How much redistribution does Uruguay accomplish through social spending and taxes?

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Introduction

Uruguay is a small country with a population of 3.3 million, living primary in urban areas (87 percent in 2009). It has an aging population in which those older than 64 years represent 15 percent of the population and those less than 15 years make up 22 percent.

Between 1990 and 1998, Uruguay's GDP grew at an accumulated annual rate of 4.4 percent. Inequality began to increase in 1995, when the country became affected by a regional recession (*tequila* effect). Shortly thereafter, between 1998 and 2002, the country went through a severe crisis that led to a 17.7 percent decline in production. During this period, the unemployment rate reached a historic high of 18 percent. The growing trend of inequality continued and poverty increased.

In 2003, GDP began to recover, with an accumulated annual growth rate of 6.2 percent between 2003 and 2009. Poverty began to fall beginning in 2005, in which a series of specific transitional measures were introduced. In the years immediately following, a financial reform took place in which a personal income tax was implemented and indirect tax rates were reduced. Additionally, a national social security program was implemented, as well as the so-called Equity Plan, which had as its primary goal the reform of child welfare (family allowance program). In this context, poverty fell from 22.5 percent to 8.9 percent (based on a Purchasing Power Parity (PPP) poverty line of US$ 4 per day) between 2003 and 2009. Changes in inequality were less clear.

Methods

In *Social Spending, Taxes and Income Redistribution in Uruguay*, we apply standard incidence analysis to estimate the impact of social spending and taxes on inequality and poverty, using the Continuous Household Survey (*Encuesta Continua de Hogares)* (2009) and the Household Survey of Spending and Income (*Encuesta de Gastos e Ingresos de los Hogares)* (2006), both of which are administered by the National Institute of Statistics. In our incidence analysis, social spending includes direct cash transfers programs, non-contributory pensions, food transfers, and public spending on education and health (also known as in-kind transfers). Contributory pensions are

considered part of market income. However, we have carried out a robustness check of our results by including contributory pensions among government transfers and assessing the sensitivity of our results.

Analysis

In Table 1 we present the impact of social spending and taxes on inequality and poverty. We do this by tracing the "evolution" of inequality and poverty from market income (pre-taxes and transfers), to net market income (market minus direct taxes), to disposable income (net market plus cash transfers), to post-fiscal income (disposable minus indirect taxes and plus indirect subsidies), and to final income (post-fiscal income plus in-kind transfers—i.e., public spending on education and health). Direct taxes and direct cash transfers are equalizing and poverty-reducing. Indirect taxes offset in part the equalizing and poverty-reducing effect of cash transfers: while the Gini (headcount index) for post-fiscal income (after indirect taxes) is lower than the market income Gini (headcount index), it is higher than the disposable income Gini (headcount index). Public spending on education and health is highly equalizing.

Overall, the combined effect of social spending and taxes reduces the Gini coefficient by 10 percentage points. Direct cash transfers reduce the incidence of extreme poverty (measured with the PPP poverty line of US$2.50/day) from 5.1 percent to 1.5 percent, and indirect taxes raise it to 2.3 percent. The combined effect is a reduction of 2.8 percentage points in the incidence of extreme poverty.

Table 1. Gini and Headcount Index for Different Income Concepts.

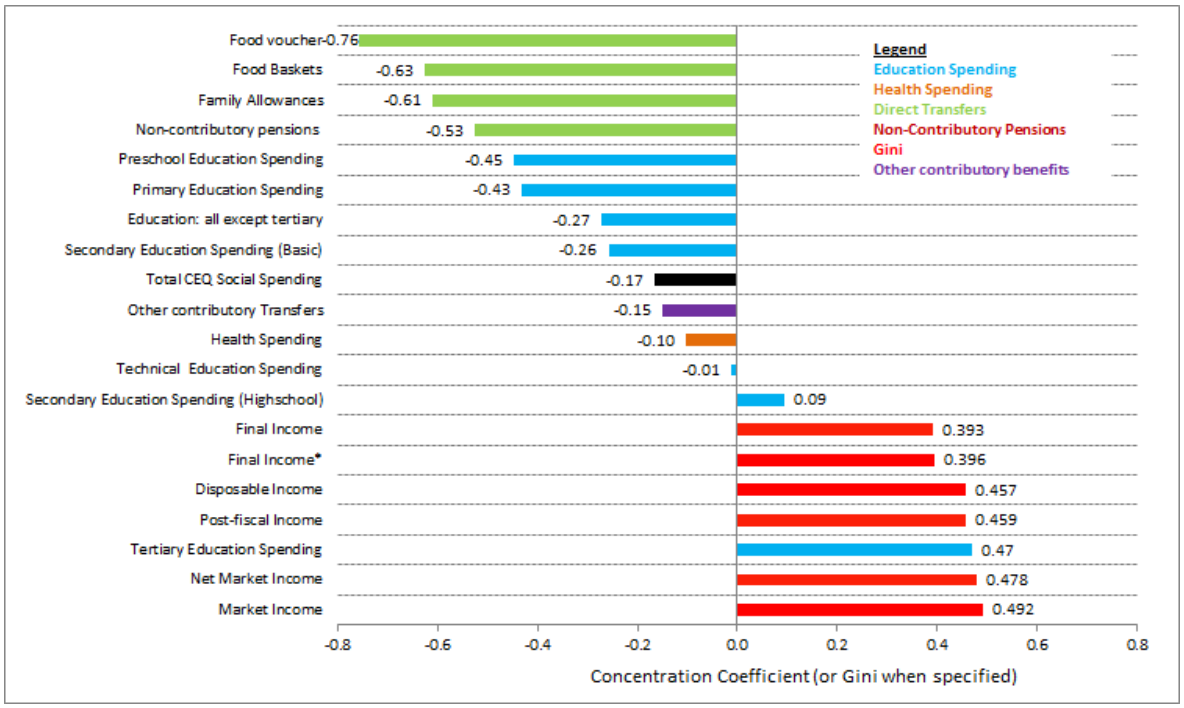
	Market Income	Net Market Income	Disposable Income	Post-fiscal Income	Final Income
Gini	0.492	0.478	0.457	0.459	0.393
Headcount index					
Poverty line: $2.5 PPP/day	5.1%	5.1%	1.5%	2.3%	..-
Poverty line: $4 PPP/day	11.6%	11.7%	6.7%	8.9%	..-
Poverty line: National moderate	25.8%	26.3%	22.7%	26.3%	..-

Source: Bucheli et al., 2013, Table 2.

In Figure 1, we present the concentration coefficients for all programs, sorted by progressiveness. The reader should recall that a negative concentration coefficient means that the transfer is progressive in absolute terms. That is, the per capita transfer declines with income. A positive concentration coefficient, but one that is smaller than the market income Gini, means that the transfer is progressive in relative terms. That is, the transfer as a share of market income declines with income. If the concentration coefficient is higher than the market

income Gini, the transfer is regressive—that is, unequalizing. The only components of social spending that are not progressive in absolute terms are spending on high school education (which is almost neutral in absolute terms—per capita benefits are the same throughout) and tertiary education. None of the transfers are outwardly regressive, but spending on tertiary education is almost neutral in relative terms. In other words, spending on tertiary education disproportionately benefits the rich (in comparison to their weight in the overall population).

Figure 1. Concentration Coefficient by Spending Category and for Total Social Spending



Source: Bucheli et al., 2013.

Conclusion

In sum, Uruguay stands out as a country in which the government seems quite committed to reducing inequality and poverty through its fiscal policy (Lustig et al. 2013), except for access to tertiary education, from which low-income individuals are blatantly excluded. This exclusion occurs because of a relatively high dropout rate in secondary education. Whether the high dropout exists because students from low-income families cannot keep up with the academic demands or because they need to work remains to be seen.

In addition, although by international standards extreme poverty in Uruguay is very low and direct net transfers significantly contribute to this outcome, extreme poverty has not been eradicated. Except for noncontributory pensions, the size of the average benefit of other direct cash transfers is not significant enough to move all beneficiaries out of extreme poverty.

References

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