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# Growth-Redistribution Balance and Shifting Coalitions: A View from Chile

by Rodrigo Valdés, Minister of Finance of Chile (2015–2017)

## Abstract

*Considering that during the last quarter-century citizens in Chile have experienced first-hand growth and redistribution, politicians need to offer a fine balance to conquer their votes. Thanks to economic growth, the expansion of income and consumption has been too important for too many households to be left on the back burner. This note illustrates that even radical redistribution policies yield only a fraction of what growth can produce in terms of income. A corollary of this is that any political coalition cannot forget to offer a credible growth strategy if it wants to gain and remain in power. An agenda focused on access and opportunities is a promising avenue to make growth and redistribution more compatible.*

## Introduction

In the last couple of years, key South American countries have seen a shift in their ruling coalitions towards the (political) right. Although there are cases in which complex internal dynamics ended in an unelected new administration (Brazil), there have been elections where the center-right has mustered significant voter support (Argentina and Chile). The obvious question is why.

As usual with this type of question, there are several answers. This note claims that, while the center-right moved towards the center, even adopting part of what could be considered the social democrat agenda, the center-left moved even further (and significantly) towards redistributive objectives, losing the required balance to conquer the median voter support.

This median voter has changed considerably in the last couple of decades. He has experienced first-hand the effects of sustained growth on household income and consumption, and also some benefits from redistribution efforts. He has enjoyed and suffered the mighty force of capitalism

as well as its failures, and the same with government policies.<sup>1</sup> He is significantly more informed and probably less trusting than in the past. He understands well, and better than some politicians believe, the extent of what is at play.

Using the example of Chile in the last 25 years, this note provides simple calculations about the relevance of both growth and redistribution for different quintiles of the income distribution. The exercise illustrates that becoming (significantly and quickly) more equal would produce effects on middle-class income that are commensurate with a relatively short period of high growth. This suggests that it is politically wise to assume that growth, and a credible strategy to deliver it, is a central theme for the median voter.

Of course, this hypothesis does not preclude other explanations of the political shifts mentioned before. The end of the commodity prices super-cycle (in 2013 for metals and 2015 for oil) probably had an important role, despite the fact that macroeconomic management was generally much better than in the

past.<sup>2</sup> Unemployment increased less than in previous cycles, notwithstanding some countries entering into recession. Still, during the last few years, economic growth was stagnant at best, an obvious difficulty for keeping ruling coalitions in power.

Something similar can be argued regarding a series of political scandals, if not outright corruption in some countries. From illegal political campaign financing in Chile and Brazil to abuse of power in other places, all took a severe toll on politicians' credibility, expediting changes in government despite suitable policy reactions (especially in Chile).

This note concentrates on the role of the appropriate balance between redistributive and growth policies. While there is some evidence that in some cases there is no trade-off between them – extreme inequality could make growth unviable – we assume that political leaders confront economic tradeoffs between these objectives and choose different combinations of growth and certain redistribution efforts.

### **Growth and Income Distribution, Chile 1990-2015**

A useful discriminating question about views on the growth-equity balance in Chile is the perception political actors have about the performance of the economy (and society in general) in the last couple of decades.<sup>3</sup>

Some would consider this as the most successful period in the country's history, with a flourishing democracy and an excellent economic performance. Some would consider it as the continuation of "neoliberal policies" implemented by force during the Pinochet dictatorship that basically delivered economic growth concentrated at the top, with little shared prosperity. Some would judge this period as an effort to gradually implement a shifting compromise

between growth and efforts to redistribute. In my view, the second group became more relevant in the ruling coalition that took office in 2014 than in the past and continued to dominate the center-left in the 2017 presidential campaign, to the point that the previous two decades were rarely considered something to be proud of.

What are the facts? Chile's per capita GDP increased almost threefold between 1990 and 2015, with short-lived and shallow recessions in 1999 and 2009 only. More precisely, per capita GDP increased a cumulative 280 percent, or 5.3 percent per year (at PPP and constant dollars).

At the same time, the distribution of income improved. According to the World Bank's World Development Indicators, the Gini coefficient moved from a shameful 57.3 to a still very high 47.7 between the same years (Table 1).<sup>4</sup> Remarkably, all but the top quintile (actually, all but the top decile) improved their share of total income after taxes and transfers.<sup>5</sup>

Despite these improvements, income continues to be pretty unequally distributed in Chile. We consider here three benchmarks for comparisons. "Río de la Plata" is the simple average of Argentina and Uruguay, which happen to have relatively similar income distributions. "Iberia" is the simple average of Portugal and Spain, also with similar indicators. Finally, "Nordics" corresponds to the simple average of Denmark, Norway, and Sweden, again with similar results among them but significantly better distribution. Despite the important improvement, Chile is far from European benchmarks.

This well-known picture also emerges in comparisons with OECD countries. The last Gini coefficient published for Chile is only better than Mexico's. (Intriguingly though, the pre-tax and pre-transfers Gini

for Chile stands 23rd out of 37 countries, and is similar to Australia and better than Germany or Japan).

Considering this unequal distribution, and to gauge the potential effects of redistribution, it is worth calculating what would happen to the income level of different segments if one could implement a sudden change, redistributing and keeping total income unchanged. Of course, this is theoretical, as no public policy could be implemented for such an objective. But it is a useful upper bound.

We consider again the distribution of the three benchmarks discussed before and recalculate per capita GDP for 2015 (Table 2). In this thought experiment we keep per capita income constant but redistribute total income among different groups using the benchmarks distribution. Compared with actual income in 2015 (Column 3), this experiment shows that the top 20 percent is the only quintile that would have less income (in line with the fact that the poor distribution in Chile is explained to a large extent by the top incomes). The second quintile would improve somewhat, while the bottom 60 percent would only see a radical income improvement under the Nordics distribution.

What about the progress in the last 25 years? Compared with 2015, per capita GDP in 1990 was much smaller for all segments: growth generally lifts all boats. But income distribution also improved and its effects were quite relevant. We can also calculate per capita GDP for each segment in 2015 but with the income distribution of Chile in 1990, as seen in Column 2. The top 10 percent would have more than US \$20,000 of additional income, while the bottom 80 percent would have between US \$1,000 and US \$3,000 less.

To gain further perspective, it is useful to compare income growth or change in different segments of the income distribution under the different thought experiments (Table 3). Concretely, we decompose actual income growth in Chile between 1990 and 2015 between redistribution and aggregate growth. Separately, we compare income growth in case the distribution changes to one of the benchmarks. There are at least three important takeaways.

First, the actual gains from the improvement of income distribution between 1990 and 2015 are only a fraction of the total income increase. For the middle 20 percent or “middle class,” growth explained more than 10 times what they gained through better income distribution. For the bottom 20 percent, the redistribution effort was more relevant, though growth was still dominant, explaining six times more than redistribution.

Second, what Chile accomplished in the last 25 years is impressive. For the middle class, even a sudden transformation to the Nordics in terms of income distribution (without changes in aggregate GDP) produces less than one-tenth of what the combination of actual growth and better distribution produced for this segment. The bottom 20 percent gained in these two and half decades more than four times what they would achieve with a sudden Nordic distribution.

Third, in comparison to its Southern Cone neighbors, and despite their better Gini coefficients, the bottom 20 percent in Chile does not gain much with the Río de la Plata distribution. Comparing Chile’s distribution to Río de la Plata and Iberia, the most important differences happen in the middle quintiles. This is not the case with the Nordics, where the bottom 20 percent is significantly better protected

**Table 1. Income Distribution Statistics  
(1990 and 2015 or latest)**

	Chile 1990	Chile 2015	Río de la Plata	Iberia	Nordics
GINI	57.3	47.7	42.2	35.8	27.5
Top 10%	47.0	38.0	30.8	26.7	22.3
Top 20%	62.5	53.6	47.5	42.3	36.7
2nd 20%	17.3	19.7	22.7	23.0	22.6
Middle 20%	10.3	13.0	15.0	16.7	17.7
4th 20%	6.6	8.9	9.8	12.0	14.0
Bottom 20%	3.4	4.8	5.0	6.1	9.1
Bottom 10%	1.2	1.7	1.8	2.1	3.5

Source: World Bank

**Table 2. Chile: Per capita GDP in 1990 and 2015 assuming different income distributions  
(USD at PPP, 2015)**

	GDP Chile 2015					
	Chile 1990	Chile 1990 Distribution	Actual 2015	Río de la Plata Distribution	Iberia Distribution	Nordics Distribution
Top 10%	29,100	110,723	89,520	72,559	62,900	52,456
Top 20%	19,348	73,619	63,135	55,950	49,766	43,229
2nd 20%	5,356	20,378	23,205	26,738	27,033	26,581
Middle 20%	3,189	12,132	15,313	17,669	19,671	20,810
4th 20%	2,043	7,774	10,483	11,543	14,135	16,530
Bottom 20%	1,053	4,005	5,654	5,831	7,185	10,680
Bottom 10%	743	2,827	4,005	4,123	4,829	8,324

Source: Author calculations based on IMF and World Bank.<sup>6</sup>

**Table 3. Chile: Changes in per capita income in different segments, between 1990 and 2015, and distribution shifts (USD at PPP, 2015)**

	Chile 1990 to 2015 due to:			Chile 2015 with distribution of:		
	Redistribution	Growth	Total	Río de la Plata	Iberia	Nordics
Top 10%	-19.1%	280%	208%	-19%	-30%	-41%
Top 20%	-14.2%	280%	226%	-11%	-21%	-32%
2nd 20%	13.9%	280%	333%	15%	16%	15%
Middle 20%	26.2%	280%	380%	15%	28%	36%
4th 20%	34.8%	280%	413%	10%	35%	58%
Bottom 20%	41.2%	280%	437%	3%	27%	89%
Bottom 10%	41.7%	280%	439%	3%	21%	108%

Total between 1990 and 2005 is the compound effect between redistribution and growth.

Source: Author calculations based on IMF and World Bank.<sup>7</sup>

(implying that there is still space for efforts to target transfers to this segment).

Of course, the median voter has not made these calculations. But having experienced the results of growth and redistribution policies, he may have constructed a view on the impact of each.

The political relevance of growth is clearly present in opinion surveys. In the case of Chile, for example, CEP asks people to choose on a scale of one to ten whether “income should be made more equal even if this does not reward individual effort” or “individual effort should be rewarded even if this leads to important income differences.” Excluding neutral answers, a strong majority (more than 2:1) prefers to reward individual efforts. González (2017) concludes that citizens have remained closer to an individualistic rather than a community view.<sup>8</sup>

### **Political Assessments and Agendas**

However, the above considerations are rarely considered in political circles. The center-left camp believes that countries in the region are extremely unfair and that efforts have to concentrate on redistribution.

At least in the case of Chile, this resonates well with a simple view of the data. While the country ranks in the top 80th percentile in per capita world income, income distribution as measured by the Gini coefficient ranks in the bottom 15 percent. The assessment implies a simple agenda: offer redistribution. In other countries in the region, the numbers differ, but the overall view is similar: voters are unhappy with the situation and a change of tack is needed.

In practice, this view has taken the form of new “guaranteed universal rights,” a way

to put redistribution so high on the agenda that all other issues, including the budget constraint, become secondary. Taxes and other expenditures will need to adjust to make space to fulfill these rights, which are often enshrined in the constitution and, depending on the exact provisions, protected by the courts.

Within the center-right, the assessment about the relevance of redistribution has been similar, although the political bids have been more nuanced and, more importantly, have produced the (electoral) benefit of moving the agenda towards the center.

Indeed, this camp has shifted from a focus on poverty alleviation as the central (and almost unique) concern to a broader view of economic vulnerability. For example, several years ago, center-right politicians embraced the concept of “ethical income,” a level of income that would be morally acceptable. Given the difficulties of determining a precise number, it can be a form of measuring poverty with cut-offs that became readily adjustable. More recently, the concern has evolved towards attenuating the risks faced by the middle class. While a “lucky” middle-class household can certainly thrive, it can also lose significantly if unemployed, sick, or displaced.

Thus, a relatively shared view that income distribution is central has produced very different outcomes across the political spectrum.<sup>9</sup>

The center-left, by deepening its focus on income redistribution, ended up neglecting growth, both directly when facing difficult trade-offs and, perhaps more importantly indirectly, through ignoring the role of incentives and the stability of rules in a market economy as well as the muscle of the private sector as an engine for growth. Indeed, the redistribution

focus has usually been accompanied by a deep mistrust of the market economy (and capitalism more broadly). Discussions about the potential entrepreneurial role of government in some economic sectors and a profound aversion to public goods provision by the private sector (as well as in social security and infrastructure) have made it difficult to offer a credible growth agenda. And, as discussed in the previous section, if economic growth is indeed first-order for income growth and citizens value income, leaving it as a secondary issue is a recipe for losing elections.

The center-right, on the contrary, became more competitive with the concern about redistribution. Because it has better credentials to offer a credible strategy for growth, it ended up moving to the center and embracing an agenda with some social democrat elements. Perhaps the clearest example in the case of Chile is the new government's offer of continuing the expansion of free tertiary technical education, something unthinkable three months before the election (although this could also be regarded as a populist step).

## Final Remarks

When deciding on the central elements of a political platform, a critical question is how to balance redistribution and growth tradeoffs. The center-left, almost by definition, leans towards more redistribution. But how much sacrifice to make in terms of growth has to be calibrated carefully. When citizens value income growth, and more importantly, have experienced it, it is a mistake to assume that an agenda centered basically on redistribution can triumph. Embracing a credible strategy for growth is also needed, and this strategy will probably fail if it forgets that without a well-functioning market economy and a robust private sector it is difficult, if not impossible, to sustain high growth.

This does not mean that equity has to be forgotten. On the contrary, the center-left has as its core mission a more just society. But careful calibration of tradeoffs needs to be made as income growth is also central. This is even more relevant when the scope for income redistribution is not large when compared with what growth can deliver, at least in terms of expanding consumption possibilities.

More importantly, a progressive agenda needs to look beyond what static income distribution figures suggest and dedicate efforts to other forms of unfairness. As the 2017 UNDP report reveals, there is unequal access to education and to political power in Chile, and there is significant heterogeneity in terms of dignity and respect received by different citizens.<sup>10</sup> Lagging regions, poverty among indigenous people and other minorities, lack of social mobility (to the point that family names determine income possibilities), and unequal access to public goods are also critical issues. These constitute differences that determine lifetime possibilities and disconnect outcomes from people's effort and intrinsic capacity. A renewed agenda centered on opportunities and access, in truly leveling the playing field, would ease the tradeoffs between equity and growth. And it would resonate better with the new empowered median voter.

## NOTES

<sup>1</sup> Carlos Peña, *Lo que el Dinero Sí Puede Comprar* (Santiago: Penguin Random House, 2017). Carlos Peña has argued for some time already that, contrary to what a majority of the left thinks, there is a large middle class that has embraced consumption as part of their life, and, more importantly, seems pleased with this new model.

<sup>2</sup> R. Valdés, "Reflexiones Prácticas con 842 días en Hacienda," in *Estudios Públicos* CEP, forthcoming.

<sup>3</sup> International Monetary Fund, "World Economic Outlook Database," <https://www.imf.org/external/pubs/ft/weo/2017/02/weodata/index.aspx>.

<sup>4</sup> World Bank, "World Development Indicators," <https://data.worldbank.org/products/wdi>.

<sup>5</sup> Latin America has shown this trend of improving

income distribution in several countries during the last decade. This is a notable result considering the global trend towards a worsening outcome. Interestingly, Sapelli (2016) shows that income (and education) distribution has improved more markedly in younger cohorts, a development that harbingers further gains at the aggregate level. Claudio Sapelli, *Chile: ¿Más equitativo? Una mirada a la dinámica social del Chile de ayer, hoy y mañana* (Santiago: Ediciones UC, 2016).

<sup>6</sup> International Monetary Fund, “World Economic Outlook Database”; World Bank, “World Development Indicators.”

<sup>7</sup> International Monetary Fund, “World Economic

Outlook Database”; World Bank, “World Development Indicators.”

<sup>8</sup> Ricardo González, *¿Malestar en Chile?: Informe Encuesta CEP 2016?* (Santiago: Centro de Estudios Públicos, 2017).

<sup>9</sup> It is tempting to put together the problems of social democratic regimes in the developed world and what has happened in South America. There is an important difference, however: in South America it delivered income redistribution, whereas in Europe it did not.

<sup>10</sup> PNUD, *Desiguales: Orígenes, cambios y desafíos de la brecha social en Chile* (Santiago: Programa de Naciones Unidas para el Desarrollo, 2017).



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