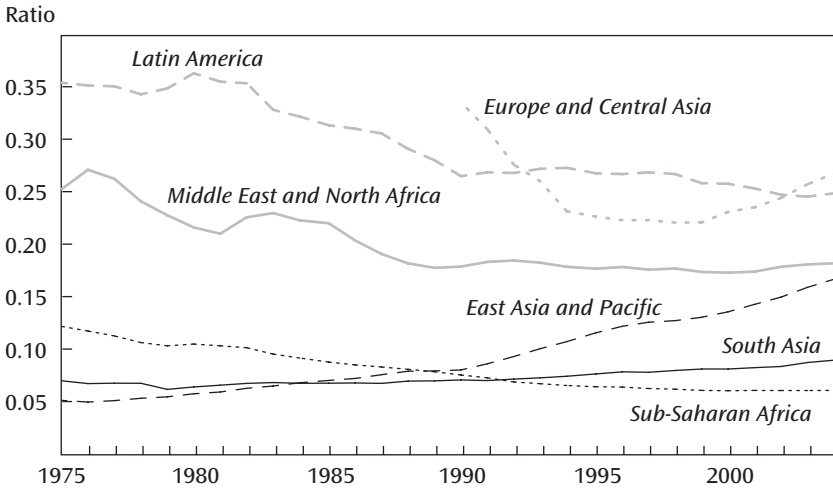
Source: IMF (2007a).

(1999–2000), Argentina (2001–02), Uruguay (2002), and the Dominican Republic (2003). Not surprisingly, during 2001–03 per capita income growth in the region was negative, even as all other regions in the world were experiencing positive growth in per capita income.

Since 2003, however, Latin America’s macroeconomic performance has improved significantly relative to its performance over the past two decades or so. Per capita income rebounded while inflation remained low. Progress was underpinned by generally more robust fiscal and monetary policy and greatly aided by a remarkably benign external environment (high global liquidity, low international interest rates, high commodity prices, and intensified cross-border market integration). Still, compared with trends in other regions in the world, the most recent Latin American trend has not been especially stellar. While per capita income growth in Latin America during 2004–06 exceeded that of the advanced economies and Africa, it was substantially below that in other regions, especially emerging Asia but also central and eastern Europe. The post-2003 increase in growth was hardly sufficient to arrest the long-term trend in Latin America whereby its per capita income has diverged more and more from that in OECD countries (figure 2).

Moreover, the macroeconomic improvement in the most recent period has not dispelled the disenchantment that Latin Americans feel with market-

FIGURE 2. Per Capita Income Relative to That in OECD Countries, 1975–2004^a

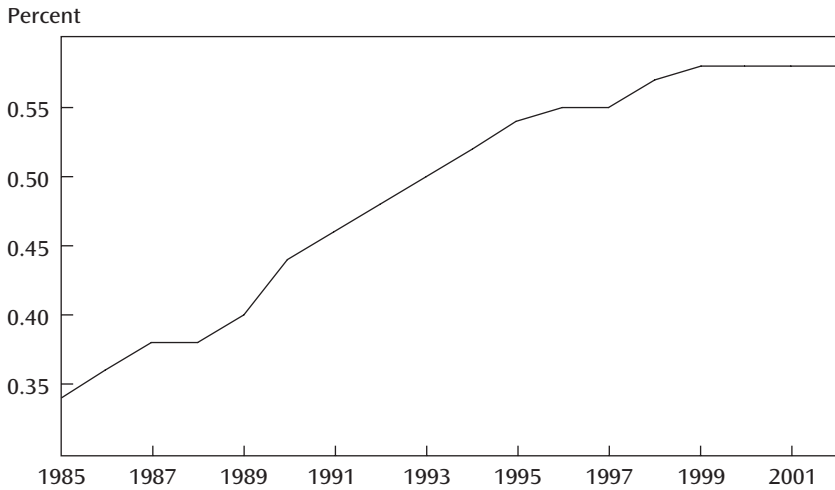


Source: WDI (2006).

a. Purchasing power parity, in current international dollars.

oriented reforms, their deep concerns about economic insecurity, and their frustration with the functioning of political systems. To be sure, technical analyses of the effects of structural reforms—trade and financial liberalization, opening of capital markets, privatization, and deregulation—suggest that Latin America would have been worse off without them. Per capita income and output would have been lower, volatility higher, and poverty deeper.² But the fact is that structural reforms (with the possible exception of financial sector reform) have not been politically viable and have stalled in the majority of Latin American countries since 1999 (figure 3). Recent public opinion polls do show a rising share—albeit from a relatively low level—of Latin America’s population believing that the economic situation today is better than the past and is likely to

2. Lora and Panizza (2002) estimates that reforms increased annual growth rates by 1.3 percent on average in 1991–93, 1 percent in 1994–96, and 0.6 percent in 1997–99, generating a cumulative increase in the region’s average per capita income of 11.4 percent. See also Escaith and Morley (2001) and Loayza, Fajnzylber, and Calderón (2005) for other estimates of the impact of reform on growth in Latin America.

FIGURE 3. Structural Reforms Index, Average for Latin America^a

Sources: Lora (2004, 2001).

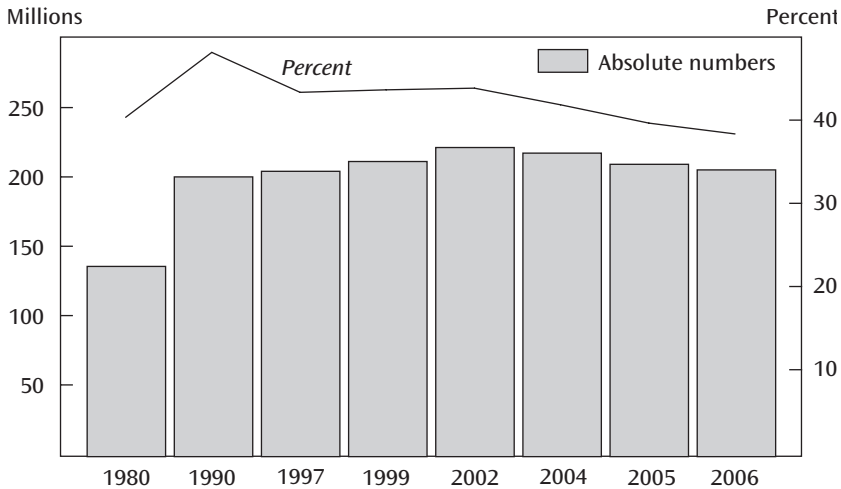
a. Extent of reforms as percent of total possible reforms.

improve further in the near future, a belief that is consistent with the recent increase in per capita income growth. However, they also show that Latin Americans are resentful of the reforms, especially privatization; tired of high unemployment and stagnant wages; and increasingly worried about violence, crime, and delinquency. Although a majority of those surveyed in 2006 endorsed democracy as the most preferable form of government, they tended to believe that their countries were ruled for the benefit of a few, self-serving, powerful groups, and they were dissatisfied with the actual functioning of their democracies.³

Those perceptions are not independent of Latin America's very slow progress in reducing poverty and its offensively high and persistent inequality in the distribution of income and assets. The share of the population living below the poverty line (as measured by ECLAC) fell only marginally from the early 1990s, to about 40 percent in 2005–06, while the number of poor people in 2006 was the same (around 205 million) as

3. Latinobarómetro (2006). Latinobarómetro is an annual public opinion survey of approximately 19,000 interviews in eighteen countries in Latin America.

FIGURE 4. Latin American Population Living under the Poverty Line, 1980–2006^a



Sources: ECLAC (2006a).

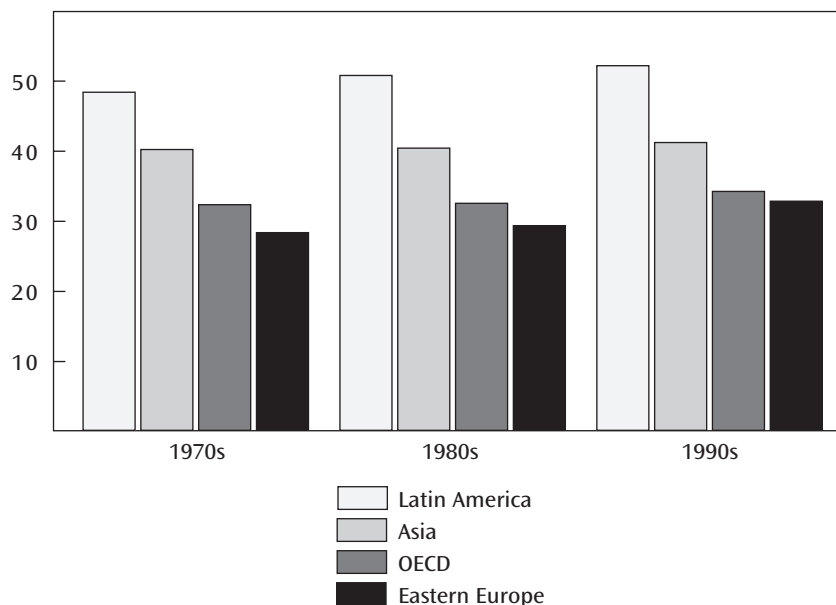
a. Based on special tabulations of household surveys in eighteen countries in the region, plus Haiti.

in 1997 (figure 4).⁴ At the same time, measured income inequality in Latin America remained among the highest in the world and in some countries has increased since the early 1990s (figure 5). And while certain measures of living conditions—infant mortality, completion of primary school, and access to clean water—have improved significantly, other key measures, such as urban violence and crime, have deteriorated alarmingly throughout most of the region.⁵

4. ECLAC (2006a). ECLAC’s poverty line is defined as “the minimum income household members must have in order to meet their basic needs.” That income is based on the cost of a basic food basket in each country that takes into account consumption habits, availability and relative prices of foodstuffs, and differences between metropolitan and other urban and rural areas, to which is added an estimate of the resources that households need to cover their basic non-nutritional needs. ECLAC (2006a) estimates that the monthly equivalent in dollars of the poverty lines in the region varies between US\$45 (Bolivia) and US\$157 (Mexico) in urban areas and between US\$32 (Bolivia) and US\$98 (Mexico) in rural areas.

5. On health and education indicators, see, for example, ECLAC (2006a, 2005) and PREAL (2001, 2006); on crime and urban violence, see Heinemann and Verner (2006) and Londoño and Guerrero (1999).

FIGURE 5. Gini Coefficients of the Distribution of Household Per Capita Income, Various Regions and Years^a



Source: De Ferranti and others (2004).

a. Africa is not included because not enough observations on income inequality in that region are available.

From the discussion above, two disturbing facts stand out. First is the contrast between the intensity of the reform effort in the 1990s and the modest results of that effort—some growth, little change in poverty, and stubbornly high inequality. Second is the contrast between the recent significant recovery of growth with low inflation and the lingering strong sense of frustration with market-based reforms as well as with the functioning of the political systems. These facts have sparked a heated debate among economists and policymakers on the shortcomings of the reform agenda—whether the problem has been too little or too much market reform or the wrong types or sequence of reforms.⁶

6. See, for example, Rodrik (2006, 2005); Zettelmeyer (2006); Loayza, Fajnzylber, and Calderón (2005); Kuczynski and Williamson (2003); Lora and Panizza (2002); Ocampo (2002, 2004); Rojas-Suarez and Johnson (2008, forthcoming); and Singh and others (2005).

In this book we take the view that the problem was not so much a shortage of reforms per se but that the various reform packages were missing an authentic and explicit concern with equity. We believe that the lingering social and political malaise in Latin America reflects in large part the sense that economic arrangements in the region have been unfair for far too long. On that score, the market reforms of the last fifteen years may have made things worse—or at least failed to make them better.

This central problem with the reform agenda since the 1990s—the lack of any explicit inclusion of equity concerns—undermined the potential benefits of reforms for social cohesion, undercut the enthusiasm for further reform, and may even have reduced some of the benefits of reforms for growth, although the last effect is difficult to demonstrate.⁷ The reform packages of the 1990s did not systematically include features aimed directly at reducing inequity. Even if the reform agenda of the 1990s yielded faster overall growth and hence faster declines in poverty than would otherwise have occurred, it has not resulted in greater equality of opportunity, let alone in lower measured inequality. It is therefore not surprising that market reforms that focused on increasing efficiency and competitiveness failed, by themselves, to alter the perception that the region's economies work unfairly.

The growing anxiety stemming from perceptions of unfairness has been reinforced by the challenges that come with globalization.⁸ Globalization's intensification of market competition has accelerated the Schumpeterian process of “creative destruction,” whereby inefficient businesses are pushed out of the market by efficient ones.⁹ That acceleration has raised economic uncertainty, especially for unskilled workers who feel at the mercy of global forces that they cannot control. The resulting sense of

7. For preliminary evidence that initial inequality may itself limit reform efforts (including but not necessarily reform of the labor market specifically), see Behrman, Birdsall, and Pettersson (2008, forthcoming).

8. See, for instance, De la Torre, Levy-Yeyati, and Schmukler (2002); Calvo (2005); De Ferranti and others (2000); and Rodrik (1997).

9. Economist Joseph Schumpeter proposed the idea that a market economy ensures growth by allowing new, better companies to topple the old through a process that he called “creative destruction,” which is essential for sustaining long-term growth in market economies. Schumpeter believed that entrepreneurs are the ones who drive economies, generating growth and, through their successes and failures, setting business cycles in motion (Schumpeter 1975).

insecurity is of course much greater in countries where social safety nets are weak or truncated and where human capital (due to lack of educational and retraining opportunities) is inflexible, as those factors make the adjustment toward new employment unduly protracted and painful.

In short, we take the position that the reform agenda in the region has been incomplete—that it has left out what we call, in an allusion to a political expression invoked in the United States in the 1970s, the “silent majority.” The economic reforms that did take place, with their emphasis on stability and competitiveness, were not meant to address a deeper underlying problem in Latin America: the poor distribution of opportunities and productive assets across households, regions, ethnic groups, and other divides. Measured income inequality in Latin America is simply a good proxy for the limited access of the poor to economic and social assets, of the low returns on the assets that they do have, and of their limited access to opportunities for advancement.¹⁰ Given the low level of education of the silent majority (see chapter 9), and their poor access to land and credit (chapters 7 and 5), it is not surprising (at least in retrospect) that the majority of households did not benefit from rising wages for educated labor and could not exploit higher returns to business and other investment. Furthermore, the lack of explicit attention to equity considerations in economic reforms happened at the time when globalization was on the rise. Hence, growing economic insecurity was added to a long-standing perception of systemic unfairness, and that combination contributed significantly to Latin Americans’ frustration with market reform.

As we write, in late 2007, the risk of a new round of populism and protectionism hangs over the region—an unsurprising result of historic injustices combined with, in most countries, rising anxiety about the future among the silent majority. That risk suggests that attacking inequality is a political as well as an economic necessity. Income inequality in Latin America is largely a function of the extremely high concentration of income in

10. Birdsall and Londoño (1997) shows that education and land inequality measured at the economy-wide level reduces the income growth of the poorest quintile twice as much as it reduces the income growth of the average household. The study also shows that Latin America is not different from other regions in terms of the effects of income distribution on growth; it is its much higher inequality in the distribution of land and education that makes it an outlier where growth is even lower than its income inequality alone can explain. See also Deininger and Olinto (2000).

the top decile. Indeed, measured inequality would be similar to that in the United States, except for the higher proportion of income captured by the richest 10 percent of households in Latin America.¹¹ The concentration of income at the top in Latin America reflects and reinforces a long history in which the economic elites were politically powerful—indeed, the economic and political elites often were one and the same, and they could abuse their political position to reinforce their economic privileges.¹²

What alternatives are there to the ultimately destructive course of populism and protectionism? What policies and practices can attack injustice while creating sustainable economic opportunities for all and helping unleash more fully shared growth? What concrete policy actions will give the region's silent majority the sense that they and their children have a chance for a better future?

In this book we suggest that Latin America should turn to a new focus—on equity, or fairness. We look beyond the Washington Consensus to an agenda explicitly designed to improve job opportunities and create assets for the region's silent majority—an agenda that attacks inequality in the distribution of productive assets. We propose a “toolkit” of twelve sets of policies, mostly economic in nature, aimed specifically at making economic life in Latin America more fair.

At the same time, we have selected policies that do not sacrifice growth. What is known about the links among poverty, inequality, and growth in developing countries suggests that opportunities abound for win-win solutions—that is, solutions that can lead to simultaneous advances in growth and equity. Because the room for win-win solutions is larger where financial markets and other markets are weak and regulatory arrangements to compensate for their inherent imperfections are inadequate, it is larger in Latin America than in developed countries.¹³ In effect, where financial and labor markets do not work well, the poor and the unskilled are more likely to be elbowed out of access to credit, jobs, and other opportunities to be

11. IDB (1999, p. 16). This comparison is for the late 1990s and does not take into account the growing concentration of income in the top 1 percent in the United States since 2000.

12. Karl (2001) elaborates on the corrosive interaction of economic and political privilege in the region. See Engerman and Sokoloff (2002) for the historic origins of this interaction.

13. Birdsall (2007) emphasizes weak markets and poor government policy as key factors in making inequality a problem in developing countries. See Barro (2000) for evidence that inequality reduces growth more in poor than rich economies.

productive. The opportunities that they lose as individuals and households are lost to the economy as a whole, reducing overall growth. An example is the inability of small business owners with movable collateral to borrow where the legal and regulatory framework does not guarantee that creditors can seize that collateral in the event of default.

In developed countries, by contrast, more competitive markets and stronger institutions help ensure more equitable access, which reduces the room for win-win situations for growth and equity. But where capital and other markets do not work well and government policy and institutions do not either, market and policy failures combine with high inequality to undermine opportunities not only for the poor, but for growth itself. That implies that there is room to reduce inequality while enhancing efficiency and growth.¹⁴ In other words, there need not be a trade-off between “economic” policies—for example, to maintain macroeconomic stability and enhance growth—and “social” policies to reduce poverty and inequality. Indeed, they can be mutually reinforcing.¹⁵ Put another way, there need not be a trade-off between efficiency and equity.

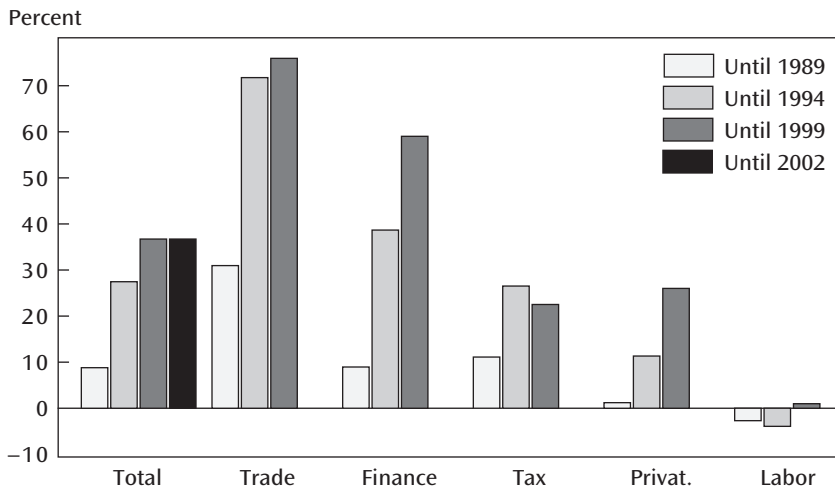
In the remainder of this introduction we set out the facts with respect to growth, reforms, and changes in poverty and equity since the early 1990s. We suggest the relevance to job and wage insecurity of the increasing integration of Latin America into global trade and capital markets and the implications of growing integration for our equity agenda. We then introduce and summarize our agenda for 2007 and beyond in the form of a twelve-part equity policy toolkit.

1990–2006: Economic Reforms, Disappointing Results, Reform Fatigue

In the 1990s, Latin America championed open market reforms. Fiscal and monetary discipline cut the inflation rate to single digits almost everywhere,

14. Birdsall (2007). That is not to say that there can never be a trade-off between growth and inequality. But when inequality is as high as it is in Latin America, it is probably a source of inefficiency, so the likelihood of a trade-off is smaller. There is, in other words, plenty of room for achieving both, well inside what economists call the production frontier defining the trade-off between equity and efficiency. Birdsall (2001) defines “equity” as distinct from inequality.

15. For essays on this theme applicable to Latin America, see Birdsall, Graham, and Sabot (1998).

FIGURE 6. Progress with Structural Reforms in Latin America^a

Sources: Lora (2004); Lora and Panizza (2002).

a. Extent of reforms as percent of total possible reforms.

and trade liberalization brought average tariffs down from more than 40 percent to nearly 10 percent. Financial liberalization was just as aggressive: direct credit controls were abandoned, interest rates deregulated, foreign direct investment (FDI) regimes opened, and foreign exchange and capital account controls dismantled. Banks, power plants, telecommunications systems, and, to a lesser extent, roads and water services were sold to the private sector (figure 6).

Implementation varied across countries, but the overall quality and extent of economic reforms in Latin America in the 1990s were far greater than at any time in memory. By reducing expenditures, writing off debt (in some cases using proceeds from privatization), and adopting steadier monetary and exchange rate policies, Latin American governments reduced inflation and volatility, at least in countries that escaped the financial crisis of the late 1990s.

But real GDP growth in the region was a modest 1.5 percent per capita per year for the decade—higher than in the crisis-laden “lost decade” of the 1980s but well short of per capita GDP growth in Asia (figure 1) and

of Latin America's own growth in the 1960s and 1970s.¹⁶ Since 2003, the region's economies have done better, expanding at about 3.5 percent per capita per year,¹⁷ bolstered by robust global demand (especially from China) and strong commodity prices.¹⁸ Macroeconomic stability and exchange rate flexibility contributed to the region's improved external sector performance and increased resilience to shocks.

But even with those gains, growth continues to lag that in other parts of the world—including, more recently, Africa and the Middle East, which once trailed Latin America. Most Latin American countries are growing more slowly than the developing world as a whole and, in some cases, even more slowly than the developed countries (figure 2).

Perhaps even more worrisome is the fact that labor productivity growth has been minimal.¹⁹ Compared with investment in the rapidly growing economies of Asia, both public and private investment in science and technology to foster learning and innovation are low in Latin America.²⁰ And

16. Annual GDP growth in Latin America averaged 2.5 percent per capita in 1960–70 and 3.2 percent per capita in 1970–80 (ECLAC 2004b).

17. Real growth in Latin America is projected to be around 4.9 percent (3.5 percent per capita) in 2007 and 4.2 percent (2.9 percent per capita) in 2008 (IMF 2007a).

18. Latin American exports grew by 21 percent in 2006 (building on 19 percent growth in 2005 and an exceptional 23 percent increase in 2004), largely as a result of the robust growth in the United States and the strong demand for commodities from rapidly expanding Asian economies, particularly China and India. Countries like Argentina, Brazil, Chile, and Peru benefited significantly from China's strong demand for soy and copper. Net oil exporters such as Colombia, Ecuador, Mexico, and Venezuela also posted strong trade performances. In 2005, the overall price index for commodities exported by Latin America rose by 21 percent (15 percent excluding energy products such as crude oil, petroleum products, and natural gas). In 2004, average prices for commodities exported by the region increased by 29 percent (Cornejo Azzarri, Mesquita and Shearer 2006; ECLAC 2006c, 2006d; IMF 2006a).

19. Between 1990 and 2005, labor productivity growth averaged 0.4 percent in Latin America, while it was 3.3 in emerging Asian economies and 1.5 in the advanced economies over the same period (IMF 2007b). IDB (2004a) shows that between 1985 and 2000, nine Latin American countries experienced negative growth rates in productivity per worker (Panama, Venezuela, Colombia, Honduras, Ecuador, Bolivia, Paraguay, Peru, and Nicaragua) and only four (Chile, the Dominican Republic, El Salvador, and Uruguay) exhibited growth rates above 1 percent a year. The study finds no statistically significant difference in the rate of labor productivity growth in the region for 1985–90, 1990–95, and 1995–2000. Low labor productivity growth explains the low wage levels and painfully slow increases in wages in Latin America over the last decade (Ocampo 2004).

20. Malkin (2006) shows that Latin America invested US\$11 billion on research and development (R&D) in 2002, US\$1 billion less than South Korea's R&D investment in 2003. Ten years ago, China and Latin America shared similar levels of R&D investment (0.6 percent

despite clear improvements in fiscal positions, public debt levels remain high—averaging an estimated 52 percent of GDP in 2006—and far exceed levels during the mid-1990s.²¹ Although there is some evidence of export diversification, most countries are still heavily dependent on primary commodity or “maquila” (apparel) exports.²² With trade overall constituting a low percentage of GDP (figure 7) and debt remaining high, many economies in Latin America continue to be vulnerable to shifts in financial market sentiments and declines in commodity prices, even given their accumulation of high reserves (as of late 2007). Finally, Latin American countries (except Chile) rank poorly in most indexes measuring ability to compete in the global economy.²³

Relatively slow growth and commodity dependence have added to the sense of vulnerability in the region, especially to competition from Asia. While China is an important and growing market for Latin American commodity exporters, it also is a significant competitor in the manufacturing sector.²⁴ China’s accession to the World Trade Organization (WTO) in late 2001 and the removal in 2005 of OECD quotas on textile

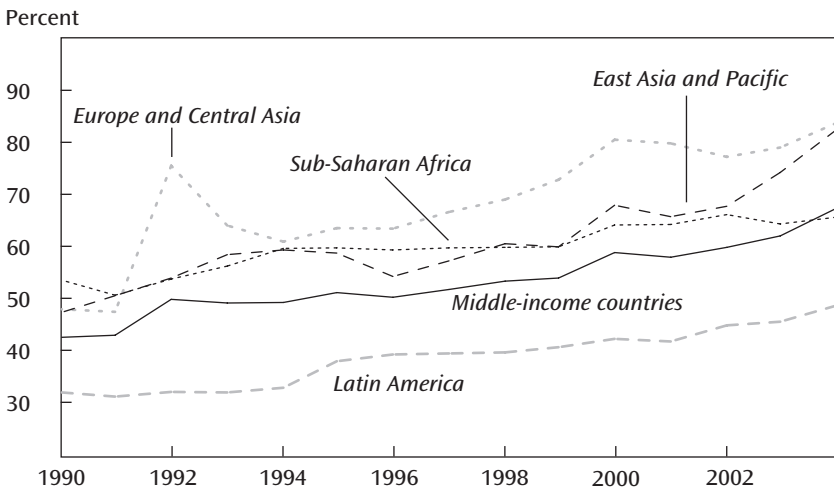
of GDP). By 2005, China had more than doubled its ratio of R&D investment, to 1.4 percent of GDP, while Latin America saw overall R&D investment shrink by 3 percent in the same period.

21. IMF (2007b); reference is to weighted averages. Between 2002 and 2006, Latin America’s debt-to-GDP ratio dropped 24 percentage points, reflecting the effects of strong primary surpluses, faster growth, and appreciating exchange rates as well as relatively benign global circumstances (IMF 2006a). More public debt is now domestic rather than external, but it continues to be short-maturity debt, implying that governments have traded a currency for a maturity mismatch and still face high rollover risk in the event of a financial or other crisis. See also IDB (2006).

22. Commodities constitute about 50 percent of Latin America’s exports, and the share in the Andean region is even higher, about 84 percent (ECLAC 2007a). Most countries still specialize in goods that are not dynamic in world trade. The little diversification that has taken place recently in Latin America (for example, in Mexico) owes more to the decisions of foreign companies and preferential access to the U.S. market than to the traditional tools of export promotion and development. Central American countries have succeeded at curbing dependency on traditional commodity exports, but El Salvador and Honduras are now increasingly concentrated on exporting maquila manufactures (goods assembled from imported inputs for export). Export concentration has increased in Guatemala in recent years (ECLAC 2006e, 2004a; ECLAC-SIGCI 2007; World Bank 2005a; IMF 2007c).

23. See, for example, the World Bank’s Doing Business indicators (World Bank 2006a; www.doingbusiness.org) and the World Economic Forum’s Global Competitiveness Index (Lopez-Claros and others 2006).

24. For further discussion, see Perry and others (2007a); Blázquez-Lidoy, Rodríguez, and Santiso (2006); Schott (2006); Lora (2007); Mesquita Moreira (2007); and Hummels (2006).

FIGURE 7. Trade as a Percentage of GDP, Various Regions, 1990–2004

Source: WDI (2006).

and clothing imports pose a special challenge for producers in Central America. Mexico in particular has an export structure that is very similar to that of China. Once in the top position in the U.S. imports market after Canada, Mexico has seen its share of exports to the United States decline, and its economy is threatened all the more by the eventual erosion of its NAFTA preference, which will come with multilateral liberalization. Other countries in Central America that had taken small steps to get into manufacturing (and services) also are experiencing losses in market share, especially in the United States, to more competitive Chinese and Asian products. Between late 2001 and 2004, China's share of U.S. imports of textiles and apparel doubled from 9 to 18 percent while that of Mexico and the Caribbean dropped by a similar amount.²⁵ So far, analysts who

25. Chinese exports to the United States of textile and apparel products liberalized under phase 3 of the WTO's Agreement on Textile and Clothing (ATC) (for example, selected home furnishings of cotton, selected fabric and yarn products, and several types of commercially important apparel accessories) grew fourfold, and China's share in those categories jumped from 15 to 45 percent between 2001 and 2004. India and Pakistan also saw increases of 29 and 24 percent respectively in their market share over the same period. Mexico's exports of the same products dropped 11 percent, and CAFTA saw an overall decline of

predicted that the combination of proximity and preferences would preserve Latin America's market share have not been vindicated.²⁶

In short, after more than a decade of open market reforms, Latin America still has not found its competitive legs. Although the region is ahead in terms of absolute income, the economic escalator is moving faster in other parts of the world. More than fifteen years after the embrace of market reforms throughout the region, only Chile (where market reforms began earlier) can claim strong and continuous, crisis-free growth.

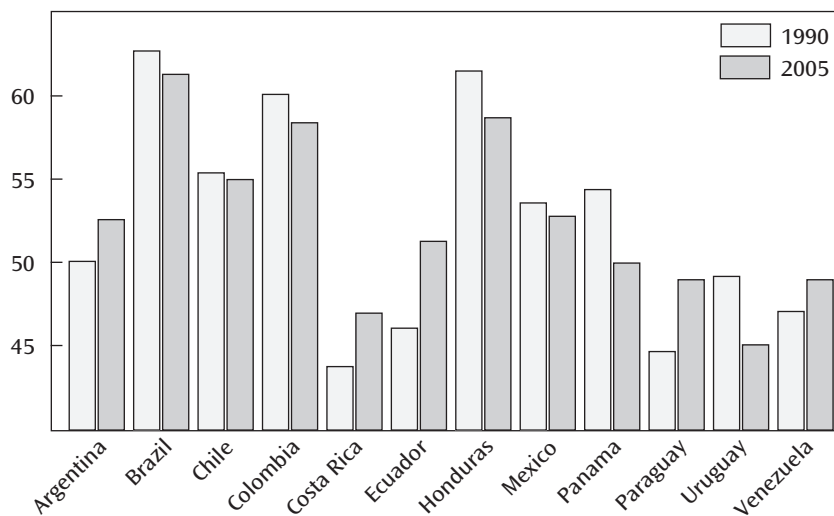
What about poverty and inequality? At the beginning of the 1990s poverty rates declined from their peaks in the late 1980s, helped by reduced inflation. But progress slowed in the late 1990s in the context of low growth and financial crises and recovered in most countries only when economic growth increased in the last few years (2004–06). In 2005–06, close to 40 percent of the region's population still lived in poverty, about the same rate as in 1980, and in absolute numbers another 73 million people had been added to the poverty rolls.²⁷ Even where poverty fell, income inequality stayed high. Between 1990 and 2005, only Uruguay and Panama (and to a lesser extent Honduras) showed any marked improvement in already high levels of income inequality (figure 8).²⁸

5.5 percent in exports in this category, although El Salvador, Honduras, and Nicaragua saw modest increases (Bhattacharya and Elliott 2005).

26. Bhattacharya and Elliott (2005). Several studies show that East Asian suppliers are ahead in adopting technologies that allow them to operate as full-package apparel suppliers (that is, they manage the process from procuring materials and assembling apparel to labeling, packaging, and shipping the product to stores) and to respond rapidly to orders. China has the workforce and the infrastructure to deliver high-quality apparel at competitive prices on a timely basis throughout the world (many Chinese firms are full-package suppliers). India (and perhaps Pakistan) also has an advantage in global textile and apparel markets because it has access to local inputs and a large pool of low-wage workers. Mexico and much of Latin America stand to lose market share because their wages are relatively high (compared with those of other apparel exporters, including China, where manufacturing wages are four times lower than in Latin America) and because Latin American producers have not made the move to providing full-package services (Blázquez-Lidoy, Rodríguez, and Santiso 2006).

27. We are referring to country-specific poverty lines (as measured by ECLAC; see note 4). In countries like Bolivia, Honduras, and Nicaragua—where poverty rates reach or exceed 60 percent—the proportion of the poor failed to drop much if at all between 1990 and 2004–05. Poverty actually increased slightly in Bolivia and also in Paraguay, Uruguay, and Argentina in the same period. In Venezuela, the proportion of poor people rose significantly before dropping again with the boom in commodity prices since 2002 (table 1).

28. On inequality in the 1990s, see also Székely (2001).

FIGURE 8. Gini Coefficients of Income Distribution, Selected Latin American Countries^a

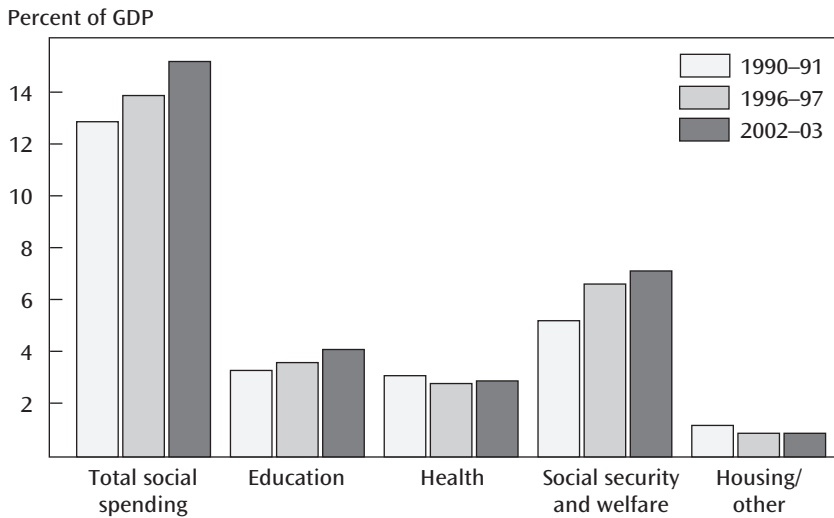
Source: ECLAC (2006a).

a. Data are for 1990 and 2005 or closest available year. For Ecuador, Panama, and Uruguay, data refer to urban areas. Data for Argentina refer to Gran Buenos Aires and for Paraguay, to the Asunción metropolitan area. Gini coefficients come from different household surveys and may not always be comparable.

Such results were all the more frustrating considering that since the 1980s Latin America has seen significant increases in the level of public spending on basic health and education (figure 9); devolution of revenue and authority for local services to local governments; and institutional innovations such as programs providing cash transfers to participants who keep their children in school or who use health services, which target the poorest households in Mexico, Brazil, and Chile (see chapter 3 in this volume).²⁹

Not surprisingly, public opinion surveys in the early 2000s indicated that in country after country, citizens were discouraged. The majority of Latin Americans surveyed believed that their economies and democracies

29. On the recent trends and orientation of public social spending in Latin America see, for example, ECLAC (2005, 2001); see also Clements, Faircloth, and Verhoeven (2007). For an overview of the gradual change over time in the criteria to design and implement social policies and programs in the region, see Birdsall and Székely (2003); and Cohen and Franco (2006).

FIGURE 9. Public Social Spending in Latin America

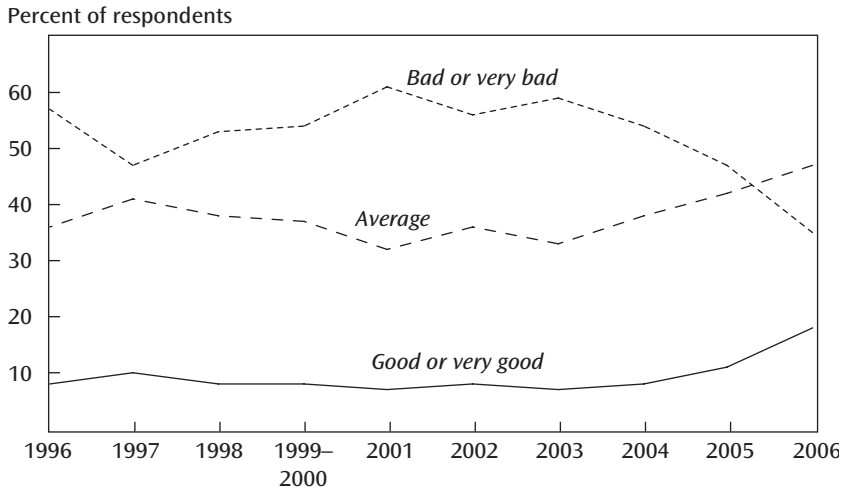
Source: ECLAC (2005).

were not functioning well (figures 10a and 10b), and that their quality of life was lower than that of previous generations (figure 10c). In the same surveys, citizens consistently expressed the sense that the region's societies were fundamentally unjust (figure 10d)—no doubt a reflection of the underlying inequity in opportunities for schooling, jobs, and participation in the political system.

There has been a recent increase, consistent with the current gain in growth, in the proportion of Latin Americans who believe that their economies are improving (figure 10a). However, opinion surveys highlight the political unpopularity of reforms across the region. In country after country, voters are increasingly unhappy with the market reforms of the 1990s and doubtful about their potential benefits (figure 10e).³⁰ That sentiment was especially strong among middle-income families. Opposition to privatization, for example, increased in the late 1990s among survey respondents with some secondary or technical education from more than

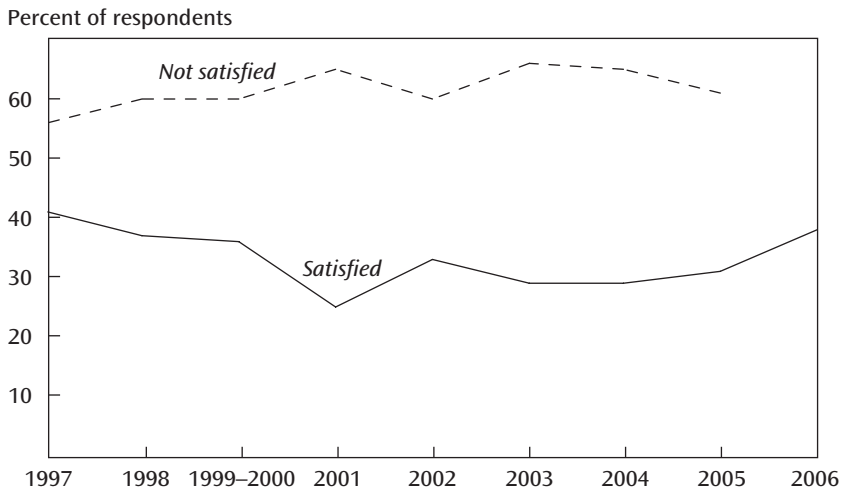
30. On the unpopularity of reforms in Latin America, see also Panizza and Yañez (2006); Lora and Olivera (2005); and Lora and Panizza (2002).

FIGURE 10 a. How would you describe your country's present economic situation?



Source: Latinobarómetro (2006).

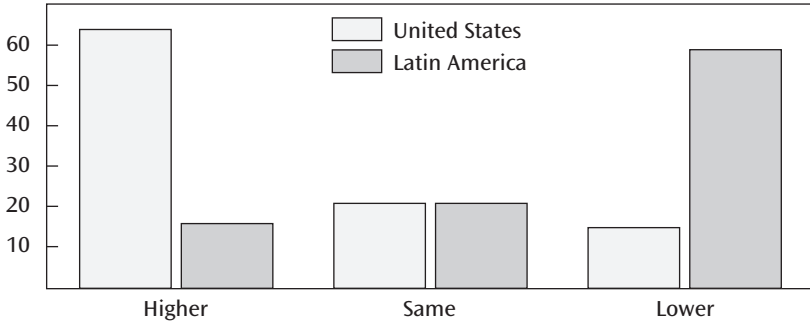
FIGURE 10 b. How satisfied are you with the way that democracy works in your country?



Source: Latinobarómetro (2006).

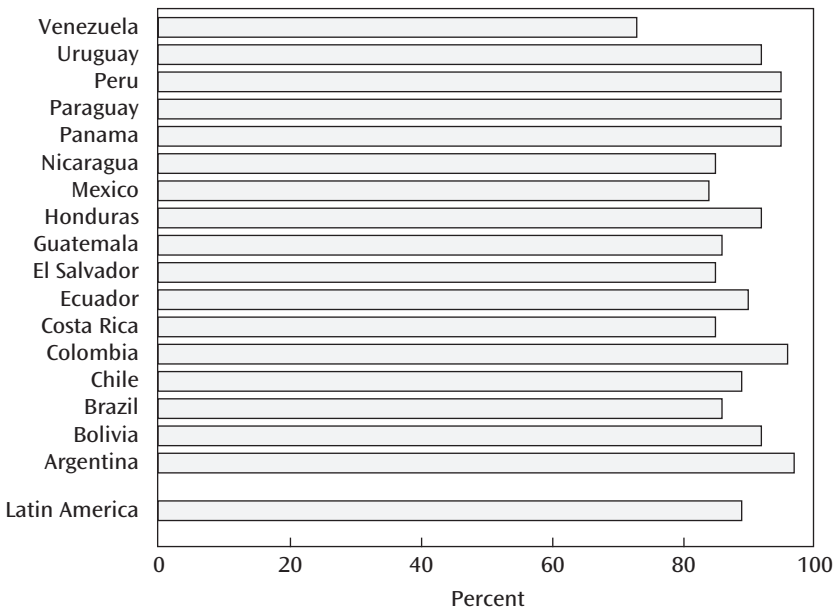
FIGURE 10 c. Would you say that your quality of life today is higher than, similar to, or lower than that of your parents' generation?

Percent of respondents, 2001



Source: Graham (2002), from U.S. General Social Survey (2001) and Latinobarómetro (2001).

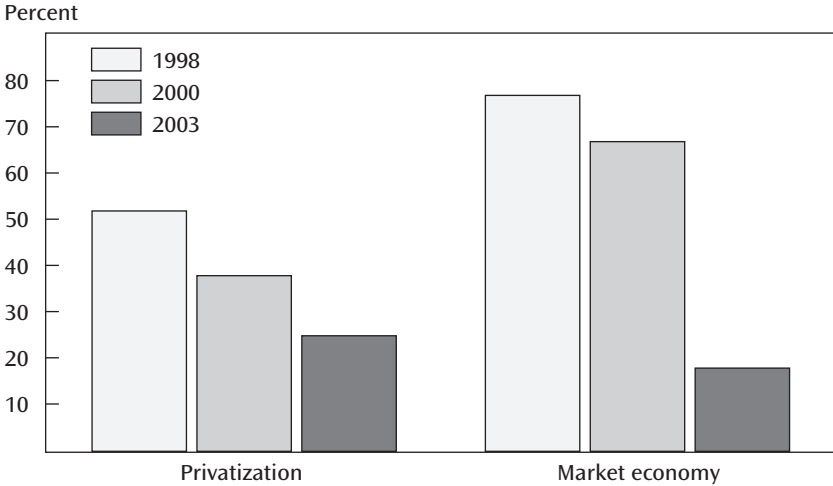
FIGURE 10 d. Do you think that the income distribution in your country is very fair, fair, unfair, or very unfair?^a



Source: Latinobarómetro (2001).

a. Percent responding unfair and very unfair, 2001.

FIGURE 10 e. Support for Privatization and the Market Economy in Latin America, 1998–2003^a



Source: Panizza and Yañez (2006) based on Latinobarómetro surveys.

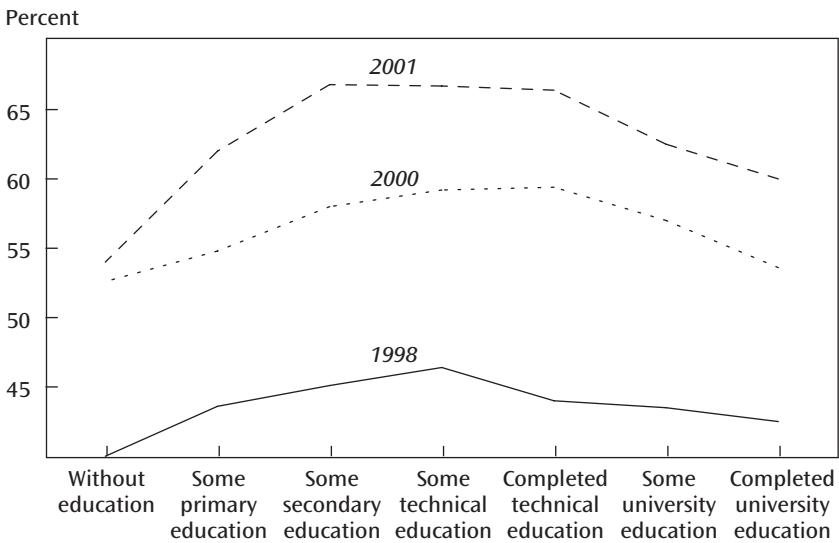
a. Percent of respondents who think that the privatization process was beneficial for the country; percent of respondents who think that a market economy is good for the country. Note that Latinobarómetro surveys from 1998 and 2000 ask “Do you think that a market economy is good for the country?” For the year 2003 the question was “Are you satisfied with the functioning of the market economy?”

45 percent to more than 65 percent, while the increase for the overall population was from 40 percent to 50 percent (figure 11).³¹

In all, the adoption of the Washington Consensus turned out to be a costly political affair for reformers. A few incumbents were favored by voters for their success in taming inflation, but little electoral recognition was accorded those who advanced the rest of the macroeconomic and structural policies deemed necessary to accelerate growth and ensure stability.³² It is

31. Lora and Panizza (2002). On the middle-income issue, see Birdsall and Menezes (2005) and Birdsall (2002). Birdsall, Graham, and Pettinato (2000) uses Latinobarómetro survey data on attitudes toward reform to assess the extent to which attitudes differed among poor, middle-income, and rich respondents. They report regression results indicating that middle-income respondents were more supportive of reforms early in the process and were least supportive later, indicating an increasingly negative overall attitude.

32. Lora and Olivera (2005) found that between 1985 and 2002 in seventeen Latin American countries the incumbent’s party was rewarded in presidential elections for reductions in the rate of inflation and (although less) in legislative elections for increases in the rate of growth. But the electorate seems averse to pro-market policies, irrespective of their effects

FIGURE 11. Negative Opinion of Privatization, by Educational Level^a

Source: Lora and Panizza (2002). Authors' calculations based on Latinobarómetro 1998, 2000, 2001.

a. Percent of respondents who believe that privatization has not been beneficial. Survey question: "State-run public services of water and electricity have been privatized. Taking into account price and quality, are you today much happier, happier, less happy, or much less happy with privatized services?" Here only "much less happy" and "less happy" responses are illustrated.

no coincidence that since 1999 the structural reform index for Latin America has flattened out (figure 3).³³ Although a widespread reversal of open market policies and a return to the irresponsible populism of earlier decades seems unlikely, the momentum for continued reform has dissipated.³⁴

on growth or inflation. The authors' estimates imply that the typical reduction in the inflation rate—from, say, 20 percent to 8 percent during a president's term—boosts the vote for his or her party by 21 percent. If the same incumbent also introduces the average number of pro-market reforms, however, the party loses 23 percent of the vote on that account. (The evidence of adverse pay-offs in legislative elections is weak.)

33. Since 2000, in Argentina, Uruguay, Brazil, and Bolivia, voters have chosen presidents who emphasized the needs of the poor and working-class population (Juan Forero, "Populist Movements Wrest Much of Latin America from Old Parties," *New York Times*, April 20, 2006, p. A8; "The Battle for Latin America's Soul," *Economist*, May 18, 2006; "The Return of Populism," *Economist*, April 12, 2006).

34. Developments in 2006 in Bolivia—including a decree by President Evo Morales renationalizing oil and gas—suggest that a return to populism in Latin America is not out of the question. In 2007, President Hugo Chávez of Venezuela also announced plans to nationalize

Globalization, Jobs, and Middle-Income Households

Globalization has almost certainly contributed to the growing sense of economic insecurity among the silent majority of middle-income and poor households in Latin America. As with domestic market reforms, the greater integration of Latin America's economies into global financial markets has not worked as hoped or as advertised.³⁵ Along with financial globalization came more frequent financial crises (although not necessarily because of globalization per se), with large economic and political costs. The collapse of the Mexican peso in 1995 was followed by major financial crises in Brazil (1999), Ecuador (1999–2000), Argentina (2001–02), Uruguay (2002), and the Dominican Republic (2003), some of which involved a triple collapse (currency, banking, and debt) and a widespread breakdown of contracts.³⁶ Latin American economies have been especially vulnerable because of their heavy reliance on external savings, relatively high debt levels, and widespread currency and maturity mismatches on debtor balance sheets. The crises probably increased insecurity despite the benefits of the increased foreign direct investment and expansion of investment and export volumes brought by greater integration and open markets.

The silent majority has not escaped the effects of the crises. To be sure, global markets have brought economic insecurity to middle-income households everywhere.³⁷ But in Latin America insecurity is a far greater

energy and telecom companies (Simon Romero and Juan Forero, "Bolivia's Energy Takeover: Populism Rules in the Andes," *New York Times*, May 3, 2006, p. A8; "Now It's the People's Gas," *Economist*, May 4, 2006; "A Hard Bargain," *Economist*, November 2, 2006; "Tin Soldiers," *Economist*, February 15, 2007; Andy Webb-Vidal, "Chávez to Nationalise Telecoms, Power," *Financial Times*, January 8, 2007; Juan Forero, "Chávez Sets Plans for Nationalization," *Washington Post*, January 9, 2007, p. A10; Andy Webb-Vidal, "Chávez Elaborates on Nationalisation Plans," *Financial Times*, February 02, 2007; Benedict Mander, "Venezuela Takes Over U.S. Oil Projects," *Financial Times*, June 26, 2007).

35. For middle-income countries, integration into the world's financial markets has not led to such expected benefits as a truly countercyclical monetary policy, consumption smoothing, deepening and diversification of domestic financial markets, noticeable reduction in the cost of capital, or significant availability of long-duration financial contracts denominated in the domestic currency (De la Torre, Levy-Yeyati, and Schmukler 2002).

36. De la Torre, Levy-Yeyati, and Schmukler (2002); De la Torre, Gozzi, and Schmukler (2007b).

37. See Birdsall, Graham, and Pettinato (2000).

TABLE 1. Poverty Rates in Selected Countries, 1990–2005^a
Percent of population

	1990	1994	1997	1999	2002	2004	2005
Argentina	21.2	13.2	17.8	19.7	41.5	25.9	22.6
Bolivia	n.a.	n.a.	62.1	60.6	62.4	63.9	n.a.
Brazil	48	45.3	35.8	37.5	38.7	37.7	36.3
Chile	38.6	27.6	23.2	21.7	20.2	18.7	n.a.
Colombia ^b	56.1	52.5	50.9	54.9	51.1	51.1	46.8
Costa Rica	26.3	23.1	22.5	20.3	20.3	20.5	21.1
Dominican Republic	n.a.	n.a.	n.a.	46.9	44.9	54.4	47.5
Ecuador ^c	62.1	57.9	56.2	63.5	49	47.5	45.2
El Salvador	n.a.	54.2	55.5	49.8	48.9	47.5	n.a.
Guatemala	69.4	n.a.	61.1	n.a.	60.2	n.a.	n.a.
Honduras	80.8	77.9	79.1	79.7	77.3	74.8	n.a.
Mexico	47.7	45.1	52.9	46.9	39.4	37	35.5
Nicaragua	n.a.	73.6	69.9	n.a.	69.3	n.a.	n.a.
Panama	39.9	30.8	29.7	25.8	25.3	22.4	24.4
Paraguay	n.a.	49.9	46.3	49	50.1	59.1	55
Peru ^b	n.a.	n.a.	47.6	48.6	54.8	54.7	51.1
Uruguay	17.9	9.7	9.5	9.4	15.4	20.9	18.8
Venezuela	39.8	48.7	48	49.4	48.6	45.4	37.1

Source: ECLAC (2006a).

a. Data are for 1990, 1994, 1997, 1999, 2002, 2004, 2005 or closest available year. For Ecuador, Panama, Paraguay, and Uruguay, data refer to urban areas. Data for Argentina are for metropolitan areas.

b. New measurement starting 2001, data are not strictly comparable with previous years.

worry for far more households, because “middle-income” households are far from “middle class.”³⁸ In the United States, the median national income is about 73 percent of average national income.³⁹ In Brazil, it is only about 33 percent of average income, and in Honduras (between 1989 and 1996) it was lower than the World Bank poverty line of US\$2.00 a day.⁴⁰

Because so many middle-income households are close to the poverty line, short-term economic downturns like the one in Argentina in 2001 can create an entire class, the newly poor. Indeed, by 2002, as many as 45 percent of individuals in Argentina were counted as poor (almost double the share of just two years earlier) (table 1). Crises have tended to

38. See Birdsall and Menezes (2005).

39. DeNavas-Walt, Proctor, and Hill Lee (2006, table A-1); reference is to median and average national household income.

40. Birdsall (2002). In Chile, median income has been about half of average income.

increase poverty, with the incidence remaining higher even after a crisis has passed.⁴¹

In retrospect, the failure to focus on job creation in the 1990s may have undermined the success of the standard market reforms—trade liberalization, privatization, and opening of the capital markets—and hampered the region’s ability to capitalize on the potential benefits of globalization.⁴² Jobs and the labor market were not part of the reform agenda of the 1990s. Job growth was extremely weak in the 1990s, about 2.2 percent a year, and it failed to keep up with the rate of growth of the working-age population; moreover, it was concentrated for the most part in low-productivity activities.⁴³

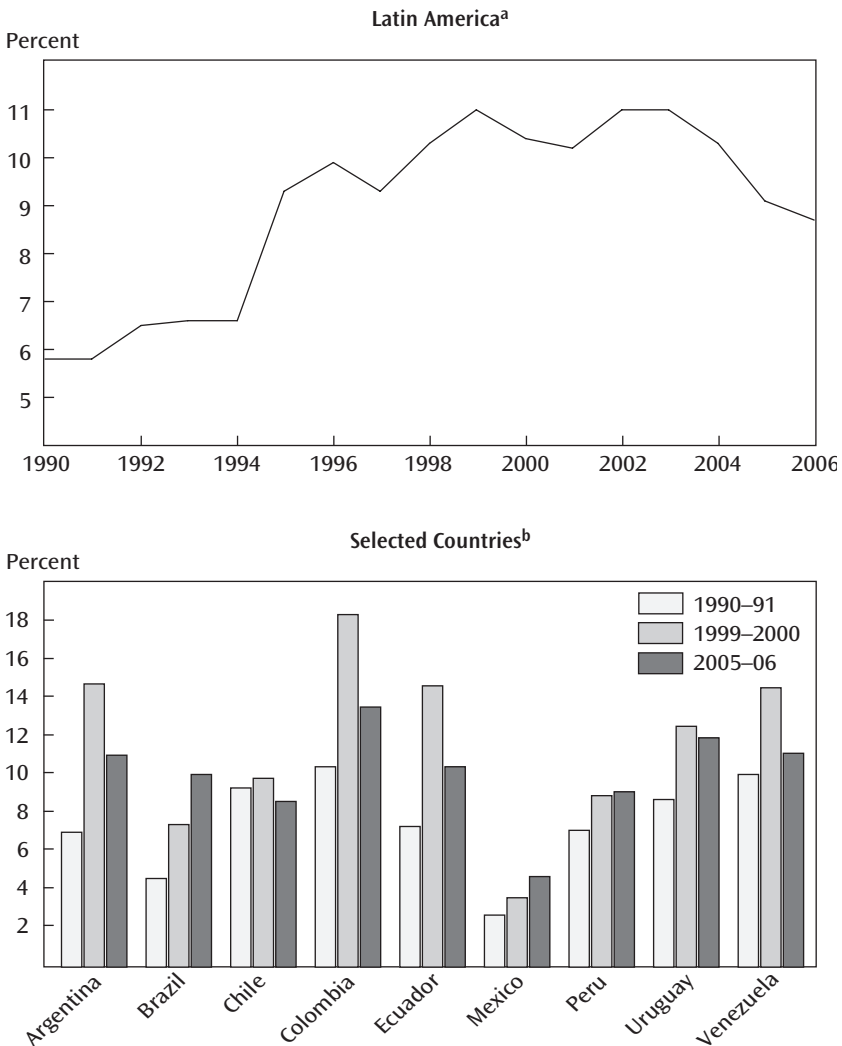
At the end of the 1990s, unemployment in most countries was as bad as or worse than it was at the beginning (figure 12). It remained high through the early 2000s and reached record levels in 2002–03.⁴⁴ Indicators of deterioration in job quality were even more widespread. Almost everywhere, salaried employment decreased as a percentage of total

41. See Lustig and Arias (2000). Cline (2002) estimates that at least 40 million people were pushed into poverty during the crises in Mexico (1995), Thailand and Indonesia (1997), Korea and Russia (1998), Brazil (1999), and Argentina and Turkey (2001). Poverty increased significantly more in countries in which crisis management was unsuccessful—for example, Indonesia, Russia, and Argentina.

42. Evidence in Heckman and Pagés (2004, 2000) suggests that labor market inflexibility (severance payments and other forms of employment protection) in Latin America has a significant negative impact on the level and distribution of employment and substantially affects the efficiency of labor markets. In particular, job security reduces the job prospects—and possibly wages—of younger and less experienced workers. Evidence in Besley and Burgess (2004) from another setting, India, suggests that job protection and other rigidities inhibited productivity, output growth, investment, and job growth in the registered manufacturing sector between 1958 and 1992. Labor inflexibility (or pro-worker regulations) was also shown to increase informal sector activity. The authors’ empirical model compares the experience of two states and predicts that without its pro-employer reforms, the state of Andhra Pradesh would have registered manufacturing output that was 72 percent of its actual 1990 level and manufacturing employment that was 73 percent of its 1990 level. Had the state of West Bengal not passed any pro-worker amendments, it would have enjoyed registered manufacturing output that was 24 percent higher than its 1990 level and an employment rate that was 23 percent higher.

43. See IDB (2004a) for a comprehensive discussion of labor market issues.

44. Between 1990 and 1999, the average unemployment rate in Argentina rose from 7.5 percent to 14.3 percent; during the same period, unemployment in Colombia and Ecuador increased from 10.5 to 19.4 percent and from 6.1 to 15.1 percent respectively. In 2003, unemployment reached more than 16 percent in Argentina, Colombia, the Dominican Republic, Panama, Uruguay, and Venezuela and was near or above 10 percent in Bolivia, Brazil, Chile, Ecuador, Nicaragua, Paraguay, and Peru (ECLAC 2007a; ILO 2006).

FIGURE 12. Urban Unemployment, 1990–2006

Source: ECLAC, Economic Development Division, Social Statistics and Indicators (BADEINSO).

a. Beginning in 1991, includes an adjustment in the data for Argentina, Brazil, and Mexico to account for changes in methodologies in 2002, 2003, and 2005, respectively.

b. Data for Chile and Venezuela refer to nationwide total. Data for Brazil are for six metropolitan areas and for Peru are for metropolitan Lima. New measurement starting 2003 and 2002 for Argentina and Brazil, respectively; data are not comparable with previous years. Mexico data from 1997 onward are not strictly comparable with previous years because of methodological changes and alterations in geographical coverage.

employment.⁴⁵ Most countries saw increases in the share of jobs considered low quality, such as temporary employment, involuntary part-time work, self-employment, and jobs in microenterprises and small firms.⁴⁶ Employment finally picked up beginning in 2004 as growth recovered, but the 2006 unemployment rate, at about 9 percent, was still higher than in 1990.

Meanwhile, average wages stagnated or declined almost everywhere (rising only slightly in 2005–06).⁴⁷ In most countries the majority of new jobs created between 1980 and 2005 were in the informal sector,⁴⁸ helping to keep average wages low. Yet the topic of wage levels was surprisingly absent from political discourse, as was that of jobs.

The impact of the overall reform package on productivity and investment growth was modest for many reasons, including the difficulty of avoiding exchange rate appreciation. But a key missing element was the politically charged issue of reducing “protections” in formal sector jobs, which ended up protecting only a fortunate minority. Unattended labor rigidities appear to have limited job creation not only directly but indirectly, by reducing firms’ capacity to adapt to changes in the economic environment and by making adjustment to the financial and other shocks of the 1990s more difficult.⁴⁹

45. ECLAC (2006a). While wage employment as a share of total employment rose between 2002 and 2005 (from 67.5 percent to 68.5 percent), the average figure is still lower than in 1990 (71 percent).

46. ECLAC (2006a); ILO (2006). Between 1990 and 2002, about seven of every ten newly employed workers in Latin America were in the informal sector and about six of every ten new wage and salaried jobs had no social security coverage. During the 1990s, self-employment grew by an average of 2.8 percent a year and domestic work by 3.9 percent a year. The recent upturn in employment and partly in wages in response to the period of growth in 2003–06 has not significantly improved the quality of new jobs in the region (ECLAC 2006a; ILO 2003).

47. ECLAC (2006a, 2006c); and Duryea, Jaramillo, and Pagés (2003).

48. ECLAC (2006a).

49. Bertola (1990) finds for a sample of industrial countries that employment protection reduces job destruction but also inhibits job creation. Caballero and others (2004) shows that job security regulation hinders the creative destruction process, with negative effects on the annual speed of adjustment to shocks and productivity growth. Loayza, Oviedo, and Servén (2005), in an analysis of a large sample of industrial and developing countries, suggests that a heavier regulatory burden—particularly in labor and product markets—reduces growth and induces informality.

It is not surprising that working-class, middle-income households felt particularly squeezed by the economic reforms, which, although they made industry more competitive, failed to create good jobs.⁵⁰ By undermining job creation in the formal sector, long-standing labor rigidities (see chapter 6) may have made the effects of other reforms not only less efficient but also less politically acceptable.

Part of the problem is that in societies that start with high levels of inequality and highly segmented labor markets, new market opportunities alone are not likely to reach those lacking good education and financial and other assets. Latin American countries that liberalized other markets but not their labor market saw increases in the size of the informal employment sector but not in wages or productivity, as the cost of capital but not the cost of labor in the formal sector fell.⁵¹ Probably because easier and cheaper access to capital tends to raise the demand for skilled but not for unskilled labor, job opportunities and salaries of skilled labor in the formal sector increased disproportionately, widening the gap between the returns on higher education and those on secondary and primary education and between the wages for high-paying jobs and those for low-paying jobs.⁵²

The job problem goes a long way toward explaining Latin American middle-income households' sense of insecurity and anxiety regarding the opening of economies and the other reforms of the past fifteen years. Arguably, the massive public protests that erupted in Argentina, Ecuador, and Bolivia in the last several years were fueled in part by discontent over high unemployment and economic instability.⁵³ The protests themselves

50. See Birdsall, Graham, and Pettinato (2000) on the middle-income squeeze in Latin America.

51. For example, in Mexico between 1996 and 1998, GDP per capita increased by 9.7 percent in real terms, but poverty hardly declined. In fact, the incomes of the poorest 30 percent of the population contracted during that period. The huge increase in average income was due entirely to income gains among the richest 30 percent, particularly the richest 10 percent of the population (Székely and Hilgert 2001; Attanasio and Székely 2001).

52. Behrman, Birdsall, and Székely (2003) concludes on the basis of an econometric analysis covering eighteen countries that structural reforms in the 1990s led to a widening of the gap between returns to more-educated workers and returns to less-educated workers in Latin America.

53. In Argentina, Ecuador, and Bolivia protests led to the ousting of incumbent presidents. However, it would be an exaggeration to blame their departure on the reforms.

involved other concerns, such as indigenous rights in the case of Bolivia and Ecuador. Still, their experience highlights the fact that open market economic reforms do not make for good politics anymore, if they ever did.

A Policy Toolkit for Promoting Equity and Growth

In this book we discuss what we call an “equity toolkit” for the region—a dozen tools to build more visibly just societies in which not only the elite but the silent majority have full access to economic, social, and political opportunities. We believe that our equity agenda is not only fully consistent with growth but that it may actually accelerate growth, by better tapping the potential of all the region’s people. Some of the policies and programs in our toolkit already are familiar in the reform debate in the region (for example, those regarding education, fiscal policy, and pension reform). But we propose that the debate about even these familiar reform challenges be reshaped to incorporate issues of fairness more explicitly.

Our equity toolkit also is designed to help make market-oriented policies more politically sustainable. A new, politically visible agenda for improving fairness would help governments, civil society, and businesses address a key political economy challenge for the region today: how to give new impetus to reforms in an increasingly hostile political environment. It is difficult to believe that there will be popular support for more reforms if there is no sense that they will improve fairness.

We distinguish our equity toolkit from anything that might be called “populist.” For example, our toolkit takes into account the demands and constraints of an open economy. Latin American economies need to remain open if they are to exploit the potential benefits of integration into the global economy. But without attention to fairness, the integration process will increase economic insecurity and produce too many losers and too few winners.

Behind our twelve tools is a simple theory of change. We believe that there is “policy space”—that there are politically realistic win-win options for equity that will not sacrifice and can even enhance growth. They need not sacrifice growth because, for the most part, they are not a matter of money but of the rules of the game and of political and civic leadership. Even when money is needed—say, for education—using these tools,

though fiscally costly today, can be politically rewarding. And, of course, it will yield more than ample economic returns tomorrow.

Some are options that have been taken up in some countries of the region but not in others, and thus there are experiences to be shared. Some are options that are understood to be about “growth” but that have not been politically shaped or sold as also being about “fairness.” Some, such as a more progressive tax structure, are politically (and even economically) controversial and create major policy challenges with many moving parts; those options demand political leadership of the first order, the engagement of civil society, and the support of the business community. Some are more like plumbing, a matter of know-how; they involve detailed technical and regulatory fixes, such as protecting minority shareholders’ rights and promoting markets for factoring and leasing.

Some can and ought to be taken up by civil society—such as charging reasonable tuition for public university students from wealthy households. Some need the active involvement of the banking and business communities in developing and monitoring detailed changes—such as new prudential rules to minimize the tendency of temporary booms to lead to overexpansion of access to credit.

Finally, our focus is on domestic policy and practices. But responsibility also lies with the industrialized countries, whose actions entail high costs to workers and the poor in Latin America, especially with regard to trade. The demands of fairness justifiably apply to rich countries and to multilateral banks and other international donor organizations (as well as to international nongovernmental organizations), from which much of the rhetoric about poverty reduction—and more recently about equity—emanates.

We have organized our twelve equity tools into four key categories. We first emphasize mainstreaming poverty and equity considerations into economy-wide policies (tools 1–4). We focus next on workers (tools 5–7), since jobs and the labor market were neglected in the reform agenda of the last decade. We then discuss policies and practices that would better respond to consumers and citizens (tools 8–11); these are relevant to both the rich and the vast majority of non-rich households in the region. Finally, we address global opportunities and constraints (tool 12), focusing primarily on how the United States can help advance the ideas and the reality of fair growth in Latin America (box 1).

BOX 1. Equity Toolkit

Mainstreaming Poverty and Equity Considerations into Economy-wide Policies

1. *Rule-based fiscal discipline.* Lack of fiscal discipline—evident when governments consistently spend more than they collect and more than they can easily finance through sustainable borrowing—has high costs for the poor and the emerging middle class. Commitment to fiscal discipline must go beyond making idiosyncratic efforts to developing a healthy budget grounded in transparent rules and procedures.

2. *Smoothing booms and busts.* Economic booms are better for the rich; busts are worse for the poor. The fiscal and monetary policies and tough banking and other financial standards needed to manage volatility and minimize crisis cannot be improvised. They should be locked in when times are good.

3. *Social safety nets that trigger automatically.* A modern system provides an income floor for working and middle-class households as well as the poor. During slumps, spending should kick in automatically for emergency public works employment and for subsidies to encourage families to keep their children in school.

4. *More taxes on the rich and better spending on the rest.* Latin America relies heavily on regressive consumption taxes. Closing income tax loopholes and reducing evasion would increase revenues without adding to the tax burden of working-class and middle-income households.

Responding to Workers in a Global Economy

5. *Giving small businesses a chance.* Weak financial and judicial systems and onerous red tape block talented small entrepreneurs from expanding their businesses. Improving enforcement of credit contracts and shareholders' rights, ending the practice of offering insiders credit from state-owned banks, and increasing access to information and professional services would help create more small firms and more jobs.

6. *Protecting job mobility and workers' rights.* The poor bear the cost of a job contracting environment that has the wrong kind of worker protections and too many legal rules. Latin America needs more aggressive protection of workers' rights of association and collective bargaining, more independent

and democratic unions, and more unemployment and other social insurance to replace inflexible rules that discourage job mobility and growth.

7. *Repairing rural markets.* Land titling and investment in rural infrastructure, research and development, and extension services can help boost the productivity and increase the competitiveness of rural markets in Latin America, finally giving the rural poor a fair chance.

Responding to Consumers and Citizens

8. *Tackling corruption head on.* Corruption undermines competition, reduces investment, and weakens government, hurting small businesses, consumers, taxpayers, and—especially—the poor. An independent judicial system, greater transparency, and an active civil society are essential elements in a serious anticorruption agenda.

9. *Schools for the poor, too.* Education systems in Latin America suffer from low levels of quality, efficiency, and equity. Critical reforms include more school autonomy and accountability to parents, reduced subsidies to better-off students for higher education, and more public spending on preschool programs.

10. *Dealing openly with discrimination.* A serious attack on poverty and inequality has to include a visible attack on discrimination. Political leadership can help break down the social and political barriers against members of Afro-descendent and indigenous groups—and, in some arenas, against women.

11. *Consumer-driven public services.* Shortcomings in infrastructure, public health, and regulatory services such as consumer protection have cost the poor and the near-poor dearly. Poor and other low-income consumers must now be at the heart of a new culture of service delivery.

Global Opportunities and Constraints

12. *How the United State can help: opening markets and more.* A practical agenda for how the U.S. can help diminish poverty and inequality in Latin America includes buttressing free trade agreements through aid programs that compensate and help the losers and pressing the financial community to encourage U.S.-based remittance senders and Latin-based receivers to open bank accounts to facilitate the process.

Choices and Caveats

We have five important caveats. First, we cannot pretend that there is any consensus on the content of our toolkit. We believe that the business elite is prepared to embrace an agenda that focuses on more widely shared opportunities, if only to reduce social tensions and stave off antigrowth populism. But we have no real basis for that intuition. In any event, although our focus on fairness as a fundamental goal is new, some of our tools are not. They already are fully endorsed by the business elite; indeed, some were included in the Washington Consensus.

Second, we do not directly address health, despite its crucial link to equity. There is nothing close to a technical consensus about the right approach to organizing and financing health systems, as there is with the issues that we do tackle. The health issue is also, from an institutional and policy point of view, so different in different countries and so complex that it would have been even more foolhardy to attack it in this short volume than it has been to tackle the twelve issues that we chose. However, the lessons of chapter 11 are relevant to public provision of health services.

Third, our toolkit focuses narrowly on economic and social policies, yet fairness concerns a much broader arena of public policy. Good governance goes well beyond our toolkit—to promoting democracy, extending civil liberties, and ensuring the rule of law, all actions that are central to equity. With one exception—corruption (see chapter 8)—we refer to these political and institutional topics only tangentially, when they have obvious links to economic and social policies.

Fourth, our toolkit is not a substitute for rigorous, case-by-case diagnosis of the binding constraints to growth and equity in a given country. It does not identify the main problems in a specific case, nor set out priorities, nor delineate the main components of a needed policy strategy, nor provide guidance on reform sequencing. That can flow only from diagnostic work on individual countries, for which our toolkit cannot substitute.⁵⁴ We just provide a set of “tools” that should come in handy once such a diagnosis has been performed.

Fifth, our toolkit approach does not pretend to completely understand the links between policy reforms and outcomes. If we have learned anything

54. On this approach to analysis, see Rodrik (2006).

over the past twenty years or so, it is that such links are elusive and that outcomes often do not correspond to initial expectations. While we believe that the appropriate use of the policies in the toolkit can help to improve equity without sacrificing growth, we do not claim to fully understand the transmission channels that link policy actions to outcomes.

That said, we do not want to be too modest. It is high time for leaders (in government, business, and civil society) in Latin America to embrace fairness as a fundamental goal. Latin America has undertaken one set of changes in order to develop more open and competitive market economies. The benefits of that first step now need to be complemented and reinforced by a second set of changes—changes aimed at fairness and at emphasizing jobs and access to key productive assets for the silent majority. Long-standing inequality in the region has fostered a deep sense of unfairness and injustice. We hope that our agenda rekindles hope that open markets and democratic institutions will, finally, make a difference.