

## Employment and Inequality

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Income inequality has become a concern across the world. But the debate on inequality often produces more heat than light.

In the rich countries of the global north, the widening gap between rich and poor results from technological change, globalization, and the misdeeds of investment bankers. In the not-so-rich countries of the south, much inequality is the consequence of a more old-fashioned problem: lack of employment opportunities for the poor.

In a book written with University of Chile economist Cristóbal Huneeus, we examine the roots of inequality in Chile and elsewhere in Latin America and come away with three policy prescriptions: jobs, jobs, jobs. In the last quarter-century, Chile managed to consolidate democracy, triple *per capita* income and achieve the highest living standards in Latin America, with near-universal coverage in health care, education, and old-age pensions. Yet the gap in the labor incomes of rich and poor has barely budged.

In Chile and elsewhere, discussions of inequality tend to focus on how much people earn. According to national household surveys, a Chilean worker earning the minimum wage takes home \$300 a month, while a professional in the top 10% of the income scale typically makes about \$2,400 dollars a month. But that 800% difference is only the tip of the inequality iceberg.

It also turns out that the poor worker lives in a household where only 0.5 people on average have a job, so that two families are needed for one steady source of income. By contrast, in the upscale professional's household, nearly two people on average hold down a regular job.

Add to this several other differences –above all, poorer families' higher fertility rates– and the sums reveal that the top 10% of households actually make over 70 times more (on a *per capita* basis) than those at the bottom. That is the kind of figure that keeps Chile and other Latin American nations ranked high globally in terms of inequality, despite other achievements.

Put differently: not only take-home pay, but also employment opportunities can be unequally distributed. Compound the two problems and you have world-class income disparities. Chile is hardly alone in this category. South Africa, another country that is proud of its exemplary transition to democracy, suffers from the same problem in an even more extreme version. And, within Latin America, Colombia and Brazil, among others, face a similar combination of low employment and high inequality.

The main victims of this state of affairs are women and the young, for which employment ratios are much lower than for the population as a whole. A typical poor household in Chile and elsewhere in Latin America is headed by a woman with only primary-school education. She has small children, limited access to day care, and few job opportunities.

That is the bad news –and it is very bad news indeed. The good news is that reducing inequality by creating jobs for the poor may prove to be faster than altering the entire structure of wages. Over the medium term, wages depend on productivity, which in turn depends crucially on high-quality education and training for the poor, which Latin American countries certainly need.

But educational reforms, however urgent and important, take a long time to bear fruit, whereas changes in employment can reduce inequality much more quickly –and the effects can be large. In our book, we estimate that if poor households in Chile had the same access to jobs as the middle classes enjoy, the gap between rich and poor would narrow by half.

So, what is the best way to create job opportunities for the poor? A growing economy with low inflation and financial stability is a necessary but insufficient condition. Pro-employment labor regulation is needed, as is what Scandinavian governments call active labor-market policies: a combination of information, training, and subsidies that help overcome what are typically serious failures in the market for young workers with limited skills and experience.

Creating good jobs with good wages also requires having dynamic private firms that can offer those jobs. Over the last decade, too much of the growth in emerging market economies came from the boom in natural resources, which in turn followed from the boom in Chinese growth. But today commodity prices are down, and so is growth in countries such as Brazil, Colombia, Chile and Peru. Because it is difficult to become ever-more efficient at producing a ton of copper or a pound of fruit (and, in Chile's case, the grade of copper ore is fast declining), further growth has to come from diversification: moving capital and labor to new sectors, where productivity is higher. That requires a deliberate strategy of export diversification and productive development by governments. The final aim: high productivity jobs in new sectors that are not permanent hostages to the vagaries of the world commodity markets.

One way to conceptualize the necessary three-pronged policy approach is this: develop training and subsidy policies to increase the supply of qualified workers, industrial development policies to create demand for those labor services, and information and coordination policies to help put supply and demand together.

The employment problem is political as well as economic. In most Latin American countries, big business and labor have a long history of mutual distrust, and getting them to agree on changes to labor-market rules is hardly an easy task. Moreover, many

unemployed young people are not registered to vote, so providing jobs for them is hardly a top priority for the political establishment. So the right kind of labor reform remains a cause to be espoused by reform-minded political leaders worldwide –and especially in middle-income emerging nations.

*Equality through employment* –not the snazziest of slogans for painting on banners and flying over demonstrations and occupied squares. But the right slogan if the goal is a deep and sustainable reduction in income inequality. Quality jobs bring a host of benefits aside from higher incomes. High and stable employment ratios are a good summary statistic of the degree of integration and cohesion in a society. That should be our goal.