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### Voices in Development S2E6

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#### FULL TRANSCRIPT (with timecode)

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So unless your project needs to say stop, rethink, the context is different. It may work, it may not work, but you can't extrapolate research from one region to another region. You've got to be careful about context, institutions, enforcement.

00:00:15:18 - 00:00:35:09

Catherine Cheney: Why do some countries advance while others fall behind? Who benefits from economic growth and who doesn't? How do inequality and climate change affect people, especially the most marginalized? What role can data play in answering questions like these and informing policies that promote economic justice? Let's find out on voices and development.

00:00:37:27 - 00:01:21:06

Catherine Cheney: Hello and welcome to our podcast. I'm your host, Catherine Cheney. We're coming to you from the Economic Growth Center at Yale University, which is focused on economics and data driven insights for equitable development. In this episode, we'll hear from researchers and economists working to tackle inequality in Latin America, a region that has had a hard time escaping a high inequality, low growth trap. You'll hear from Santiago Levy, the prominent Mexican economist and politician who served as a vice president at the Inter-American development Bank, general director at the Mexican Social Security Institute and deputy minister at Mexico's Ministry of Finance and Public Credit, where he was the main architect of the social program Progres a Oportunidades.

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Catherine Cheney: You'll also hear from Marcela Eslava, professor of economics at Universidad de Los Andes in Bogotá, Colombia, and Ana De La O, associate professor of political science at Yale University. Santiago, Marcela, and Ana have collaborated on the Latin American and Caribbean Inequality Review, or, LACIR, a new initiative to understand the causes and consequences of the region's high inequality in order to provide a basis for action that could make the region more equitable. It's a collaborative effort between Yale, the Inter-American Development Bank, the London School of Economics, and the Institute for Fiscal Studies.

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Catherine Cheney: Through LACIR, scholars, including our guests today, are taking a comprehensive approach to the problem of inequality in Latin America to understand why, despite major structural, economic, and social change, inequality has persisted in the region. Now onto the conversation.

00:02:21:03 - 00:02:24:02

Santiago, Ana, Marcela, thank you so much for joining us.

00:02:24:04 - 00:02:25:22

Santiago Levy: Our pleasure. Thanks for inviting us.

00:02:25:24 - 00:02:29:10

Marcela Eslava: Hi, Catherine. Thanks for having us.

Ana De La O: Thank you so much for having us, Catherine.

00:02:29:12 - 00:02:42:22

Catherine Cheney: So I'd love to hear briefly from each of you. Can you tell us a little bit more about your path into this work, and specifically how inequality became such a focus of your work? We'll start with you, Santiago.

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Santiago Levy: I'm a Mexican economist, and I've been working in Mexico and then in Latin America for more years than I'd like to remember. And if you do work in Latin America, inequality is one of the central issues. So you cannot really think about development problems in the region without thinking about an inequality dimension, both positive or negative. You know, sometimes it helps, sometimes it hurts, but clearly it determines a lot of what is happening. So whenever you think about Latin America, you have to think about some dimension of inequality that is probably part of the problem that you're looking at.

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Catherine Cheney: Marcela would love to hear from you a little bit more about your path into this work.

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Marcela Eslava: I've been working, first of all from Latin America, so I'm based in Colombia and a Colombian economist, and I've been based here since I finished my PhD, and I've been mostly working on issues related to the development of the productive sector, because getting into the relationship of that work with inequality was sort of a multifaceted thing. On the one hand, as Santiago said, nobody can work in Latin America and just not be interested and aware of how inequality intertwines with everything that happens, but also from the point of view of the context of the region.

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Marcela Eslava: The issue has become more of a political and policy focus. And then the literature from which I come has also become interested in the relationship between firms and inequality in general in the world. And that has been a focus of the discussion by economists in this area, with the very directed target towards Europe and the US. And I felt Latin America had to be part of that discussion.

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Marcela Eslava: And it has such different characteristics that I thought it was very useful to at least try to start, lay out the basic facts, and take it from there.

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Catherine Cheney: Ana, what about you? Thanks.

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Ana De La O: Thanks, Catherine. Santiago, I'm also from Mexico, so in some sense that partly explains my interest in these questions of inequality. But in my work I have studied more generally the political factors that hinder or can help human development. I started being very interested in the politics of the design and implementation of conditional cash transfer programs. And I have also examined issues related

to accountability mechanisms and in what are the circumstances under which they can help curb corruption.

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Ana De La O: And more recently, I have been quite interested in studying an increase in the trend of opting out from public services in Latin America. And these three strands of work very directly relate to the point about inequality.

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Catherine Cheney: Thank you. And I definitely want to make sure we return to some of this more recent work. But, Santiago, I want to go back to you for a moment. You bring a really unique perspective to this conversation. So I wonder if you can speak to why you see research and the work of development economists as so critical to the conversations that happen within the Mexican government or the Inter-American Development Bank.

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Santiago Levy: I think research is fundamental because we never really know the problem 100%. Policymakers never really understand the problem that they're trying to solve, and never really understand the constraints that are there until they actually begin to deploy policies. And along the way they learn and they get some things right, but often they get some things wrong. And what research is good for is to separate. In fact, this was a good idea at that time because of these reasons.

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Santiago Levy: But then this was a bad idea because we did not take into account XYZ. Reality is always changing. It's not static. And every time that you're doing policy, you're doing policy in a context in which there is some shock in the world economy, there is some shock in the domestic economy and so you always have to feed, ideally feed your policymaking with research that the main problem with research is that is usually 4 or 5 years behind what is really going on, and that's in its nature because data is always a little bit old.

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Santiago Levy: But the concept of using research for policy making, I think, is central and I think we don't do enough of it. Unfortunately, we should do more.

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Catherine Cheney: Marcela. Ana, do either of you have anything to add to that in terms of either the role of research in policy making, specifically when it comes to inequality in Latin America and the Caribbean, or any specific examples that can kind of point to how this works in practice?

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Ana De La O: It seems to me that there are three ways in which research can be really helpful, and one research can help policymakers define the boundaries of a social problem. And here a very good example of this is the LACIR network, which the three of us are part of. This is an interdisciplinary network that is studying various aspects of inequality in Latin America. And I would say that all of that research has really enhanced our understanding of the many different ways in which inequality manifests itself in the region.

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Ana De La O: The second point, I guess, and that's probably where sort of experimental work adds more to the policy process, is I've been trying to figure out which policy interventions work and which do not work. And I would say that the third way in which research might be really, really helpful is that evidence

based policy can really help a policy champion create a coalition to support the scale up of a policy. And so in that sense, I would say that research can be a very valuable tool to move the agenda forward in terms of policy implementation.

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Marcela Eslava: Because, I would add first on the importance of research or let me more broadly talk about knowledge. I think there are many instances that show how misguided policy can be very frequently, as policy is, and it is not so unlikely that we see that it is guided by intuition or by only partial diagnostics, then policy can be very misguided, and therefore it can actually have unintended consequences strong enough to undo whatever it was supposed to do or collateral damage that can be large enough to create deeper problems than the ones it was supposed to help with.

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Marcela Eslava: And research and more generally, knowledge that is broader. That is, at the same time, deep can help deal with those risks. Of course, research has its own risks, and economists know well about those. It's easy to also fall to the temptation, for instance, of informed policy with very partial research that's very well conducted and very deep, but not sufficiently well put in context. And so, of course, those risks arise as well.

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Marcela Eslava: And I would say that's where the LACIR project Ana was talking about falls, because it has the virtue of trying to use research to inform the issue of inequality in Latin America. That is to say, to create sort of a broader picture of what the characteristics and the roots of inequality are in the region. But it does so in an extremely collaborative way, where very many researchers with different approaches from different disciplines based in different parts of the world that share in common.

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Marcela Eslava: Their origin in Latin America, or their being based in Latin America, or their interest in Latin America. They come together to create a shared view. It also relies on research that it's broader than a typical paper would be, for instance, because rather than creating particular pieces of knowledge by themselves, it is fostering some new research, but also trying to bring together what we know from previous research. And so in that way, I think LACIR has the aspiration, and I very much foresee that we will get there.

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Marcela Eslava: At some point, I've created sort of a shared vision of what are those roots and what are those shared characteristics. Of course, there are some disagreements in the group, and I think those are going to actually be very informative as well. And so I would say not only research is very useful, but if we are able to deal with the risks of policy on the one side and research on the other by creating sort of a way to translate research into policy advice, that is enough based. I think that is going to be even more useful than just separate pieces of research.

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Catherine Cheney: So I did want to hear, for those who are less familiar with this collaborative effort to look at inequality in the region. What are you finding? What are some of the highlights of insights that are emerging, and what are the implications for how to respond to that inequality?

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Ana De La O: So LACIR has been focusing on five areas that relate to inequality. The first has to do with sort of mapping out what we already know about income and wealth inequality. So try to establish like some basic trends on what has happened with those two dimensions of inequality in recent times. And

then it follows different dimensions of inequality from inequality of opportunities, inequalities in the labor markets, inequality that relate to the workings of capital and land markets.

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Ana De La O: And then there is a theme that examines the role of the state in changing or not changing those inequalities. And then we have a theme that explores political inequality and the role of political power in sustaining the equilibrium of high inequality in the region. So we have been working on background chapters that try to explore all of these different angles of inequality.

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Catherine Cheney: Thanks, Ana. It's really interesting to hear how you all structured this. Marcela, I wonder if you can share with us some of the takeaways so far.

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Marcela Eslava: There are like three big headlines. The first one is that inequality is undoubtedly very high in the region. And it may seem not surprising, but actually, in the first takes it turned out that the numbers can actually be very varied, but at least we do know one, that inequality is very high and that there is more agreement in terms of the trends of inequality than the levels of inequality in the region, that that inequality has always been very high, that it increased in the 90s.

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Marcela Eslava: And it started to decrease in the beginning of the 2000s, and it has been decreasing for the most part of the 2000s, but not at a rapidly enough pace to sort of undo the damages. The second keyword, I would say, is multifaceted. It has very different manifestations in economic and social terms, in political terms. And so it is crucial for policymakers to understand that multi dimensionality of inequality and how those different dimensions are intertwined.

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Marcela Eslava: And then thirdly, that inequality is very deeply rooted in causes that are different, in dimensions that represent different dimensions that are interconnected between them. And so, in terms of what implications those findings have, I would say one important thing is how there is no single button that you can push and think that that's going to be sort of the main solution to the problem. And actually that at the same time, any single button is going to have consequences that are not directly what you expected.

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Marcela Eslava: And so, for instance, the Social Security system is something that arises in different teams of those that Ana mentioned. Of course, Social Security has an insurance part of it. By definition, it has a redistribution power to it, but it also has an incentives part to it. And those work in different directions. Social protection protects some people, and it's designed to do so. But perhaps the way it is designed, and that's partly what we're finding in the chapters in which I was more involved, where Santiago raised most of his discussions.

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Marcela Eslava: Perhaps it's designed in a way that is aimed to protecting people in a very comprehensive manner, but by its very design creates incentives such that in the end, that protection is very limited and a lot of people is left unprotected. And in terms of its consequences on the productive sector, you have perverse incentives that end up also implying less of this productive development than you would need, which in turn translates into, say, more poverty and therefore more inequality as well.

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Marcela Eslava: So those series of interconnections are things that arise very clearly in these collection of papers and discussions.

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Catherine Cheney: So I want to bring Santiago into this, because we're talking about the way you design social protection mechanisms. And one of the things you're most known for is being the main architect of the social program. Progresá Oportunidades in Mexico, and so I'm sure what Marcela is saying resonates with you, that there's no single button you can push and have a solution, but we'd love to hear a little bit more from you about how that played out in your experience, and how you integrate those experiences in this collaborative effort.

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Santiago Levy: I think the LACIR project has two big interests, right? There's a big sign of measurement and diagnosis, but the part that interests me most is the power of policy. And what happens in Latin America, a lot of the times is that people say, look, there's a lot of inequality, therefore we should do X. Marcela mentioned a few examples on Social Security. I can multiply the examples by ten. I'll give you just two. There's a lot of inequality in the region. Therefore, we should raise the minimum wage. And you know, there's this paper by debit card in an American economist from Berkeley that showed that in Pennsylvania and New Jersey, when you did that, you find this and that.

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Santiago Levy: And then some policymaker in Latin America says, yeah, we should raise the minimum wage because there's a lot of inequality. So the LACIR project needs to say stop, rethink, the context is different. It may work. It may not work, but you can't extrapolate research from one region to another region. You've got to be careful about context, institutions, enforcement. That's one example. Another example, policymakers will say, look, you know, there are all these small firms that create a lot of jobs. And this is part of the inequality problem.

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Santiago Levy: And therefore we should help these firms and create a special tax regime for them. And Marcela and I have studied these issues. And as it turns out, they're often counterproductive. So the policy side of how do you fight inequality? You have the evidence, you have the diagnosis. But then the policy design problem is extremely complex. But it's really what matters at the end. The progressive program that I worked on about 25 years ago is much simpler than the inequality problem, because it is simpler to fight poverty than to fight inequality.

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Santiago Levy: When you're worrying about poverty, you're only worrying about a segment of population that is below some poverty line. Whereas when you're looking at inequality, you're looking at the whole population, and you're also very aware of what's happening at the very top. At the bottom is a much more complex problem. You raise progressives who use 30s to talk about the importance of research and how research is actually sometimes a little bit outdated. So when *Progresá* was being designed, I read all the literature or tried to read all the literature within the government back then, and there was all this literature about nutrition and the importance of, you know, helping children.

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Santiago Levy: But the literature and early child development was in its infancy. So the program back then did not include a component of every child development. If I were to redesign *Progresá* today with the research that is out there today, the design would have been a little bit different, but the research back then was a little bit late. And so it's a continuous adding of knowledge that allows you to make fewer

mistakes and hopefully the LACIR project, if it's successful, aside from providing a lot of interesting insights, will hopefully make policymakers make less mistakes.

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Santiago Levy: We're going to make mistakes, but hopefully less mistakes and recognize them sooner. And if that happens? Fantastic Project. We should all get the Nobel Prize.

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Catherine Cheney: That's a fantastic goal helping policymakers make fewer mistakes and recognize them sooner. So zooming in on a few areas where that might be possible. Earlier, you mentioned some more recent work on households opting out of public services, and I wonder if you can talk about that work and what insights it might reveal about addressing inequality in the region.

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Ana De La O: Yeah. So it's a trend that both policymakers and scholars have already identified that people are opting out more and more from essential services such as education, health, in some cases, even security, some segregation. Residential segregation is happening too in the region, and some people take this as one manifestation of a fragmented social contract in the sense that when people can't afford it, they opt in to private services because they perceive them to be higher quality than what is provided by the state.

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Ana De La O: There is also, in the region quite a bit of mistrust in state authorities and institutions, and so that sort of further incentivizes people to leave public services when they can't afford to do so. In the particular case of education, which is what we have studied more deeply with Cecilia Rosell and Pilar Manzi, we find pretty much that in most countries in our region, there is no strong inter-class coalition sort of championing public education.

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Ana De La O: And in some cases this is quite dramatic. So there are some cases, for instance, in Peru, that the probability that a middle class household sends their children to private school is close to 60%. There are other cases, for instance, Colombia, Argentina and otherwise, that this probability is about 40%. And even in countries where the enrolment of school aged children in private schools is lower, like Bolivia and Mexico. It's still the case that the probability of a middle class household sending their kids to a private school is around 30% and 20%, so in many of these cases, the middle class is split, and it's hard to see how you could form a very strong inter-class coalition that combines the middle class and lower income people to champion investments in public education.

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Ana De La O: What is a little bit more problematic is, in some sense, that opting out from public schools has some consequences for the way people see the state, and the way that people see the role of the state in redistributing income in their country. So we do find that opting out from public schools is associated with people having worse evaluations of the public service option. They preferred less public spending in the provision of public education, and they also expressed the support for redistribution towards low income people.

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Ana De La O: And so in that sense, this trend that I'm describing creates another of these traps that Marcela was describing, because in these countries where there are very high levels of inequality, lower income people have less political power than the middle class and high income people. And so in that sense, if the powerful are the ones that are setting, say, the policy priorities and the budget that is assigned

to public services, then those public services are going to continue to have lower quality than what we would want, which would perpetuate, say, lower social mobility.

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Ana De La O: So you can see how that perpetuates this trap of inequality.

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Catherine Cheney: So this seems to connect back to something you were saying earlier when you said that LACIR is exploring what is sustaining the equilibrium of high inequality in the region. Can you expand on what you meant by that?

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Ana De La O: I'm thinking about this in two ways. One, and this is something that comes from some of the chapters of LACIR that talk about early childhood education, and the way that inequalities then manifest in labor markets is that over the course of a lifetime, people who do not have opportunities to access high quality education, high quality health, then end up later on in their lives confronting the labor markets and not getting good enough salary, which then cycles and perpetuates into the next generation.

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Ana De La O: So their choices in terms of investments in the education and nutrition of their children are going to affect the future prospects of their children. So that creates an inequality trap. But I was also thinking about a longer term trap or equilibrium, which has to do with sort of the politics of inequality. And this has to do with the fact that the people who have more political power are the ones that are making policy decisions that end up under investing in public services that are essential for social mobility.

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Ana De La O: And so in that sense, that it's another way in which inequality becomes an equilibrium.

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Catherine Cheney: Of course, breaking out of this equilibrium can only happen by addressing the root causes of inequality. So that brings us back to policy and the role of research in informing policy. And Santiago, I want to return to that study. You mentioned earlier on about minimum wages. So this is a paper by David Cod and Alan Krueger which will make sure to link to in the show notes. Why is this an example of how important context is in policymaking?

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Santiago Levy: Basically, they compare McDonald's in one state in which the minimum wage went up versus where it didn't. So they had very nice data where the policy was put in versus not put in, which econometrically provides a lot of insight. And they find that firms have market power and you can raise the minimum wage, shift the bargaining power in favor of workers, and increase worker welfare at very little or no cost to employment. So it's a very important finding. The question is whether that finding works in Mexico City and where 95% of the businesses in Mexico City are not McDonald's, there are 3 to 4 person firms.

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Marcela Eslava: That's, I think, a very good example of what LACIR can shed light on. So take that finding the way that many policymakers in the region have taken it to say, let's continue raising minimum wages in the region. And the hopes are that, as is the case in the US, this is going to help the most vulnerable people and in that way that's going to combat inequality. Once you put together the bulk of the evidence for Latin America, then it turns out that the most vulnerable people in Latin America are not



earning the minimum wage, that there are countries where 50%, some countries where 70% of the workers, earn less than the minimum wage.

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Marcela Eslava: That is to say, the minimum wage is not minimum. It is only minimum in some degree that people are going to abide by. But that's not happening. On the contrary, you need to ask why are people not being paid the minimum wage? And how can we deal with the problems that the minimum wage was supposed to deal with and unsuccessful to do so? And what we see is that if we compare this region with others, for inequality is not as bad. And I'm here specifically talking about economic inequality, income inequality.

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Marcela Eslava: Then you see that one of the big failures that we have is that out of that 50% that I mentioned, more than half are people who are self-employed. And the other part of it are people who are in very tiny businesses of 1,2, 3 workers. And if you go look at those businesses and you see how much people are earning there, it's one considerably below the minimum wage. But second, if you were to say, let's enforce this minimum wage and have these owners or these people who are themselves their own employers, pay themselves this minimum wage, the answer you're going to find is, well, the productivity of their business is just not enough.

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Marcela Eslava: It's just not produces the revenue that would be needed to be able to pay that minimum wage and pay the taxes and cover these people with social Security contributions, so that they are going to have a pension at the end of their lives. And so in the end, the question is, how do we achieve the same goal with a different instrument that is actually well tailored to the realities of the region? Or how can we complement these tools that we have in ways that at the same time create the good incentives so that we have the hope that at some point, we're going to have a productive sector that can actually bring these people out of self-employment.

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Marcela Eslava: That is there because there is no other option into some form of employment where there's going to be better conditions.

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Catherine Cheney: So just to close, I'd love to hear any thoughts on what gives you hope that despite the complexity of addressing inequality in the region, that progress can be made and that we can bridge this gap between research and policy?

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Ana De La O: The challenge is daunting. And we know, as Marcela was saying, that inequality has very, very deep roots in Latin America. And Santiago was saying, too, it requires a lot of investment on the part of the research community and the policy community to sort of make way in fighting inequality, but the region has already achieved a reduction in inequality. So I think it's important to keep in mind that this is something that can be done and that even though it seems politically very difficult to achieve, there are ways in which to achieve political coalitions that would support the types of policies that would help us reduce inequality once again.

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Marcela, Santiago, Ana, thank you so much for joining us.

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Marcela Eslava: Thank you Catherine.

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Santiago Levy: Thanks for inviting us.

00:29:00:22 - 00:29:01:21

Ana De La O: Thank you Catherine.

00:29:04:01 - 00:29:31:21

Catherine Cheney: That's all for this episode of Voices in Development. If you'd like to learn more about the Economic Growth Center, you can visit the website at [egc.yale.edu](http://egc.yale.edu), where you can also sign up for the EGC newsletter. There you'll also find links to the LACIR program, which you'll also find in our show notes. If you enjoyed this episode, please share it and leave a rating and review and look for the next installment of Voices in Development on EGC's website, Apple Podcasts, Spotify, or wherever you get your podcasts.