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SHIFTING GEARS TO ACCELERATE SHARED PROSPERITY
in Latin America and the Caribbean

World Bank LAC

opportunities for all

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CONTENTS

Acknowledgements

The views and interpretations expressed here are the sole responsibility of the authors and should not be attributed to the World Bank, the Board of Executive Directors or the countries that they represent. The numbers presented in this brief are based on a regional data harmonization effort known as SEDLAC that increases cross-country comparability of selected findings from official household surveys. For that reason, the numbers discussed here may be different from official statistics reported by governments and national offices of statistics. Such differences should not be interpreted in any way as a claim of methodological superiority, as both sets of numbers serve the same important objectives: regional comparability and the best possible representation of the facts of individual countries. The welfare aggregate used in this study is income-based.

Executive summary

L atin America and the Caribbean (LAC) have made laudable progress in the past fifteen years in reducing poverty, building the middle class and promoting prosperity for all levels of society. Extreme poverty, defined in this region as life on less than $2.50 a day, has declined by half, while in 2011, for the first time in recorded history, the LAC region had a larger number of people in the middle class than in poverty.

Across this region of close to 600 million people, the poor have been gaining faster than the already well off. But despite these impressive achievements, about 80 million people still live in extreme poverty, half of them in Brazil and Mexico. And millions more who have risen out of poverty risk being pulled back down into it by economic shocks and severe weather brought on by climate change.

In April this year, World Bank Group President Jim Yong Kim announced a twin strategy for the World Bank going forward: (1) to end extreme poverty at the global level by 2030, and (2) to promote "shared prosperity," a sustainable increase in the well-being of the poorer segments of society, defined as the lowest 40 percent. "Assuring that growth is inclusive is both a moral imperative and a crucial condition for sustained economic development," Kim said.

This brief reviews LAC's progress toward these objectives, outlines the continuing challenges and proposes a policy framework for keeping the region on its upward arc and picking up the speed.

Around 2000, economic growth in the region began to accelerate, increasing average real incomes by more than 25 percent in the following ten years. But equally important, the decade brought major gains for the societies' least fortunate members.

Extreme poverty was cut from 25 percent of the population to 13 percent during the 2000s. Rising income from employment was the main driver of this reduction, while pensions, transfers and other non-employment income explained more than a third of the extreme poverty reduction. LAC also cut in half its chronic poverty, a different form of the problem characterized by persistent low income and such deprivations as shanty housing and outdoor latrines.

The World Bank's indicator of shared prosperity, the growth rate of real income per capita of the bottom 40 percent of a country's people, underscores that recent years' economic expansion in LAC has benefitted the less well-off. From 2003 to 2011, mean real per capita income for the region's population as a whole grew by about three percent, while the rate for the bottom 40 percent was considerably faster, almost five percent.

Despite LAC's strong gains in shared prosperity, going forward it faces significant hurdles to delivering the sustained high levels of economic growth and welfare gains that many other regions of the world have achieved. And it is still far from reaching the low levels of income inequality found in OECD and other high-income countries.

According to the Shared Prosperity Convergence Index (SPCI), which tracks progress in equity adjusted growth, LAC in 2011 had reached only a fifth of the benchmark level of top global performers. A key challenge facing the region is the continuing uneven standards of living within different areas of LAC countries.

If LAC keeps up the economic growth (three percent in per capita terms) and the inequality reductions it has achieved since 2003, when growth accelerated sharply, it will still fail to reach the global benchmark by 2030. To do so, the region would need to more than double the past rate of growth to 7.5 percent annually (in per capita terms).

Reform agendas that are underway in a number of the region's countries are helping accelerate shared prosperity by strengthening links between growth and equity and focusing on raising the living standards of the less well-off. The region now needs second-generation reforms that will reinforce the "virtuous cycle" of economic growth and equity to foster shared prosperity.

This brief highlights four important policy themes that LAC countries should consider to keep on track in the years ahead.

1. Maintain an equitable, efficient and sustainable fiscal policy that will foster shared prosperity.
2. Strengthen fair, transparent institutions that deliver quality public goods and services.
3. Enable an environment of well-functioning markets that are accessible for all economic levels of society.
4. Improve risk management both at the macro and household levels.

I. LAC has exceeded its past performance in poverty reduction

Latin America and the Caribbean achieved impressive gains in reducing extreme poverty in the last 15 years, breaking historical patterns.[1] The share of the population living below an extreme poverty line of $2.50 a day, the minimum necessary in the LAC region to meet basic food requirements, dropped by half, from 26.3 percent to 13.3 percent (Figure 1 and Annex 2). Over the same period, the proportion of people living below the global extreme poverty line of $1.25 a day was also cut by about half (Box 1).

Labor income was the main driver of the reduction in extreme poverty after 2003 in LAC, while transfers and pensions also played an important role, explaining more than one third of the decline. The majority

Figure 1: Latin Americans are moving out of extreme poverty ($2.50 a day)
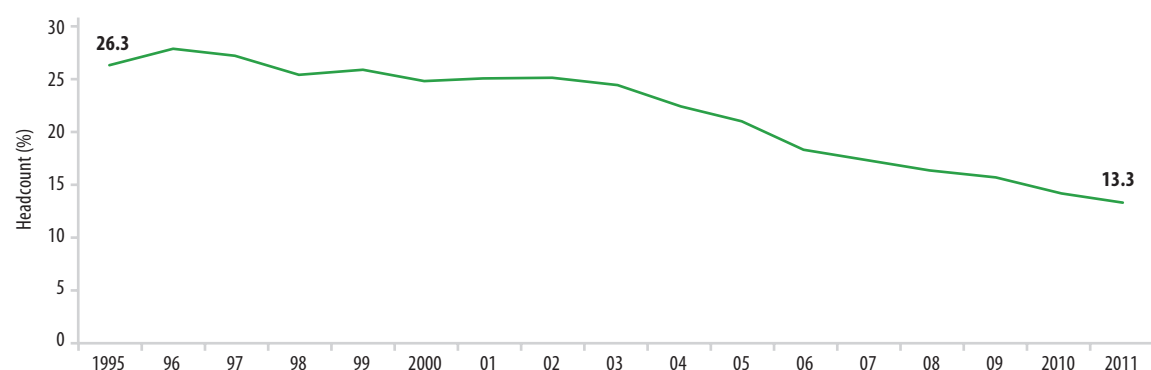
Source: Authors' calculations using SEDLAC data (CEDLAS and the World Bank). Note: Estimates of poverty at the regional level are population-weighted averages of country estimates. In order to analyze the same set of countries every year, interpolation was applied when country data was not available in a given year. For methodological details, please refer to Annex 1.

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1   All poverty rates presented in this report are income-based.

BOX 1: LAC is on its way to ending global extreme poverty ($1.25 a day) by 2030

In April this year, World Bank Group President Jim Yong Kim announced a twin strategy for the World Bank going forward, (1) to end global extreme poverty by 2030, and (2) to promote "shared prosperity," a sustainable increase in the economic well-being of the poorer segments of society, defined as the poorest 40 percent of the population. The basic indicator set for the extreme poverty goal is that the percentage of people living on less than $1.25 a day will fall to no more than 3 percent globally by 2030.

The level of economic development in the LAC region has led analysts to use poverty lines that are higher than the global $1.25 a day. A $2.50 a day extreme poverty line (an average of national extreme poverty lines) and a $4 a day moderate poverty line are more appropriate for the prevailing costs of living in the LAC region. Applying the $1.25 standard to the region would show that extreme poverty was stable in the 1980s and '90s at approximately 12 percent of the population but began to fall in 2002. By 2011, extreme poverty as measured by the global standard had declined to about 5 percent, putting the 3 percent goal within reach by 2017.

(61 percent) of the decline was due to higher incomes, with females' higher earnings responsible for 21 percent of the decline and males' earnings for 40 percent (Figure 2). Income from transfers (both private and public) also played an important role in extreme poverty reduction between 2003 and 2011, accounting for 23 percent of the fall, while pensions contributed 13 percent.

The extreme poor in LAC have fewer years of education compared to the vulnerable and the middle class, are more likely to work in primary-sector jobs, and live in households in which women are less likely to work (Annex 3). In 2011, about 30 percent of people in rural areas in LAC were living under the $2.50 a day extreme poverty line, while for the first time in history less than 10 percent of urban people were extremely poor (Figure 3). Still, by head count, the majority of the extreme poor in LAC lived in urban areas.

Progress toward eradicating extreme poverty has been faster in some areas of LAC than others. Although all regions within LAC have decreased extreme poverty in the last 15 years, the Southern Cone (extended) region—Argentina, Brazil, Chile, Paraguay and Uruguay—has been the most dynamic, followed by the Andean region (Bolivia, Colombia, Ecuador and Peru) and then the Mexico and Central America region (Figure 4). Today the extreme poverty rate is lowest in the Southern Cone, at 10.6 percent. The Andean region has a 15.2 percent rate, while in Mexico and Central America the figure is 16.4 percent.

Despite overall impressive performance, about 80 million people still live in extreme poverty in LAC, half of them in Brazil and Mexico. This reality keeps extreme poverty as an important issue even in the region's middle-income countries and has inspired governmental anti-poverty strategies such as Brazil's "Sem Miseria" and Mexico's "Cruzada Nacional contra el Hambre."

Figure 2: Extreme poverty reduction has been mostly driven by labor earnings
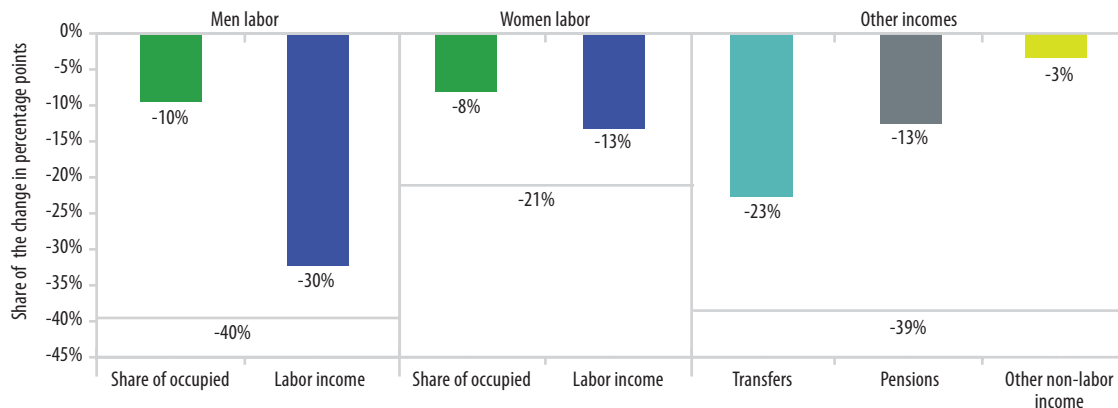
Source: Authors' calculations using SEDLAC data (CEDLAS and the World Bank). Note: Share of occupied refers to gains attributable to additional members of a household who start working. Estimates of poverty at the regional level are population-weighted averages of countries. The figure shows the Shapley Decomposition of poverty changes between 2003 and 2011 (See Table A1) by components of income aggregate. See Azevedo, Sanfelice and Cong Nguyen (2012) for more details about the decomposition technique.

Figure 3: Extreme poverty in LAC by area of residence
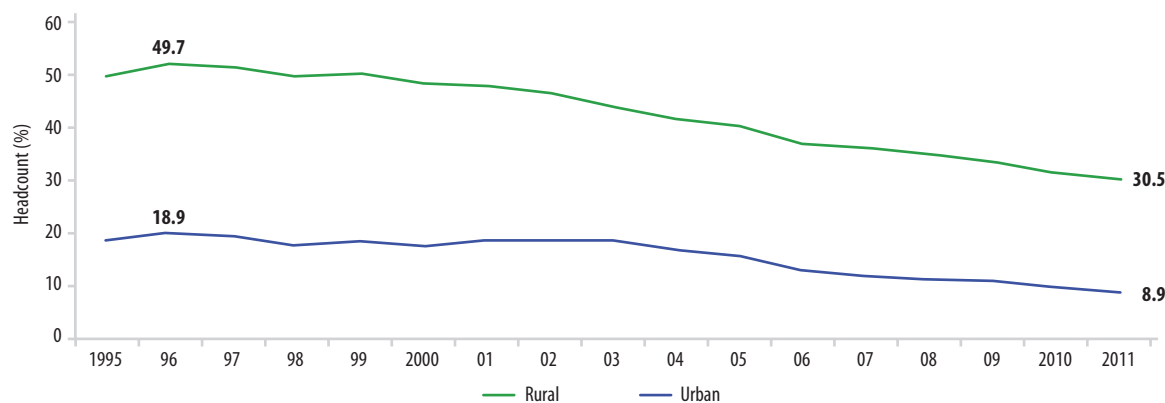
Source: Authors' calculations using SEDLAC data (CEDLAS and the World Bank). Note: Rural poverty estimation does not include Argentina, Bolivia and Uruguay. Estimates of extreme poverty ($2.50 a day) at the regional level are population-weighted averages of country estimates. In order to analyze the same set of countries every year, interpolation was applied when country data was not available for a given year. For methodological details, please refer to Annex 1.

Figure 4: In what LAC subregions do the extreme poor live?
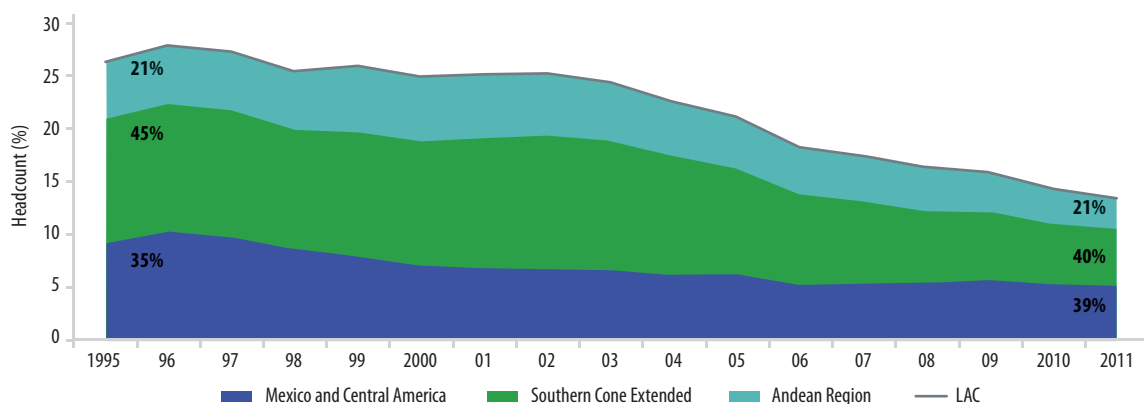
Source: Authors' calculations using SEDLAC data (CEDLAS and the World Bank). Note: The numbers represent the percentage that each region has in the extreme poverty headcount of the LAC region. The Andean region includes Bolivia, Colombia, Ecuador and Peru; the Southern Cone (extended) region includes Argentina, Brazil, Chile, Paraguay and Uruguay; the Mexico and Central America region includes Costa Rica, Dominican Republic, Guatemala, Honduras, Mexico, Nicaragua, Panama and El Salvador. Estimates of poverty at the regional level are population-weighted averages of country estimates. In order to analyze the same set of countries every year, interpolation was applied when country data was not available for a given year. For methodological details, please refer to Annex 1.

BOX 2: Identifying the chronic poor in the absence of panel data

Poverty is characterized by its depth, complexity and persistence. The depth of poverty is captured by setting low income thresholds and by looking at the gap with respect to the poverty line. Complexity is associated with multidimensionality. Persistence, on the other hand, is what we refer to as "chronic" poverty, and its measurement requires following individuals and measuring their income or consumption over time by means of panel data. However, panel data often does not exist.

Castañeda et al. (2012) have proposed a method to instead identify the chronic poor using cross-sectional data, which does not follow individuals over time. The method relies on the idea that depth and complexity—two static characteristics of poverty—are associated with persistence. Using synthetic panels—a methodology that allows the estimation of directional mobility measures using cross sectional data (Dang et al., 2011; Cruces et al., 2011)—for Brazil, the study showed that individuals who are both income and multidimensional poor in non-monetary ways simultaneously (group A) are more than twice as likely to be income-poor in more than one period compared to those who are income-poor alone (group B). The methodology has been validated using actual panel data for Chile, Mexico and Peru by Lopez-Calva et al. (2013).

To conduct their study, Castañeda used data from Brazil's PNAD household survey to track individuals who are in extreme poverty in two different periods of time. The Multidimensional Poverty Index (MPI), based on work by Alkire and Foster (2011), was applied to assess whether a household is deprived in seven indicators: (i) child school attendance; (ii) years of schooling; (iii) sanitation; (iv) safe water; (v) electricity; (vi) shelter, and (vii) an index of assets. Every period, households were classified into four groups: (i) *chronic poor* (those who were multi-dimensionally and income poor); (ii) *transient poor*: monetary poor but non-poor in the other dimensions; (iii) *poor in non-monetary dimensions*: not poor in monetary but poor in non-income dimensions; and (iv) *the better off*: those who were not deprived in any indicator.

The information used under this method is cross-sectional, or static, but the label "chronic poor" refers to dynamic conditions, namely, persistence. Such persistence is approximated by its associated factors, which can be measured every period. See the summary of this classification system in Figure 5.

Measures of monetary poverty typically include both transient and persistent poverty. Studies have shown that people who are poor only as measured by income are often only temporarily in this condition due to a short-term shock, and are referred to as "transient poor." People who are chronically poor, i.e., stuck in the condition over an extended period, are typically not only income-poor but also face complex non-monetary challenges, such as sub-standard housing or lack of access to clean water and sanitation. Identifying and differentiating who is transient poor and who is chronic poor is crucial, given that the policy mix to address these types of poverty effectively may differ substantially (Box 2).[2]

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2 Castañeda *et al.* (2012) developed a multidimensional approach that combines both monetary and non-monetary deprivations which has been used to differentiate the chronic from the transient poor, without having to depend on longitudinal data. The methodology relies on the coexistence (or not) of shortfalls in monetary and non-monetary dimensions, which has been shown to be associated with higher probabilities of being monetary poor in more than one period over time.

Figure 5: Multiple non-monetary deprivations persist in LAC
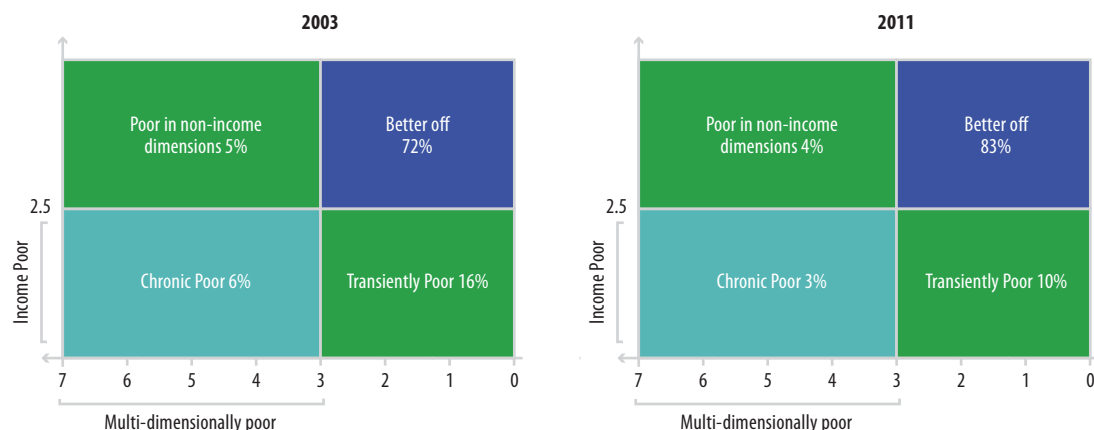
Source: Authors' calculations using SEDLAC data (CEDLAS and the World Bank). Note: Figures are LAC averages using the classification proposed by Castañeda, et al. (2012). Chronic poverty refers to the proportion of individuals who are simultaneously deprived in monetary and non-monetary dimensions (those who are multi-dimensionally poor). "Poverty in non-income dimensions" refers to the proportion of the population who live above the monetary poverty line but who are deprived in three or more non-monetary dimensions (using Alkire and Foster (2011) methodology, for k=3). The transiently poor refer to people who are not multi-dimensionally poor in spite of living below the poverty line. Better-off refers to those who are neither income poor nor multi-dimensionally poor. The poverty line used is equivalent to $2.50 a day in 2005. Multidimensional poverty identifies as poor those individuals who are deprived in at least three out of the following six dimensions: (i) school-aged child (7 to 15) is out of school, (ii) none of the household members has completed five years of schooling, (iii) dwelling with precarious wall materials, (iv) no access to tap water in the dwelling, (v) no flush toilet or pit latrine in the dwelling, and (vi) no electricity.

The LAC region has cut chronic poverty by half since 2003. The number of people in chronic poverty, defined as the proportion of individuals who are deprived in monetary and non-monetary dimensions (using the $2.50 a day extreme poverty line), declined by three percentage points between 2003 and 2011—from six percent of the population to three percent (Figure 5). In the same period, the proportion of transient poor dropped from 16 percent to 10 percent. Also, in the last eight years the proportion of people classified as "poor in non-income dimensions" shrank too (i.e., those living above the extreme poverty line of $2.50 a day but deprived in other ways such as bad housing and sanitation).

In 2011, the most common non-income deprivation for LAC households concerned access to sanitation. About 26 percent had no access to basic sanitation in 2011. Sixteen percent of Latin American households lived in dwellings built of precarious materials, 10 percent had no running water in the dwelling and 8 percent had no member who had completed five years of schooling. On the positive side, only 4 percent of households had a school-age child who was out of school and less than 3 percent lived in a home without electricity (Annex 4).

II. Latin Americans are moving out of poverty and into the middle class

I n 2011, for the first time in recorded history, the LAC region had more people in the middle class than in poverty. The threshold for the middle class of $10 a day per capita reflects a level of income at which the probability of falling back into poverty is less than 10 percent (Box 3). Faster and more equitable income growth helped expand the middle class to 32 percent of the region's total population in 2011. For the first time, this grouping surpassed the poor, who numbered 27 percent based on the $4 a day moderate poverty line (Figure 6). Income growth accounted for about three quarters of the rise in the middle class between 2003 and 2011, while redistribution of income contributed the remaining one quarter (Annex 5).

Despite these impressive gains, about 40 percent of Latin Americans remain vulnerable to falling back into poverty. Indeed, most LAC citizens who escaped poverty did not enter the middle class, but made it only into the vulnerable group, living on $4 to $10 a day. That translated into a net rise in the number of people who left poverty but were not yet wealthy and/or secure enough for a place in the middle class; the vulnerable increased to almost 40 percent of the total population, making it the largest economic class in the region. They are more likely to reside in urban areas and be engaged in wage activities (and less in the primary sector) most likely in the informal sector, where they are also likely to be more vulnerable to economic contractions and weather shocks (Annex 3).

The Southern Cone (extended) region broke with the LAC pattern; its middle class grew to be its largest economic group in 2011, expanding to about 40 percent of its population. In 2011, the size of the middle class in the Southern Cone surpassed both the vulnerable and the poor economic classes (Figure 7). The other two major regions reflected the overall LAC pattern: In Mexico and Central America and in the Andean region, the vulnerable were the largest class, with 40 percent of the population. In both of these regions, the poor were the next largest class, followed by the middle class.

BOX 3: Defining the Middle Class in LAC

The recent World Bank LAC regional flagship report, *Economic Mobility and the Rise of the Latin American Middle Class*,[3] characterizes the middle class based on the concept of economic security. A defining feature of membership in the group is household economic stability, which implies a low probability of falling back into poverty. The study defines a household as vulnerable if it faces a more than 10 percent likelihood of falling back into poverty over a five-year interval, which surveys show is approximately the average probability in countries such as Argentina, Colombia and Costa Rica. This, in turn, yields an income threshold of about $10 a day per capita (2005 purchasing power parity) to be part of the middle class. This threshold was independently validated by an alternative approach, based on self-perceptions of class membership, which was separately applied to five countries: Brazil, Chile, Colombia, Mexico and Peru.

The regional report defines three economic classes: (1) the poor, those who have a per capita income below $4 a day; (2) the vulnerable, with $4 to $10 a day; and (3) the middle class, with $10 to $50 a day (all in 2005 purchasing power parity). The remainder, people with more than $50 a day, makes up less than 3 percent of the region's population.

Figure 6: The vulnerable and middle classes are growing as Latin Americans move out of poverty
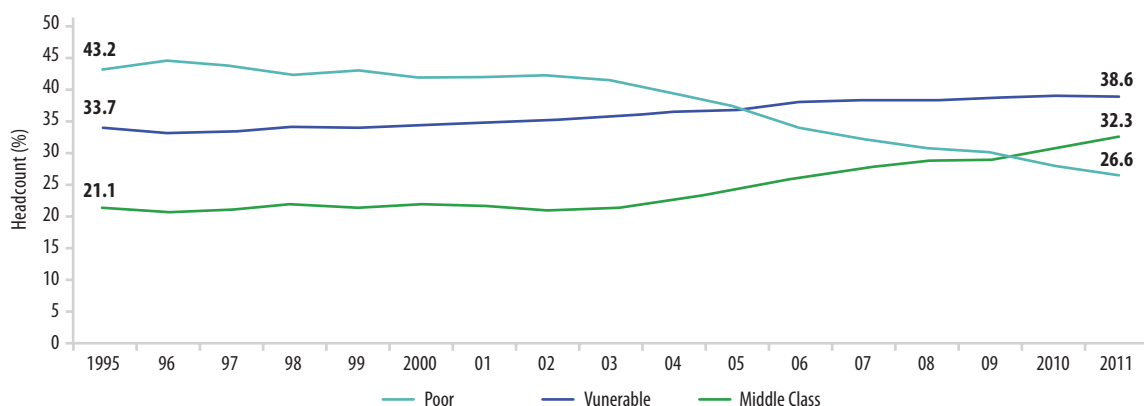
Source: Authors' calculations using SEDLAC data (CEDLAS and the World Bank). Note: Estimates of poverty, vulnerability and the middle class at the regional level are population-weighted averages of country estimates. The poor are those living on less than $4 a day, the vulnerable are those living on $4 to $10 a day, and the middle class are those living on $10 to $50 a day (all in 2005 purchasing power parity). In order to analyze the same set of countries every year, interpolation was applied when country data was not available for a given year. For methodological details, please refer to Annex 1.

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3   Ferreira, Messina, Rigolini, Lugo, Vakis, and Lopez-Calva (2012).

Figure 7: The middle class is the largest economic class in the Southern Cone (extended) region but the smallest group in the Andean and the Mexico and Central America regions
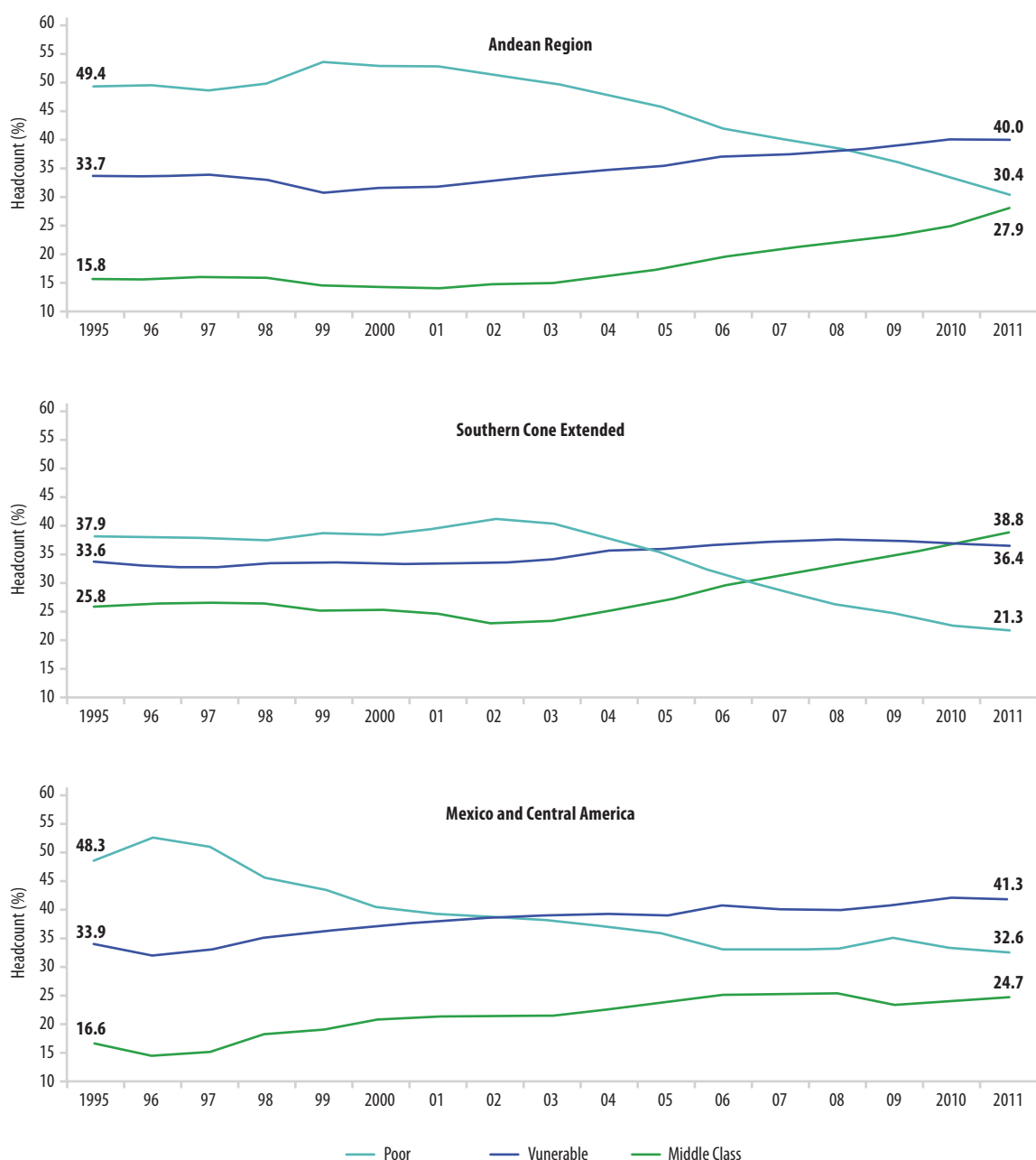
Source: Authors' calculations using SEDLAC data (CEDLAS and the World Bank). Note: Estimates of poverty, vulnerability and the middle class at the regional level are population-weighted averages of country estimates. Poor are those living on less than $4 a day, vulnerable are those living on $4 to $10 a day, and middle class are those living on $10 to $50 a day (all in 2005 purchasing power parity). The Andean region includes Bolivia, Colombia, Ecuador and Peru; the Southern Cone (extended) region includes Argentina, Brazil, Chile, Paraguay and Uruguay; and the Mexico and Central America region includes Costa Rica, Dominican Republic, Guatemala, Honduras, Mexico, Nicaragua, Panama and El Salvador. In order to analyze the same set of countries every year, interpolation was applied when country data was not available for a given year. For methodological details, please refer to Annex 1.

The downward trend in poverty is expected to have continued for 2012, based on labor market indicators from several leading economies in the region. The Labor Income Poverty Index (LIPI) measures the share of households that cannot obtain the basic food basket with their labor incomes.[4] The LIPI is also a leading welfare indicator, because it uses the high-frequency data of quarterly or monthly labor force surveys. The LIPI showed poverty on a downward trend in 2012 in Argentina, Brazil and Paraguay, while in Ecuador and Peru similar movement in that direction in the first half of 2012 was reversed in the second half (this volatility may reflect the cyclical nature of the economy and the high frequency nature of the data). Moreover, after remaining at its 2009 crisis level for two years, poverty in Mexico as measured by the LIPI started to decline in 2012, falling below the 2010 baseline (Figure 8).

Figure 8: Poverty appears to have declined further in 2012
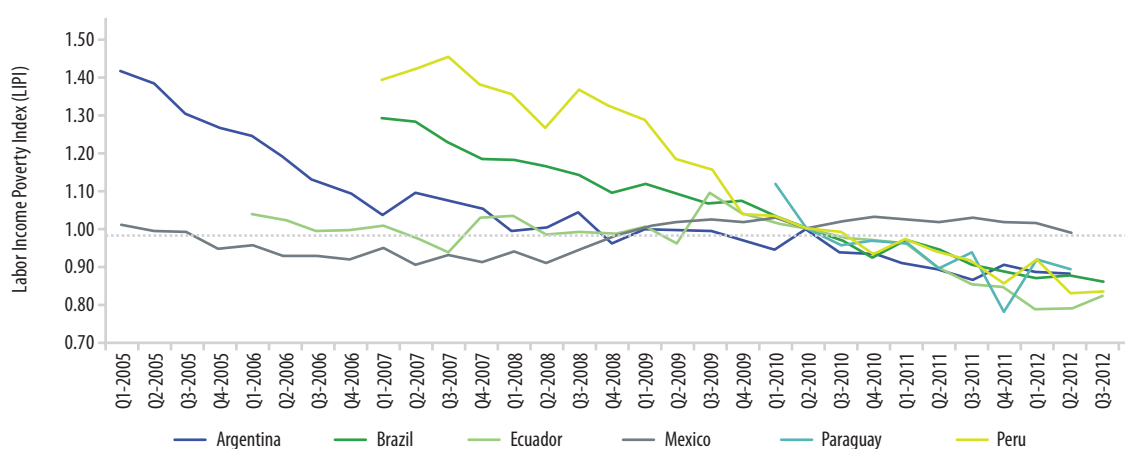
Source: Authors' calculation using LABLAC Data (CEDLAS and the World Bank). Note: Moderate poverty ($4 per day) was used to compute LIPI. The second quarter of 2010 is the reference period.

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4   The average percentage of income from labor sources in the total income of the household varies from 68% to 80% in the countries where LIPI was calculated (Figure 8).

III. Shared prosperity in LAC

The LAC economy took off in the decade starting in 2000, breaking old patterns of crisis and lethargy. Real incomes grew more than 25 percent in the ensuing decade. GDP per capita rose by 2.1 percent per year on average, compared to 1.6 percent per year in the second half of the 1990s (Figure 9). LAC had traditionally been known for frequent economic crises, stagnant growth and relatively high levels of poverty despite its status as a region composed largely of middle-income countries. But growth proved resilient even during the 2009 financial crisis, when the region experienced only a minor dip in GDP.[5]

Figure 9: LAC gains in GDP per capita and reduction in income inequality
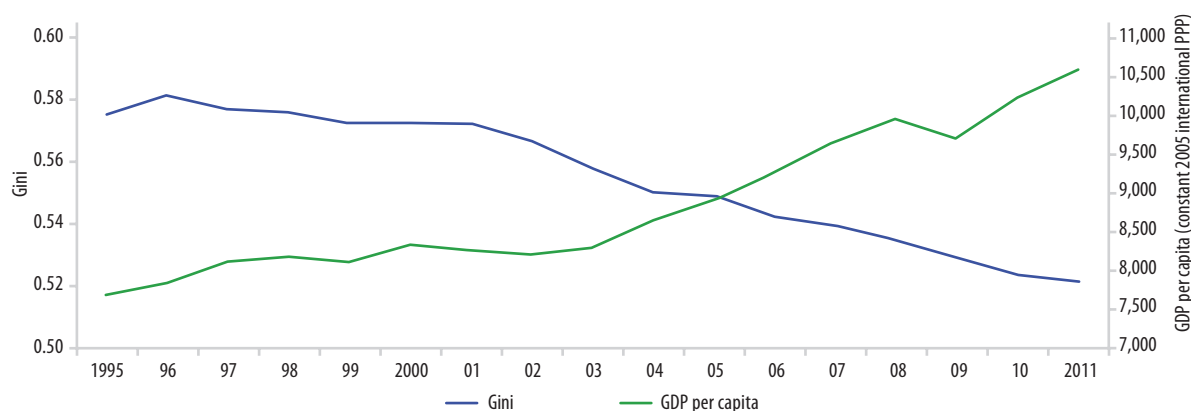
Source: Authors' calculations using SEDLAC data (CEDLAS and the World Bank) and World Development Indicators (WDI). Note: Inequality is based on the Gini coefficient calculated using total household per capita income from pooled data of countries and it considers zero incomes. In order to analyze the same set of countries every year for Gini calculations, interpolation was applied when country data was not available for a given year. For methodological details, please refer to Annex 1.

5   World Bank (2011b) "On the edge of uncertainty: Poverty reduction in LAC during the great recession and beyond;" and World Bank (2011a) "A break with history: Fifteen years of inequality reduction in Latin America."

Figure 10: Shared prosperity in LAC, 2003 to 2011

Legend: Annualized Growth Rate Mean Income Bottom 40% ● Annualized Growth Rate Mean Income
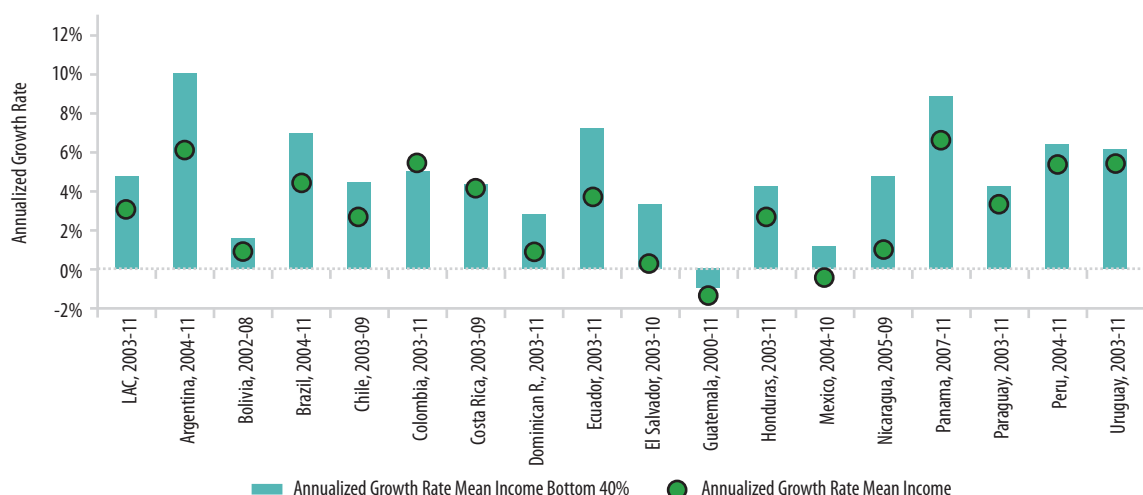
Source: Authors' calculations using SEDLAC data (CEDLAS and the World Bank). Note: The numbers for LAC are calculated using pooled data of countries. In order to analyze the same set of countries every year, interpolation was applied when country data was not available in a given year. For methodological details, please refer to Annex 1.

Equally as important, high levels of income inequality in LAC have started to recede. Income inequality, as measured by the Gini coefficient, has fallen steadily in LAC, dropping from its peak of 0.58 in 1996 to the lowest level ever recorded in the region, 0.52 in 2011 (Figure 9). Labor earnings were the biggest factor behind the fall, labor earnings from men accounted for 34 percent of inequality reduction, while labor income from women contributed to 15 percent (Annex 8). Income from transfers, both private and public, also played an important role in the reduction of the Gini coefficient, accounting for 34 percent of the inequality drop.

The World Bank's indicator of shared prosperity—the growth rate of real income per capita of the bottom 40 percent in every country—underscores how LAC's growth in the recent past has benefited poor and vulnerable households. While shared prosperity requires rapid and sustained expansion of the economy, not any type of growth will do. What is needed is sustainable growth that achieves the maximum possible increase in the living standards of the less well-off—and LAC countries showed strong progress toward finding that type of growth (Figures A.4 and A.5).

In the recent past, the less well-off in the region have benefitted more from growth than the average person. From 2003 to 2011, mean real per capita income grew by about 3 percent in LAC as a whole, while that income for the bottom 40 percent rose at a considerably higher pace, almost five percent (Figure 10). On a country-by-country basis, the figure for the bottom 40 percent exceeded or was very close to the national average in all countries. Guatemala was the only country where income fell for the population as a whole, but incomes for the bottom 40 percent fell less.

Despite LAC's strong gains in shared prosperity, it continues to face significant hurdles to deliver sustained high levels of economic growth and welfare gains as compared to other regions. Despite the region's solid economic growth over the past decade, catching up with US levels of GDP per capita has proven elusive (Figure 11). As long ago as 1900, LAC's GDP per capita was estimated at 22 percent of the US figure. In 2011, that performance had only slightly improved, to 24 percent. In contrast, after World War II, Japan's GDP per capita stood at 16 percent of the US's but is now more than 70 percent. Similarly, around mid-century, LAC

Figure 11: Other regions have fared better in closing the economic gap with the United States
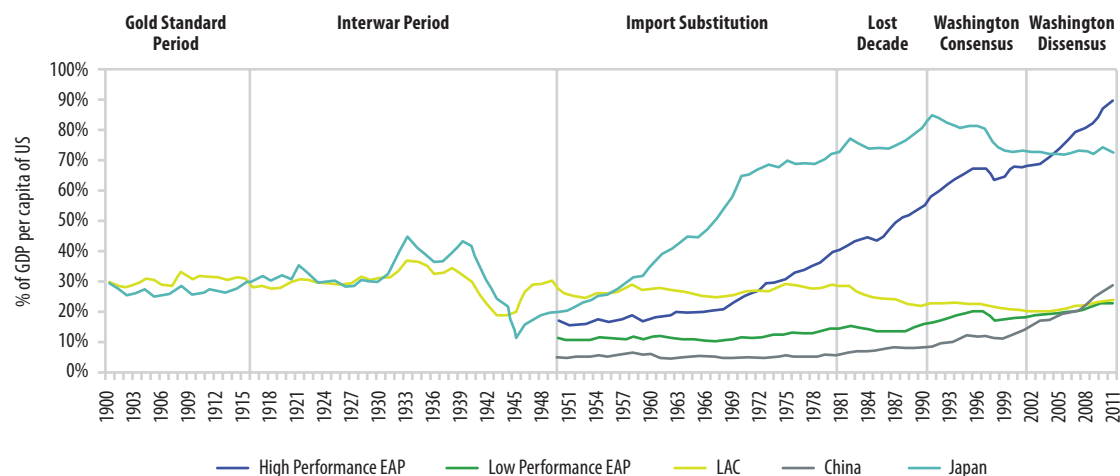
Source: Maddison (2007) and WDI. Note: The graph shows GDP per capita relative to the US.

exceeded the East Asia and Pacific countries in terms of GDP per capita but high-performing East Asian countries such as South Korea had soared ahead of LAC by 1980 and in 2011 were at 90 percent of the US figures.

LAC is still far away from reaching the relatively low levels of income inequality of other countries, in particular members of the OECD. Figure 12 compares the after-tax income Gini coefficient of Latin American countries in 2011 with a group of OECD countries in the late 2000s. In all cases, countries in Latin America had higher income inequality than non-LAC OECD countries. LAC Gini coefficients ranged from 0.43 to 0.57 in 2011 compared to 0.24 to 0.41 for non-LAC OECD countries in the late 2000s. In other words, all countries in Latin America were more unequal than the most unequal non-LAC country in the OECD, Turkey.

The Shared Prosperity Convergence Index (SPCI) tracks progress in equity-adjusted growth and underscores the challenges the region still faces in delivering inclusive growth. By this measure, LAC's standing in 2011 was just 20 percent of the benchmark (the top ten global performers in terms of equity adjusted GPD per capita in 2000).[6] The region had, however, risen from a score of about 15 percent in the mid-1990s (Figure 13). Over the same period, the Southern Cone and Mexico were LAC's best performers by this measure, while Central America lagged behind.

A key challenge facing the region in closing the gap with top performers is the persistent uneven standards of living at the subnational level in LAC countries. In Brazil, for example, the poorest states of Piauí and Maranhão have a Sen's Welfare Index of less than 20 percent of the benchmark (São Paulo 2009), and these figures have increased only very slowly since 1995 (Figure 14a). In contrast, Rio de Janeiro and Santa Catarina have made much faster progress and now rank at 70 and 90 percent of the benchmark. Mexico has similar disparities. Progress toward the benchmark (Distrito Federal 2010) has been slower in poorer states such as Chiapas and Oaxaca than in richer states such as Nuevo Leon and Coahuila (Figure 14 b).

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6 The SPCI measures the gap between the Sen's Welfare Index (GDP per capita adjusted by income inequality) for any given country with respect to the average Sen's index of the top ten global performers. The SPCI proposed is based on the Sen's Welfare Index (Sen 1976), which is calculated as the mean income (μ) times one minus the Gini coefficient (G), that is, $S = \mu(1-G)$ The benchmark is fixed and it refers to the average Sen's Welfare Index in 2000 of the top 10 countries.

Figure 12: LAC is one of the most unequal regions in the world
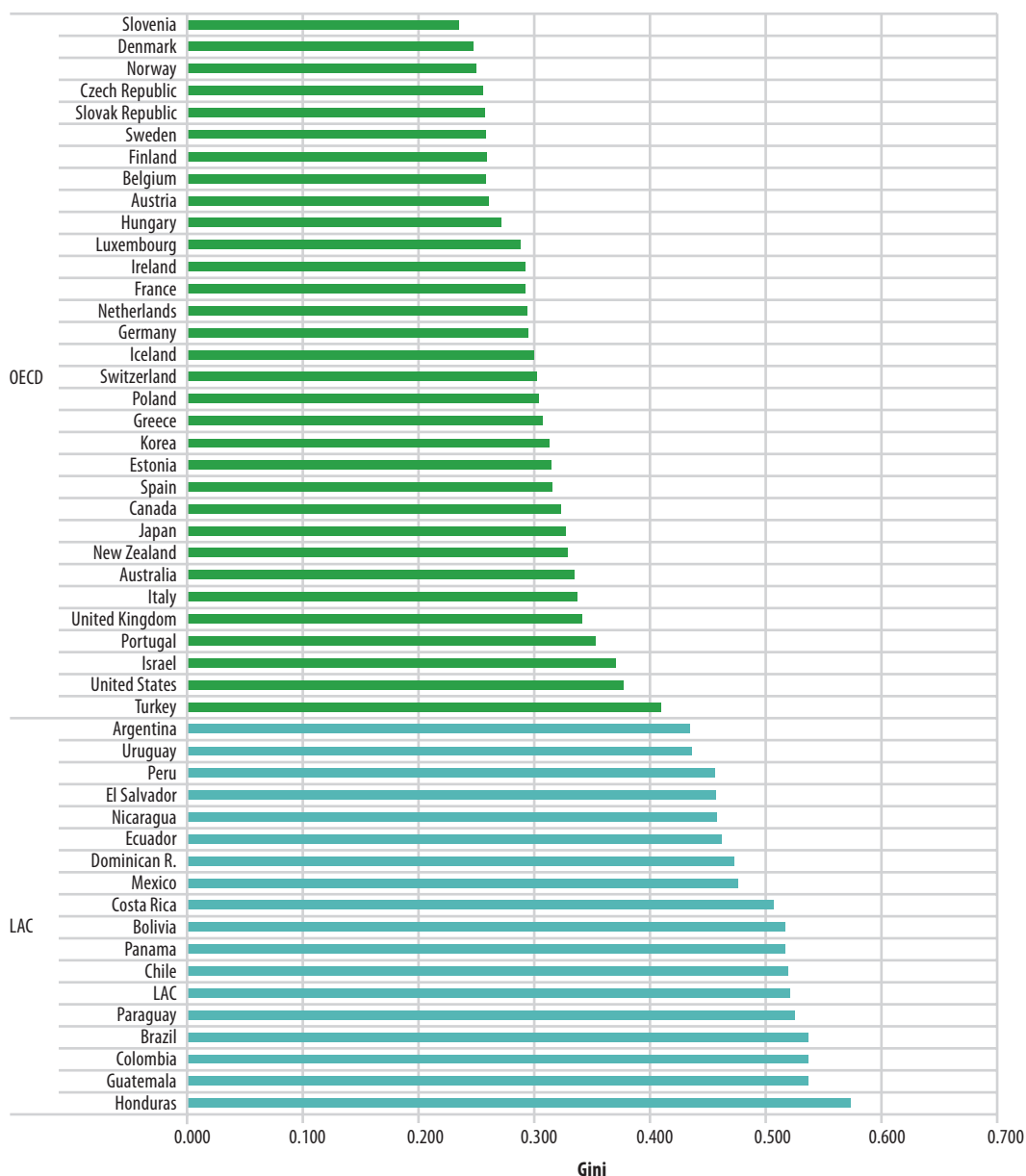
Source: Authors' calculations based on data from SEDLAC (CEDLAS and The World Bank) for LAC countries and OECD (2012), "Income Distribution: Income distribution: inequality", OECD Social Expenditure Statistics (database) for OECD countries. Note: Circa 2011 for LAC countries and late 2000s for OECD countries.

Even if LAC keeps to the quickened pace of economic growth and inequality reduction of the 2000s, the region as a whole will not catch up by 2030 with the benchmark, the top global performers in 2000. Only Argentina, Panama, and Uruguay, continuing to grow at their 2003-2011 rates, might be able to achieve the benchmark in 2030 (Figure 15). Prospects look more promising for income inequality. If LAC countries continue the steady decline in the Gini coefficient of the last eight years, almost half might reach the benchmark by 2030. Those countries are Argentina, Dominican Republic, Ecuador, El Salvador, Mexico, Nicaragua, Peru and Uruguay.

Figure 13: Trends in shared prosperity in LAC, measured by SPCI
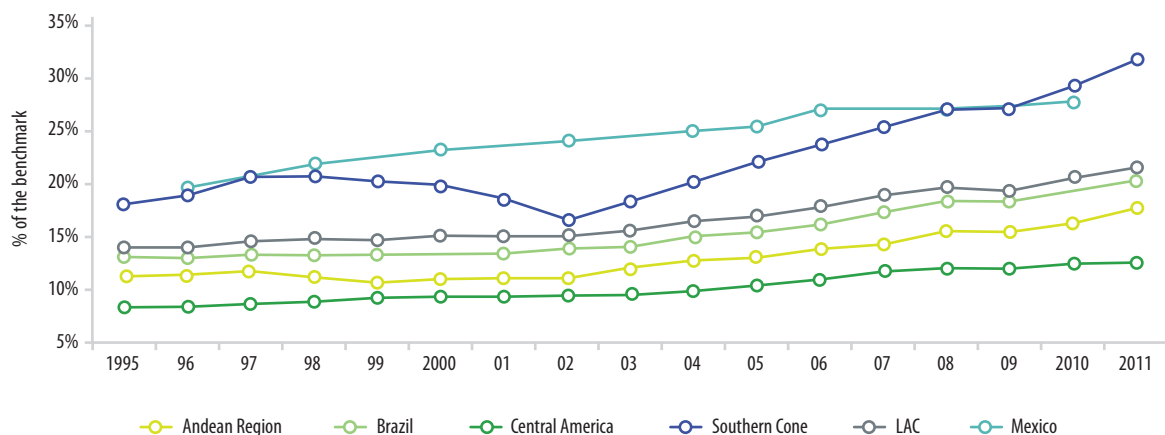
Source: Authors' calculations using SEDLAC data (CEDLAS and the World Bank) and World Development Indicators (WDI). Note: Gini coefficients are calculated using pooled data of countries, while GDP per capita figures for LAC and sub-region are population-weighted average of countries. The Sen's Welfare Index benchmark is 23,535 (equity-adjusted per capita GDP per year, PPP 2005), derived from the population-weighted average of the Sen's Welfare Index of the top ten countries in 2000 (Luxembourg, Qatar, Norway, Denmark, United States, Netherlands, Switzerland, Austria, Ireland and Singapore).

Figure 14: Divergence in equity adjusted growth within countries in LAC
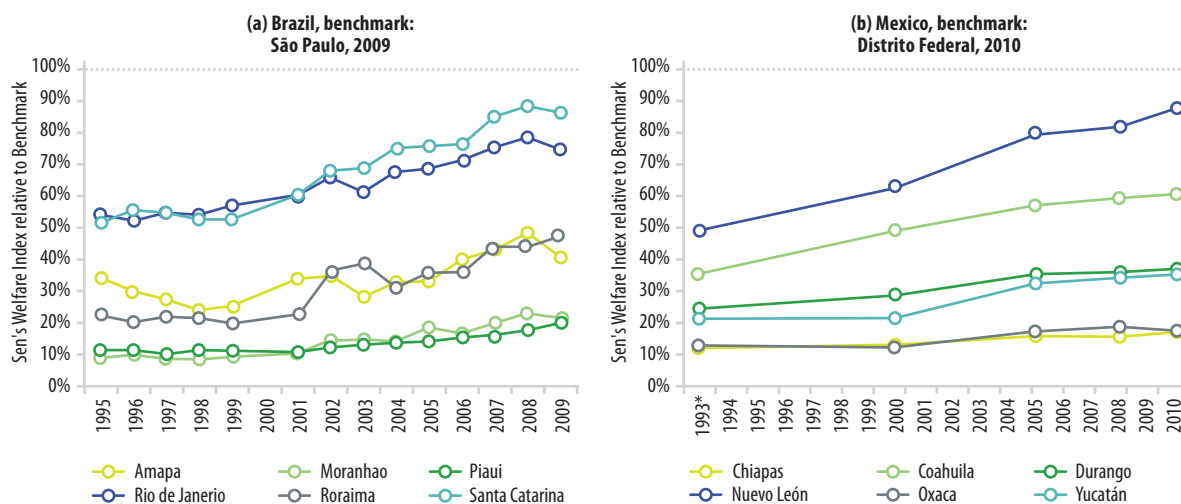
Source: Panel a: Authors' calculations using data from SEDLAC (CEDLAS and World Bank) for Gini coefficients and IPEADATA for GDP per capita. Panel b: Authors' calculations using data from Coneval for Gini coefficients and INEGI for GDP per capita. Note: In panel b, the Gini coefficient in 1993 corresponds to values in 1990, estimated by Coneval using PovMap (ENIGH 1992 and Censo 1990).

LAC would need a per capita growth of real income of 7.5 percent annually to close the gap with the most prosperous countries by 2030, keeping the same pace of inequality reduction observed in recent years. That is more than twice the 3.1 percent achieved from 2003 to 2011, the period of higher growth in the region (Figure 9). Assuming a continuation of the 3.1 percent rate and the same pace of inequality reduction, LAC as a whole would need 41 years to close the gap with global top performers, while it would take 51 years if inequality were to remain constant at the 2011 level.

Figure 15: Growth rates needed to achieve the benchmark in GDP per capita and Gini in 2030

GDP per capita

Gini

Annualized Growth Rate

Annualized Growth Rate

Countries (both charts): LAC, Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican R., Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay

■ Annualized growth rate observed circa 2003-11 ■ Annualized growth rate need to achieve benchmark in 2030

Source: Authors' calculations using SEDLAC data (CEDLAS and the World Bank). Note: See Table A1 for the years used for each country. The benchmark refers to the population weighted average of the Sen's Welfare Index of the top ten countries in 2000, which include Luxembourg, Qatar, Norway, Denmark, United States, Netherlands, Switzerland, Austria, Ireland, and Singapore. Benchmark for GDP per capita is $38,909 international purchasing power parity 2005 a year and Gini is 0.395.

Figure 16: Years to close the gap with top performers

Years to converge to benchmark

51
41

Annualized Growth Rate GDP per capita

── Observed reduction rate of Gini from 2003 to 2011 ── No reduction of Gini
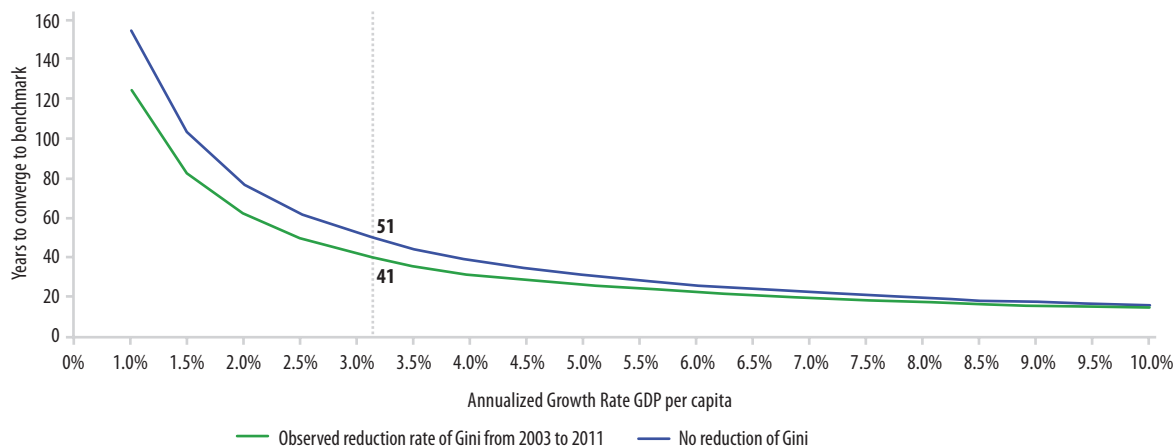
Source: Authors' calculations using SEDLAC data (CEDLAS and the World Bank). Note: The benchmark refers to the population-weighted average of the Sen's Welfare Index of the top ten countries in 2000 (Luxembourg, Qatar, Norway, Denmark, United States, Netherlands, Switzerland, Austria, Ireland and Singapore).
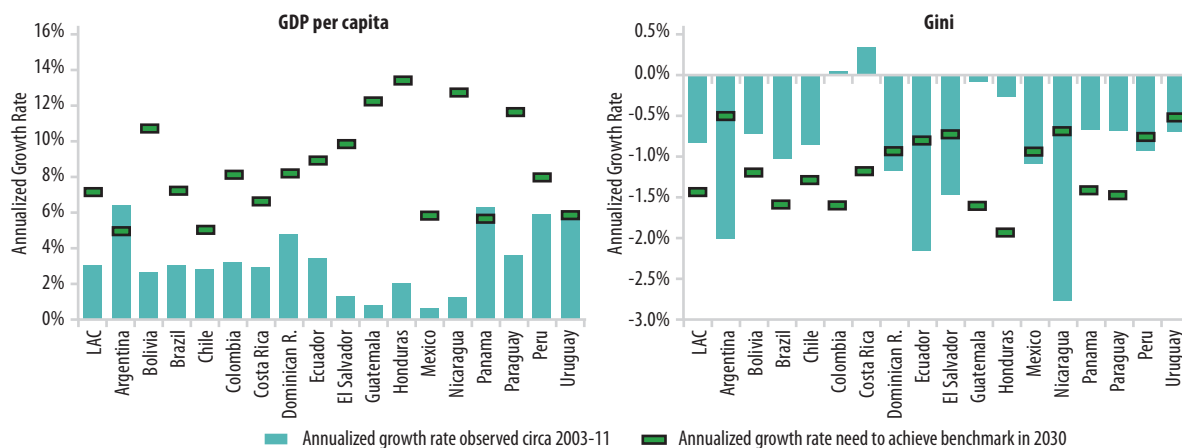
IV. Opportunities to accelerate shared prosperity in LAC

LAC is likely to face significant challenges to accelerate shared prosperity under a modest global economic outlook. According to a recent World Bank report,[7] economic growth in LAC will continue in the short run to rely on natural resources and foreign capital inflows, while in the long run it will depend on the level and composition of investment, both physical and human capital.

Strengthening the links between growth and equity, with a clear focus on improving the well-being of the poorest and the vulnerable, will boost shared prosperity in LAC. The link between economic growth and equity means that while growth is important for increasing welfare, how equitable a society is also plays a primary role in driving progress. Equity-oriented policies can enhance a region's capacity to grow in a sustained manner. Enabling people who are currently marginalized to improve their living conditions will unleash their inherent economic potential, increasing overall productivity and thus spurring growth. For instance, improvements in equity—more access to health and quality education—raise the productive capacity of the poor and enhance social inclusion through higher employability and productivity. This, in turn, leads to higher growth, which makes more fiscal resources available to improve the quality of life for all.

Assuming that economic growth will continue, four important policy themes aimed towards achieving a more equitable society could enhance the capacity of the system to accelerate shared prosperity. These themes are: (1) maintaining an equitable, efficient and sustainable fiscal policy; (2) strengthening fair, transparent institutions that deliver quality public goods; (3) enabling an environment of well-functioning and accessible markets; and (4) developing instruments to improve risk management both at the macro and household levels.

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7   de la Torre et al. (2013).

Figure 17: Tax collection in LAC is low and has remained relatively constant (2010)
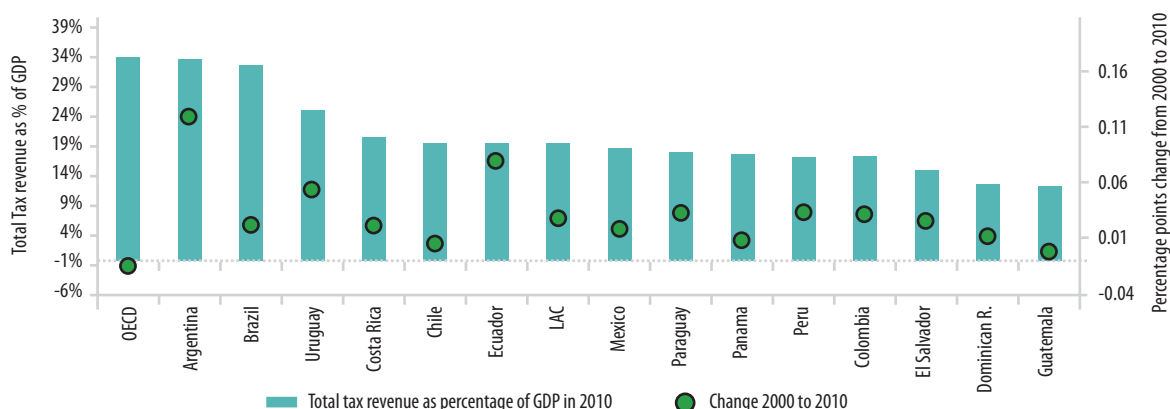
Source: OECD/ECLAC/CIAT (2012). Note: The figures exclude local government revenues for Argentina (but include provincial revenues), Costa Rica (up to 1997), Dominican Republic, Ecuador, El Salvador, Panama (up to 1998 and 2010), Paraguay (up to 2004), Peru (up to 2004), and Uruguay, because the data are not available. In ECLAC and CIAT data on Mexico, fees levied on hydrocarbon production are treated as non-tax revenues. ECLAC data for Paraguay does not consider contributions to certain social security pension funds, such as those for railway, bank, and power companies, to be tax revenue. LAC figures cover a selected group of Latin American countries. Chile and Mexico are also members of OECD; OECD figure represents the unweighted average for OECD member countries.

IV.1 Equitable and sustainable fiscal policy and stability

Fiscal policy's contribution to promoting shared prosperity in LAC is relatively weak, compared to OECD countries, both in terms of levels of tax collection and progressivity. The share of tax revenues as a percentage of GDP is just under 20 percent on average in LAC, compared to 34 percent in OECD countries (Figure 17). As of 2010, there was a large variation across countries in LAC, with Argentina and Brazil having the region's highest level of tax collection, about 33 percent of GDP, and Dominican Republic and Guatemala the lowest, less than 15 percent.

There is important potential for improving the progressivity of the fiscal system in LAC countries, both in terms of tax revenue and government spending. According to data from the OECD StatExtracts for the late 2000s, the Gini coefficient before taxes and transfers for OECD countries was 0.45 while the same indicator after taxes and transfers was 0.31. This suggests 14 Gini points of redistribution solely by the fiscal system. Similar conclusions come from applying the Commitment to Equity (CEQ) methodology to compare market income (before taxes and transfers) to post-fiscal income (after taxes and transfers) for a selected group of LAC countries (Figure 18)[8]: while fiscal policy in LAC is progressive, redistributive impact is small compared to OECD countries. In Colombia, Bolivia and Guatemala, fiscal policy has no noticeable redistributive impact at all.[9] The largest effect occurs in Uruguay, where fiscal policy reduces the Gini from 0.49 to 0.46. In sum, the LAC country with one of the most redistributive fiscal systems reduces the Gini by only three percentage points while the OECD average is more than four times this number (14 percentage points).

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8   The CEQ is an interagency initiative led by the University of Tulane and the Inter-American Dialogue, working closely with The World Bank, Inter-American Development Bank and United Nations Development Programme. The CEQ framework is a diagnostics tool developed to assess the extent to which fiscal policies support a minimum living standard, human capital accumulation and inequality reduction (Lustig, Gray-Molina, Higgins, Jaramillo, Jimenez, Paz, Pereira, Pessino, Scott, and Yanez 2012).
9   This may change in the case of Colombia, because in December 2012 it passed tax reform that is projected to reduce the Gini Coefficient by 1.9 points.

Figure 18: There is significant room for improving progressivity of taxes and spending in LAC
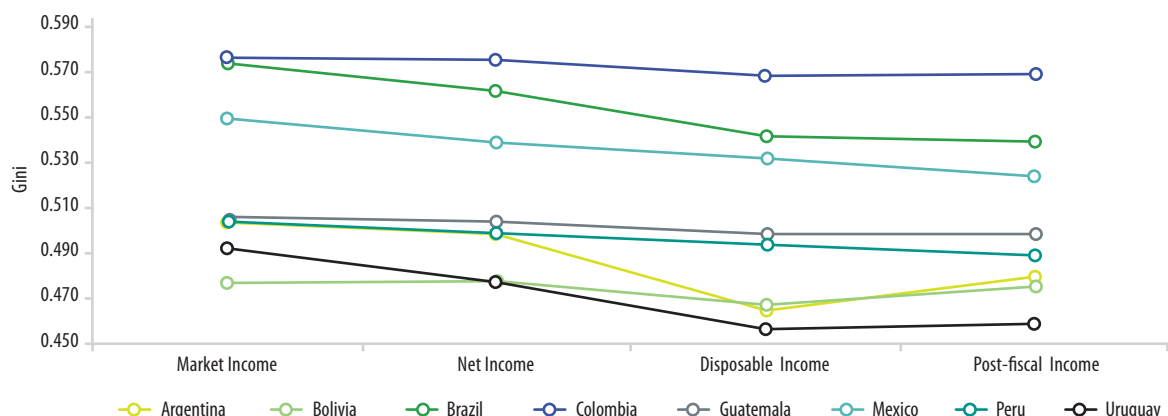
Source: Bucheli et al. (2012); Hurtado et al. (2013), and Lustig et al. (2012). Note: The figure shows Gini coefficients. Market Income is the income perceived by each household before taxes and transfers. Net market income is market income net of income tax. Disposable income equals net market income plus direct transfers. Post-fiscal income equals disposable income plus indirect subsidies and minus indirect taxes. The following data were used—Argentina: Encuesta Permanente de Hogares, 1st semester of 2009; Bolivia: Encuesta de Hogares, 2009; Brazil: Pesquisa de Orçamentos Familiares, 2008- 2009; Colombia: Encuesta Nacional de Condiciones de Vida para 2010; Guatemala: ENIGFAM (Encuesta de Ingresos y Gastos Familiares) 2009-2010; Mexico: Encuesta Nacional de Ingreso y Gasto de los Hogares, 2008; Peru: Encuesta Nacional de Hogares, 2009; Uruguay: Encuesta Continua de Hogares, 2009. Data on government revenues and spending is obtained from the country's national accounts.

IV.2 Accountable and efficient institutions and equitable access to services

Public services have been improving over time in the LAC region. However, poor and vulnerable households often lack access, limiting their ability to participate in and contribute to growth. The Human Opportunity Index (HOI) measures how individual circumstances[10] such as place of residence, gender and education of the household head can affect a child's access to basic goods and services such as education, water, electricity and sanitation.[11] These services are all highly relevant to the development of children, yet access to them remains largely unequal, both between and within countries, and far from universal in some cases (Figure 19a).[12] Questions of quality of services arise when equity adjusted access to school enrollment in LAC, with an HOI of 91.1, is higher than on-time completion of sixth grade, 63.7 (Figure 19b).[13] The HOI values for access to safe water (62.1) and adequate sanitation (56.8) are also disturbingly low. Particularly alarming is the safe water figure, because water influences health and other important opportunities such as not missing school days due to diarrhea.

Opportunities that are lagging behind, such as quality of education, water and sanitation, require special attention. Societies with more unequal access to basic goods and services early in life will be more prone to present higher inequality of outcomes during the life of their citizens.[14] Given the high levels of inequality of opportunities early in life in LAC, different children will have different jobs, labor incomes, health and access to quality education later in life, which will likely end up increasing inequality of outcomes and potentially

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10   Circumstances are personal, family and community characteristics that society believes should not determine access to basic goods and services (Molinas et al., 2012).
11   The Human Opportunity Index is generally computed based on children aged 0-16 in order to remove effort and choices and to focus on opportunities given early in life. Paes de Barros, Ferreira, Molina and Saavedra (2009) developed the index.
12   Molinas, Paes de Barros, Saavedra, y Giugale (2012).
13   Finishing 6th grade at the proper age partially captures the quality of the education; children who finish on time are more likely to have accessed education of better quality that allowed them to avoid grade repetition.
14   Paes de Barros, Ferreira, Molinas, Saavedra-Chanduvi (2009).

Figure 19: Human Opportunity Index (HOI) in LAC, circa 2010

(a) Access to basic services as measured by HOI remains unequal and not universal in LAC

Chile, Uruguay, Argentina, Costa Rica, Mexico, Venezuela, Colombia, Brazil, Ecuador, Dominican R., LAC, Paraguay, Jamaica, Bolivia, Peru, Panama, El Salvador, Guatemala, Honduras, Nicaragua

(b) HOI by type of opportunities in LAC

School Enrollment	6th Grade on Time	Water	Electricity	Sanitation
92	64	62	85	57

Source: Molinas, Paes de Barros, Saavedra, and Giugale (2012).

hampering economic growth. One recent study shows that between one-fifth and one-third of individual earning inequality is accounted for by inequality of opportunity in Brazil, Colombia, Ecuador, Guatemala, Mexico, Panama and Peru.[15] This higher inequality of outcomes due to unequal opportunities is likely to obstruct inclusive growth. For instance, another study has found a negative relationship between growth and inequality of opportunity in the US.[16]

IV.3 Well-functioning and accessible markets

Low and unequal access to goods and services markets is a major challenge for shared prosperity in LAC. Improved access to markets by a country's less affluent citizens is an important element of development and poverty reduction. New ways of collecting and analyzing geographic data have allowed sharper measuring of market accessibility. One 2004 study,[17] using Geographic Information System (GIS) data, found that a 10 percent increase in an Accessibility Index of micro firms (which typically are founded by or employ low income people) in the south of Mexico represented an enhancement of 13 percent in productivity.

The poor and vulnerable in LAC also have low access to financial services compared to the same economic groups in high-income countries. Access to bank accounts is a good example. In OECD countries, more than 90 percent of adults have an account (either on their own or shared with someone else) at a bank, credit union or other type of financial institution, and differences in participation rates by people in the top 60 percent income bracket and the bottom 40 percent are small. But in almost all the LAC countries, less than 40 percent of adults have accounts at formal financial institutions. In addition, there is a significant gap in access between the poorest 40 percent and the richest 60 percent of the population (Figure 20).

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15   Paes de Barros et al. (2009). In order to measure how outcome inequality stems from inequality of opportunity, income inequality is broken down into a part attributed to circumstances that are beyond an individual's control such as gender and ethnicity and a part that refers to effort, talent and luck. The smaller the fraction of income inequality that is explained by factors over which people have no control the greater is a country's equality of opportunity. Formally, this is done by looking at the between group inequality over total inequality, where groups are defined by these circumstance variables (Paes de Barros et al. 2009).
16   Marrero and Rodriguez (2013).
17   Deichman et al. (2004).

In a 2013 study, Ortiz-Juarez and Perez-Garcia estimated a non-parametric variant of the Human Opportunity Index (HOI), which was first proposed by Barros et al. (2009). The main objective of the variant was to measure differences in the distribution of human opportunities at the state level in Mexico, as well as the changes in HOI values between 2000 and 2010.

The estimation, for children between five and 15 years old, used the following variables of access: (1) household without overcrowding; (2) home with a finished floor; (3) with electricity; (4) with running water; (5) with flush toilet; (6) with access to sewage disposal; and (7) school attendance. The circumstances were the following: (1) sex of children; (2) sex of the household head; (3) rural or urban location; (4) incidence of physical or mental disabilities; and (5) education of the household head (complete secondary or more versus incomplete secondary or less).

The results show that Mexican states with the lower HOI values in 2000 experienced the higher increases in 2010, reducing opportunity gaps (Table B3.1). In particular, traditionally poor states achieved the best results. For example, Oaxaca increased the value of its HOI by 49.8 percent between 2000 and 2010; in Guerrero the rise was 37.2 percent, in Puebla it was close to 34 percent, and in Chiapas it was 32 percent.

Table B2.1: HOI by states in Mexico, 2000 and 2010

States	HOI 2000	HOI 2010	% Change	States	HOI 2000	HOI 2010	% Change
Oaxaca	0.301	0.451	49.8	Queretaro	0.597	0.728	21.9
Yucatan	0.469	0.647	37.8	Morelos	0.550	0.670	21.8
Guerrero	0.308	0.422	37.2	Tabasco	0.511	0.618	21.1
Veracruz	0.407	0.554	36.3	Guanajuato	0.617	0.746	21.0
San Luis Potosi	0.488	0.660	35.3	Colima	0.680	0.791	16.4
Campeche	0.435	0.586	34.7	Mexico	0.623	0.725	16.3
Puebla	0.429	0.576	34.1	Durango	0.628	0.715	14.0
Hidalgo	0.497	0.657	32.3	Sonora	0.712	0.811	13.9
Chiapas	0.330	0.436	32.1	Nayarit	0.540	0.614	13.8
Quintana Roo	0.553	0.712	28.9	Coahuila	0.731	0.827	13.1
Sinaloa	0.580	0.746	28.7	Jalisco	0.733	0.822	12.2
Zacatecas	0.624	0.800	28.2	Chihuahua	0.744	0.832	11.8
Baja California	0.662	0.838	26.6	Baja California Sur	0.720	0.798	10.8
Tamaulipas	0.623	0.774	24.2	Nuevo Leon	0.791	0.856	8.3
Tlaxcala	0.585	0.725	24.0	Aguascalientes	0.795	0.850	7.0
Michoacan	0.573	0.706	23.2	Distrito Federal	0.782	0.824	5.4
				National	**0.586**	**0.701**	**19.5**

Source: Ortiz-Juarez and Perez-Garcia (2013).

Figure 20: Accounts at formal financial institutions in OECD and LAC, 2011
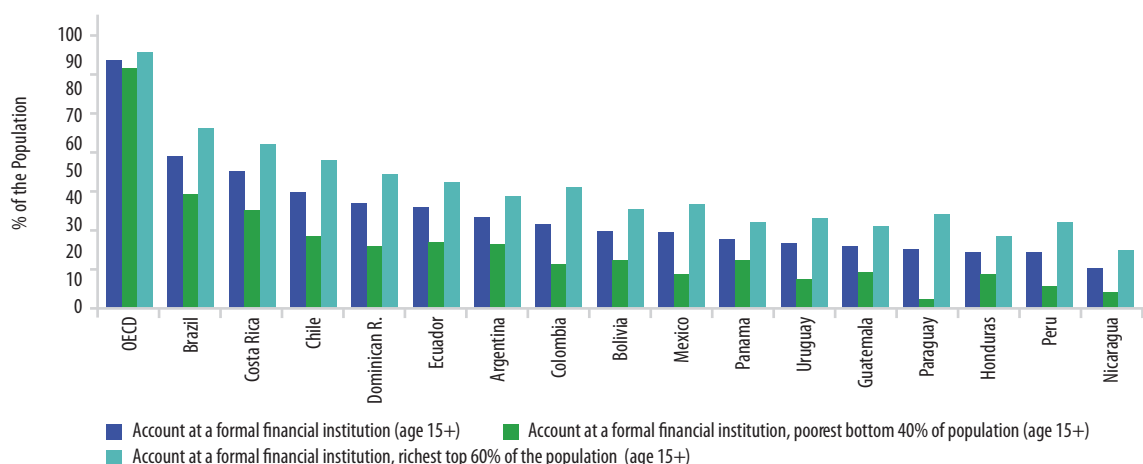
Source: Global Findex (Global Financial Inclusion database). Note: Includes adults with an account (on their own or together with someone else) at a bank, credit union, or another financial institution (e.g., cooperatives, microfinance enterprises, post office), as well as people who reported having a debit card.

Figure 21: Economically active population contributing to the pension system by decile in labor income, 2012
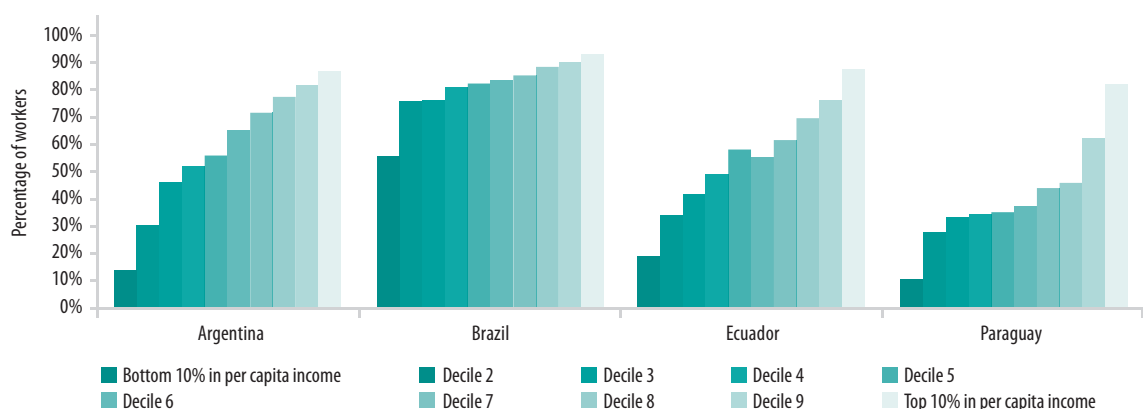
Source: Authors' calculation using LABLAC Data (CEDLAS and the World Bank). Note: Period of reference is the second trimester of 2012. The graph shows the percentage of workers who reported they had rights to a pension, by decile of per capita income of their households. Only members of households with per capita income greater than zero were considered.

There are potentially harmful differences in access to the formal labor market by economic class in LAC. According to a World Bank report,[18] the informal economy has negative effects on growth and rising social well-being. Most countries in the LAC region, the report says, are characterized by "truncated welfare systems" in which people working in the formal sector enjoy often generous bundles of social security, while those in the informal sector get by with few benefits or safety nets such as unemployment insurance. Figure 21 shows that in several countries in the region informality measured by the share of the labor force not covered by pensions is significantly higher among low-income than among high-income workers.[19]

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18 Perry et al. (2007).
19 Figure based on Rofman, Lucchetti, and Ourens (2008).

Figure 22: Natural disasters and their correlation with poverty

(a) Total number of natural disasters in LAC between 1970 and 2012

(b) Correlation between poverty and natural disasters in LAC, 2009
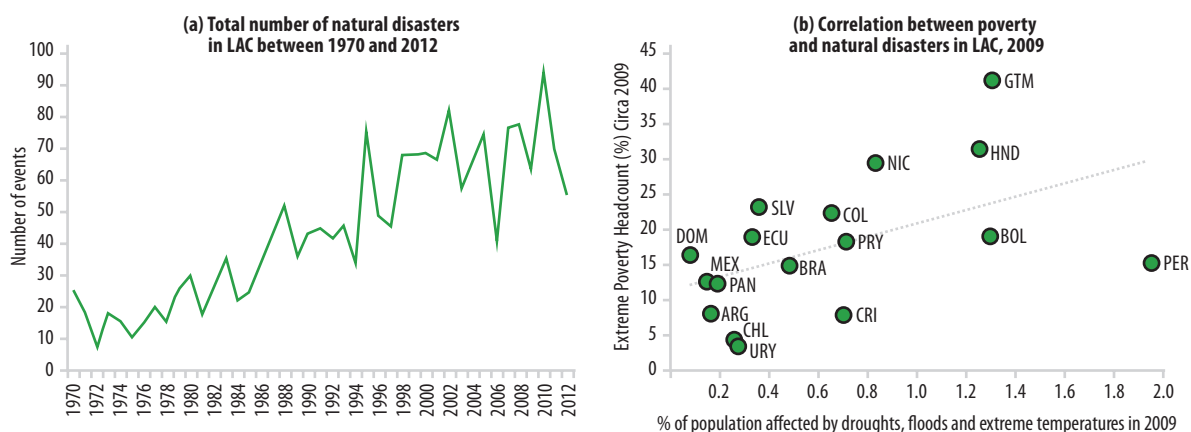
Source: Authors' calculation using EM-DAT: The OFDA/CRED International Disaster Database – www.emdat.be, Université Catholique de Louvain, Brussels (Belgium) in figure (a) and LABLAC Data (CEDLAS and the World Bank) for poverty headcount and World Development Indicators (WDI) for natural disaster in figure (b). Note: Figure (a) considers all natural disasters that happened in all Latin America and the Caribbean countries between 1970 and 2012.

IV.4 Enhancing risk management and resiliency

Climate change threatens global shared prosperity. Climate change poses two challenges, especially to poor rural households: increased frequency and severity of extreme weather events, and long-term shifts in temperature and rainfall.[20] Latin America has already experienced increased variability, frequency and strength of natural disasters in recent years (Figure 22a).[21] In fact, there appears to be a positive correlation between natural disasters in LAC and a worsening of welfare indicators (Figure 22b). To quote some recent study findings, severe rainfall and droughts triggered poverty persistence among poor households in Nicaragua.[22] In Colombia, heat waves have had a negative impact on birth weights, an important predictor of intergenerational inequality.[23] Nicaraguan children living in households affected by 1998's Hurricane Mitch were more likely to be malnourished after the shock.[24]

LAC countries should strengthen risk mitigation and adaption systems to prevent natural disasters from disrupting links between economic growth and equity. There is room for more public policy to strengthen the limited capacity of poor households to adapt to climate change. Investing in improved household data collection and analysis should be considered, including the development of longer-term sets of data, which would allow policy makers to better understand and counter the impact of climate change. Scaling up weather warning systems, agricultural extension advice, insurance (such as weather-indexed coverage) and social safety nets for people hit by weather events could go a long way toward mitigating the impact of climate change.[25] In Nicaragua, the combination of these kinds of safety nets with interventions such as vocational training and productive investment grants has proved to be effective in helping households cope with weather-related risks compared to beneficiaries of social safety nets alone.[26]

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20 Baez, Kronick and Mason (2012).
21 The increase in the frequency of natural disasters may be partially driven by better reporting and growing human settlement in areas of risk (Baez et al. 2012).
22 Premad and Vakis (2010).
23 Azevedo et al. (2013).
24 Baez and Santos (2007).
25 Baez et al. (2012).
26 Marcours, Premand and Vakis (2012).

Latin America and the Caribbean have also experienced increased volatility of food prices in recent years. Between 2005 and 2008, world food prices rose considerably.[27] In general, LAC benefited from this shock because most of its countries are net exporters of food. However, urban populations in the region and vulnerable households in Central America[28] and Mexico that were net consumers of food were adversely affected.[29] The 2007-2008 food price shock increased poverty rates in some countries in Central America for which estimates are available; poverty increased by about four percentage points in Nicaragua and by about one percentage point in Guatemala and Honduras.[30] Even in Brazil, a large producer and net exporter of food, the population experienced a decline in welfare, and extreme and moderate poverty increased by more than one percentage point as the result of the food price spike of 2007-2008.[31] The impact was higher in urban areas where few people are engaged in agriculture.

To minimize the impact of food price shocks, policies should focus on protecting the poorest, especially in urban areas. The quickest response is to expand benefits and coverage of existing programs that target the poor, such as conditional cash transfer programs.[32] In response to the food price spike in 2007-2008, Brazil increased the benefit of the *Bolsa Familia* program, its main conditional cash transfer program, which helped those covered by this targeted program to cope with the shock.[33] In absence of these programs, other interventions such as food provision, microfinance programs and nutrition education, might also be considered as alternatives to help households coping with higher food prices.[34, 35]

Lastly, the weakness of the global economy raises concerns regarding the capacity of the region to continue growing and reducing poverty. LAC witnessed a deceleration of the economy during the 2008-2009 global financial crisis. Economic contractions are likely to affect the "vulnerable" group—those who are neither middle class nor poor—because they tend to work more in the informal sector (Annex 3) and to be less covered by social safety nets and insurance. Therefore, social protection systems should pay special attention to this group to prevent it from falling back into poverty if the global economy weakens again in the future.[36]

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27   Ivanic and Martin (2008).
28   The proportion of the households considered "net consumers" before the rise of food prices was about 69 percent in El Salvador, 83 percent in Guatemala, 89 percent in Honduras, and 90 percent in Nicaragua (Robles and Torero 2010).
29   World Bank (2011c).
30   Robles and Torero (2010).
31   Ferreira, Fruttero, Leite and Lucchetti (2013).
32   World Bank (2011c).
33   Ferreira et al. (2013).
34   Robles and Torero (2010).
35   World Bank (2011c).
36   Ferreira et al. (2012).

Final remarks

Compared to its performance during the last two decades of the 20th century, the Latin American and the Caribbean region has done very well during the new millennium. Extreme poverty has been cut in half since 1995, dropping to 13 percent in 2011. Higher growth coupled with lower income inequality has meant that the less well-off have benefitted and the middle class has grown from one fifth to one third of the population. Today, for the first time, there are more people considered middle class than poor.

There is no question, then, that the region has been getting many things right in its recent past. But, where does that put it in a larger perspective? Compared to today's rich countries, where does the region stand? And how far does it have to go to reach similar levels of prosperity?

The fact is that today around one in four Latin Americans remain below the region's moderate poverty line ($4 a day). The equity adjusted level of GDP per capita remains just above 20 percent of the level of the top global performers. Moreover, there is growing divergence within the region: the share of the region's extreme poor in the Southern Cone has dropped in the last fifteen years while this share has risen in Mexico and Central America.

What this means is that at current trends, it won't be until 2052 that the average Latin American citizen achieves the standard of living that citizens in high-income countries had in 2000. Clearly, there needs to be a dramatic increase in growth and further reductions in the region's persistent inequality to help close the gap with richer nations more quickly and eliminate extreme poverty. Given the global economic climate, growth will be increasingly dependent on internal sources and will need to be less commodity-driven than in the past. Key to this process will be strengthening the virtuous circle between growth and equity: building more accessible markets, more fully exploiting fiscal policy, delivering more and higher quality services and reducing vulnerability to economic and weather shocks.

Past experience suggests that raising labor market incomes should be the focus, as they were responsible for the majority of the gains in poverty reduction and falling inequality. While public transfers have played a significant role in achieving these improved social outcomes and enhancing household resilience to shocks, concerns over how they may be affecting household incentives for savings, investment and employment suggest that their role needs to be evaluated carefully and adjusted to specific country contexts.

Recent World Bank research underscores that the solutions to expanding labor incomes will likely lie outside the labor market and involve improving human capital levels, particularly the quality of education, reforming financial markets to expand access, ensuring that markets reward talent equally and that there is no differential treatment due to race and gender, as well as expanding connectivity and lowering transport and other transactions costs to access markets. Micro reforms such as these may require that the region's most privileged agree to some reforms necessary to expand the pie for all. Similarly, it will be important to give voice to those less fortunate through targeted efforts to capture and transmit their views with new technologies for receiving and disseminating information, as well as through participatory policy making and greater public sector transparency and sharing of information. These two lines of action are complementary; and both of them will require strong leadership to generate the change needed to ensure that a Latin American citizen born today does not need to wait for her grandchildren to experience the level of prosperity known by the global top performers in 2000.

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Annex 1. LAC harmonized databases and estimation of regional poverty and inequality numbers

To track trends in poverty, inequality and unemployment across the region, it is important to have timely, reliable, transparent, and comparable statistics. Since 1996, the Poverty and Gender Unit of the Latin America and the Caribbean (LAC) region of the World Bank has been investing in statistics, providing targeted support to governments in the region to help improve the quality, frequency, accessibility and comparability of statistics.

An important capstone of this effort is the partnership with the Center for Distributional Labor and Social Studies (CEDLAS) in La Plata, Argentina to support the Socio-Economic Database for LAC (SEDLAC - http://sedlac.econo.unlp.edu.ar/eng/). This project allows for timely access to high-quality, harmonized databases of socio-economic and labor market statistics, covering more than 300 surveys.

This brief uses the harmonized SEDLAC data to provide the most accurate and comparable assessment of poverty and labor market trends in the region. In 2010, to improve the timeliness of the information, a second project was introduced, Labor Market Statistics for Latin America and the Caribbean (LABLAC), which captures high-frequency labor force survey data. LABLAC currently includes quarterly labor market indicators from seven countries: Argentina, Brazil, Ecuador, Mexico, Paraguay, Peru, and Uruguay.

The estimation of LAC poverty rates is based on microdata of 17 countries for which some database is available for the 1990s or 2000s. These countries are Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Peru, Paraguay and Uruguay. Regional poverty rates are population-weighted averages of country-specific poverty rates using international poverty lines. Whenever possible, annual household surveys from 1995 to 2011 have been used to estimate annual poverty rates. However, many countries do not conduct such surveys. To overcome this limitation, estimated poverty rates have been obtained by generating artificial surveys using macroeconomic information on private consumption growth rates from the Bank's World Development Indicators.

Because it does not satisfy group decomposability, the regional Gini coefficient cannot be computed as a population-weighted average of country-specific Gini coefficients. Instead, the regional Gini coefficient is computed based on pooled country-specific data previously collapsed into 4000 percentiles.

## Table A.1: Household surveys used from SEDLAC and LABLAC harmonization

Relevant information on the Socio-Economic Database for Latin America and the Caribbean (SEDLAC)

Country	Name of survey	Acronym	Circa 2003	Circa 2011	Coverage
Argentina	Encuesta Permanente de Hogares-Continua	EPH-C	2004	2011	Urban-31 cities
Bolivia	Encuesta Continua de Hogares- MECOVI	ECH	2002	2008	Urban
Brazil	Pesquisa Nacional por Amostra de Domicilios	PNAD	2004	2011	National
Chile	Encuesta de Caracterización Socioeconómica Nacional	CASEN	2003	2009	National
Colombia	Gran Encuesta Integrada de Hogares	GEIH	2003	2011	National
Costa Rica	Encuesta de Hogares de Propósitos Múltiples	EHPM	2003	2009	National
Dominican R.	Encuesta Nacional de Fuerza de Trabajo	ENFT	2003	2011	National
Ecuador	Encuesta de Empleo, Desempleo y Subempleo	ENEMDU	2003	2011	National
El Salvador	Encuesta de Hogares de Propósitos Múltiples	EHPM	2003	2010	National
Guatemala	Encuesta Nacional de Condiciones de Vida	ENCOVI	2000	2011	National
Honduras	Encuesta Permanente de Hogares de Propósitos Múltiples	EPHPM	2003	2011	National
Mexico	Encuesta Nacional de Ingresos y Gastos de los Hogares	ENIGH	2004	2010	National
Nicaragua	Encuesta Nacional de Hogares sobre Medición de Niveles de Vida	EMNV	2005	2009	National
Panama	Encuesta de Hogares	EH	2007	2011	National
Paraguay	Encuesta Permanente de Hogares	EPH	2003	2011	National
Peru	Encuesta Nacional de Hogares	ENAHO	2004	2011	National
Uruguay	Encuesta Continua de Hogares	ECH	2003	2011	Urban - Montevideo and Interior >5000 inhabitants

Relevant information on the Labor Database for Latin America and the Caribbean (LABLAC)

Country	Name of survey	Acronym	Last Month	Coverage
Argentina	Encuesta Permanente de Hogares-Continua	EPH-C	June 2012	Urban-31 cities
Brazil	Pesquisa Mensual de Emprego	PME	October 2012	Urban-6 cities
Ecuador	Encuesta de Empleo, Desempleo y Subempleo	ENEMDU	September 2012	National
Mexico	Encuesta Nacional de Ocupacion y Empleo	ENOE	June 2012	National
Paraguay	Encuesta Continua de Empleo	EPH	June 2012	Urban
Peru	Encuesta Permanente de Empleo	EPE	November 2012	Lima-Urban
Uruguay	Encuesta Continua de Hogares	ECH	December 2010	National

Note: Years 2004 and 2008 were used for the decomposition by source of income in Costa Rica. The EPH-C in Argentina covers only urban areas. This study considers urban areas in Bolivia and Uruguay, which might understate national poverty numbers.

Annex 2. Datt-Ravallion decomposition of changes in extreme poverty

Figure A.1: Growth and redistribution have contributed to the decline in extreme poverty
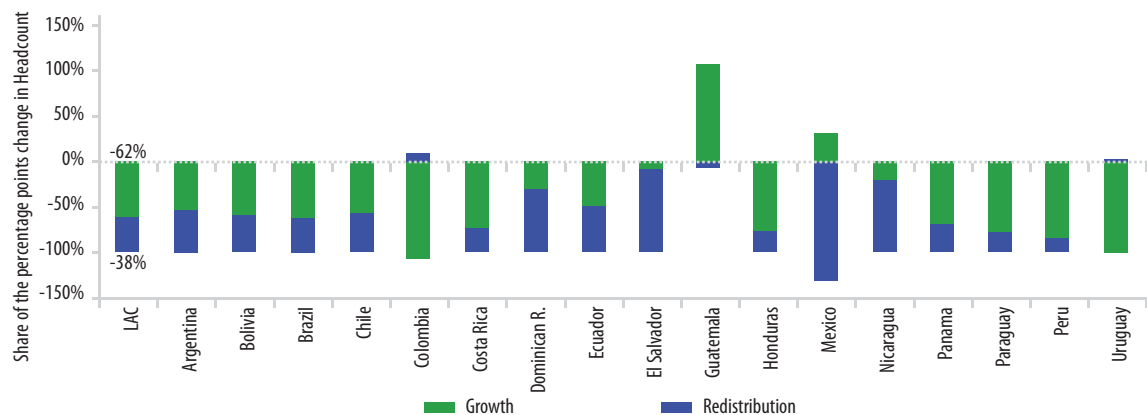
Source: Authors' calculations using SEDLAC data (CEDLAS and the World Bank). Note: Estimates of poverty at the regional level are population-weighted averages of countries. The figure shows the Shapley Decomposition of poverty changes circa 2003 to 2011 (See Table A1). See Datt and Ravallion (1992) for more details about the decomposition technique.

Annex 3. Typology of economic classes in LAC

Table A.2: Average Characteristics of Poor, Vulnerable, and Middle Class in LAC (circa 2011)			
	Poor	**Vulnerable**	**Middle Class**
Household			
Family per capita daily income	2.3	6.8	19.2
Age of household head	43.9	47.9	50.3
Living in urban area	67.2	81.9	89.6
Female labor participation (25-65)	46.2	58.1	70.6
Household size	4.3	3.7	2.9
Number of household members ages 0-12	2.0	1.5	1.3
Number of household members ages 13-18	1.4	1.3	1.2
Number of household members ages 19-70	2.0	2.2	2.1
Number of household members ages 70+	1.1	1.1	1.1
Years of education (household head)	5.7	6.9	9.7
Labor Force			
Employer (%)	3.9	3.7	6.8
Employee (%)	43.7	62.8	67.7
Self-Employed (%)	31.1	24.7	20.8
Unpaid worker (%)	9.9	3.8	2.3
Unemployed (%)	11.5	4.9	2.4
Employment sector			
Public sector (%)	4.1	9.1	19.0
Private sector small (%)	20.9	37.2	48.2
Private sector big (%)	78.1	61.7	50.7
Primary (%)	36.2	14.2	6.5
Manufacturing (%)	10.4	14.3	13.3
Construction (%)	10.0	9.8	6.3
Retail (%)	20.2	26.1	25.1
Utilities (%)	4.4	7.0	7.4
Services (%)	10.6	20.5	37.7
Domestic services (%)	8.2	8.1	3.8

Source: Author's calculations using SEDLAC data, 2011 (CEDLAS and the World Bank).

# Annex 4. Percentage of LAC household by type of deprivation

Table A.3: Percentage of LAC households by poverty dimension (circa 2003 and 2011)		
Dimension	**2003**	**2011**
School-aged child (7 to 15) is out of school	5.8%	4.3%
None of the household members has completed five years of schooling	11.6%	8.0%
No electricity	5.7%	2.8%
No flush toilet or pit latrine in the dwelling	31.9%	26.3%
Dwelling has precarious wall materials	16.2%	16.3%
No access to tap water in the dwelling	13.8%	9.9%

Source: Authors' calculations using SEDLAC data (CEDLAS and the World Bank).

Annex 5. Datt-Ravallion decomposition of changes in the middle class ($10 to $50 a day)

Figure A.2: Growth and redistribution have contributed to the increase in the middle class
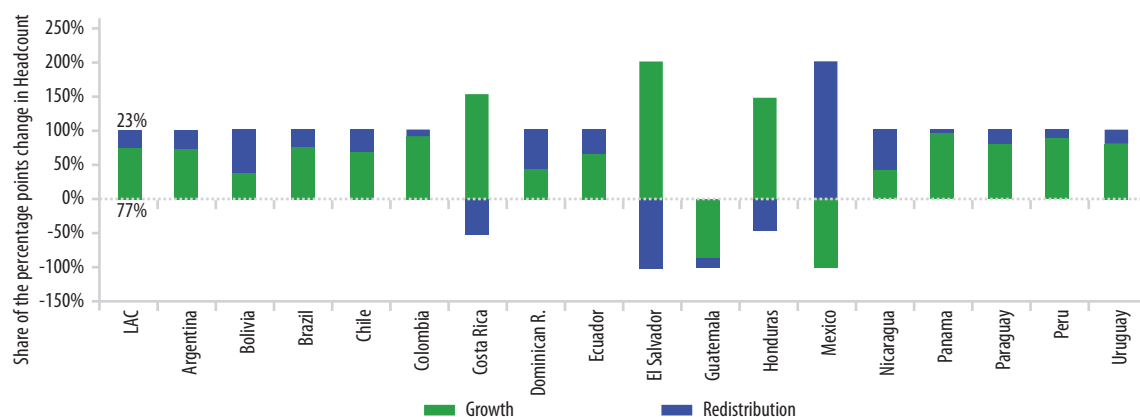
Source: Authors' calculations using SEDLAC data (CEDLAS and the World Bank). Note: Estimates of poverty at the regional level are population-weighted averages of countries. The figure shows the Shapley Decomposition of poverty changes circa 2003-2011 (Table A1). See Datt and Ravallion (1992) for more details about the decomposition technique.

Annex 6. Contribution of each sub-region to the LAC middle class

Figure A.3: Evolution of Poverty, Vulnerability and Middle Class by subregions, 1995 to 2011
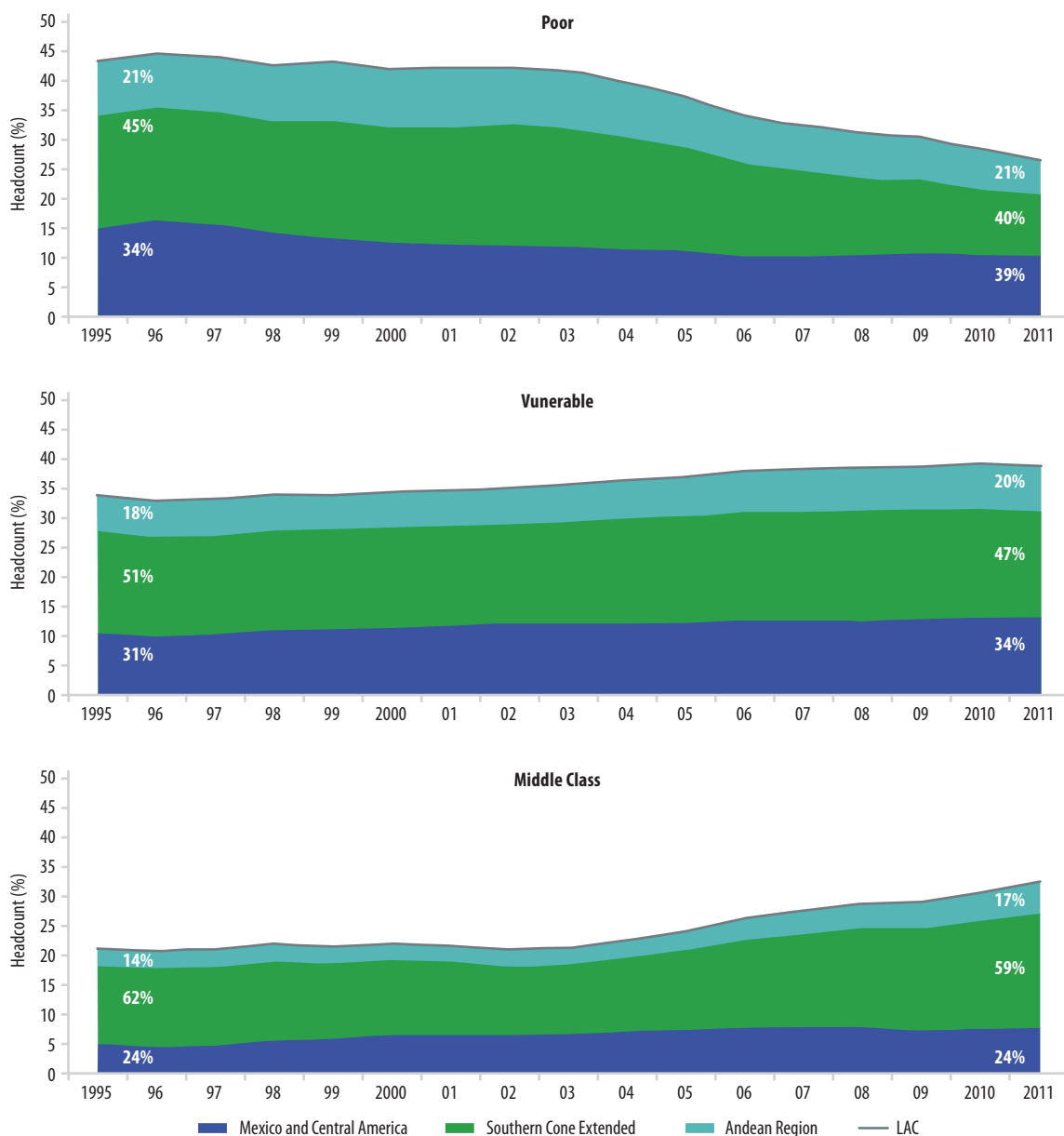
Source: Authors' calculations using SEDLAC data (CEDLAS and the World Bank). Note: The Andean region includes Bolivia, Colombia, Ecuador, and Peru; the Southern Cone (extended) region includes Argentina, Brazil, Chile, Paraguay, and Uruguay, and; the Mexico and Central America region includes Costa Rica, Dominican Republic, Guatemala, Honduras, Mexico, Nicaragua, Panama, and El Salvador.

Annex 7. Shared prosperity in LAC

Figure A.4: Correlation between growth in GDP per capita and growth in mean income of bottom 40%
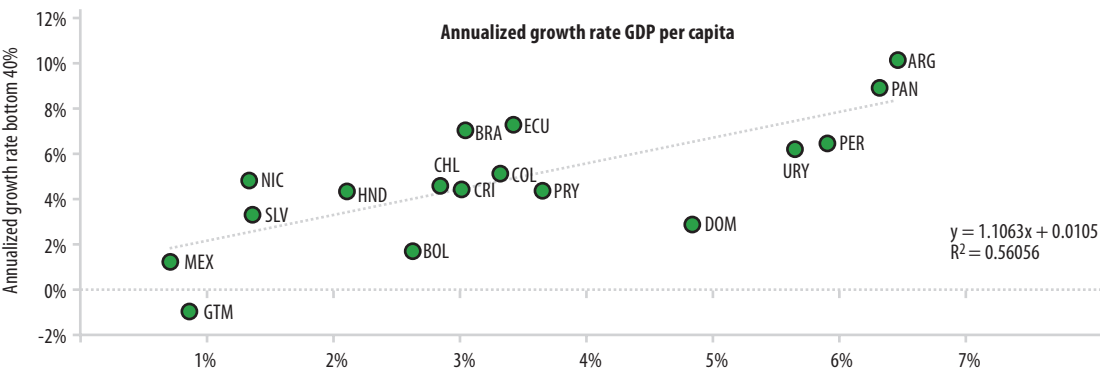
Source: Authors' calculations using SEDLAC data (CEDLAS and the World Bank) and WDI.

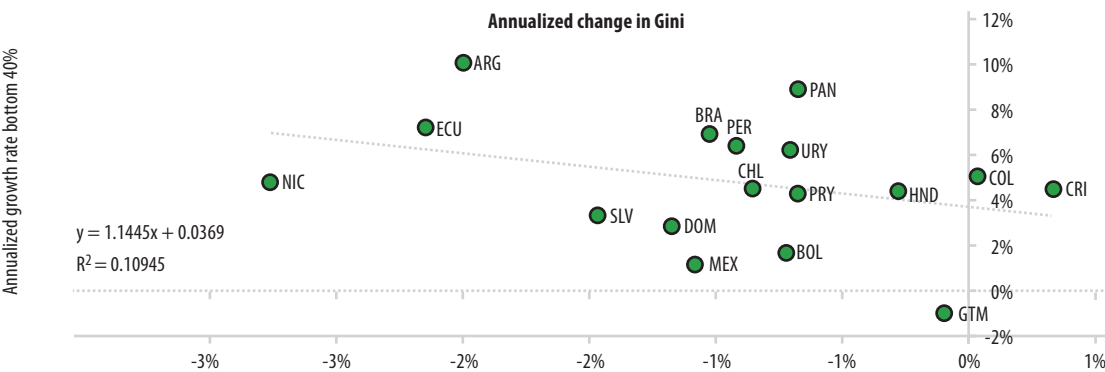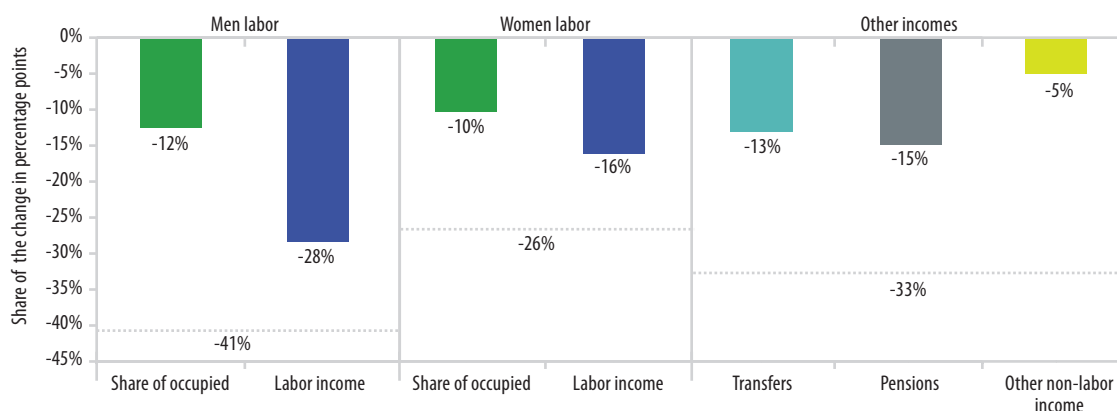**Figure A.5: Correlation between change in Gini and growth in mean income of bottom 40%**

Source: Authors' calculations using SEDLAC data (CEDLAS and the World Bank).

Annex 8. Decomposition of changes in moderate poverty and inequality by income components

Figure A.6: Moderate poverty reduction has been mostly driven by labor income

Source: Authors' calculations using SEDLAC data (CEDLAS and the World Bank). Note: Estimates of poverty at the regional level are population-weighted averages of countries. The figure shows the Shapley Decomposition of poverty changes circa 2003- 2011 (see Table A1) by components of income aggregate. See Azevedo, Sanfelice and Cong Nguyen (2012) for more details about the decomposition technique.

Figure A.7: Inequality reduction has been mostly driven by labor income and transfers
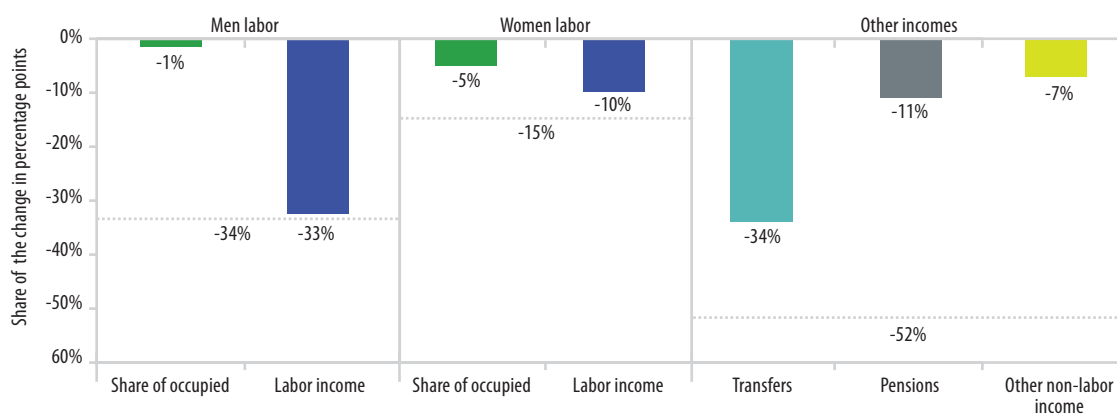
Source: Authors' calculations using SEDLAC data (CEDLAS and the World Bank). Note: The figure shows the Shapley Decomposition of poverty changes circa 2003- 2011 (Table A1) by components of income aggregate. See Azevedo, Sanfelice and Cong Nguyen (2012) for more details about the decomposition technique.

Annex 9. Poverty rates and Gini coefficient per country, 2006-2011

Table A.4: Extreme poverty ($2.50 a day) by country, 2006-2011						
Country	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**
Argentina	10.3	8.8	8.2	8.0	6.1	4.6
Bolivia	16.9	21.9	19.0			
Brazil	19.6	18.1	15.6	14.9		12.6
Chile	5.1			4.1		
Colombia			25.0	22.3	19.7	17.0
Costa Rica	11.6	8.2	7.6	8.1		
Dominican Republic	18.7	17.9	18.4	16.4	16.1	14.0
Ecuador	20.0	19.8	19.3	18.9	15.9	13.6
El Salvador	20.6	19.5	21.3	23.1	22.7	
Guatemala	33.6					41.1
Honduras	42.0	37.0	34.0	31.3	34.0	37.4
Mexico	11.7		13.2		12.5	
Nicaragua				29.3		
Panama		18.3	16.7	12.3	13.2	11.6
Paraguay	24.7	19.7	17.3	18.1	16.3	14.4
Peru	23.0	21.8	18.0	15.4	13.4	12.7
Uruguay	7.1	6.2	4.1	3.5	2.8	2.6

Source: Authors' calculations using SEDLAC data (CEDLAS and the World Bank). Note: The survey from Argentina covers only urban areas. For Uruguay the study only considers urban areas, as well as in the case of Bolivia, which might underestimate national poverty numbers. For more details, see Table A.1.

Table A.5: Moderate poverty ($4 a day) by country, 2006-2011

Country	2006	2007	2008	2009	2010	2011
Argentina	20.6	19.5	17.3	16.3	14.1	11.6
Bolivia	36.7	39.2	36.4			
Brazil	34.8	31.8	29.1	27.4		24.5
Chile	15.6			11.6		
Colombia			42.3	40.1	36.8	33.1
Costa Rica	25.2	20.1	18.9	19.6		
Dominican Republic	37.5	36.4	37.9	34.7	35.1	33.3
Ecuador	38.3	38.1	36.8	37.1	33.4	29.5
El Salvador	40.9	39.1	42.1	42.7	42.3	
Guatemala	53.2					63.1
Honduras	58.8	56.0	52.1	50.0	53.3	56.4
Mexico	26.7		27.9		28.0	
Nicaragua				52.2		
Panama		32.2	28.8	25.3	24.0	21.2
Paraguay	43.7	38.7	35.7	33.0	30.7	27.7
Peru	41.4	38.1	34.2	30.8	27.7	25.8
Uruguay	20.0	18.4	13.8	11.9	10.7	8.6

Source: Authors' calculations using SEDLAC data (CEDLAS and the World Bank). Note: The survey from Argentina covers only urban areas. For Uruguay the study only considers urban areas, as well as in the case of Bolivia, which might underestimate national poverty numbers. For more details, see Table A.1.

Table A.6: Gini coefficient by country, 2006-2011						
Country	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**
Argentina	0.478	0.474	0.463	0.452	0.445	0.436
Bolivia	0.509	0.519	0.517			
Brazil	0.567	0.559	0.550	0.545		0.536
Chile	0.518			0.520		
Colombia			0.558	0.555	0.551	0.537
Costa Rica	0.491	0.493	0.489	0.507		
Dominican Republic	0.519	0.487	0.490	0.489	0.472	0.474
Ecuador	0.532	0.543	0.506	0.493	0.493	0.462
El Salvador	0.462	0.470	0.468	0.483	0.457	
Guatemala	0.559					0.538
Honduras	0.574	0.562	0.557	0.516	0.534	0.574
Mexico	0.499		0.506		0.478	
Nicaragua				0.458		
Panama		0.533	0.527	0.520	0.519	0.518
Paraguay	0.536	0.521	0.510	0.497	0.518	0.526
Peru	0.491	0.497	0.471	0.463	0.451	0.457
Uruguay	0.474	0.479	0.465	0.465	0.455	0.437

Source: Authors' calculations using SEDLAC data (CEDLAS and the World Bank). Note: The survey from Argentina covers only urban areas. For Uruguay the study only considers urban areas, as well as in the case of Bolivia, which might underestimate national poverty numbers. For more details, see Table A.1.

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