

SPEECH BY ALICIA BÁRCENA, EXECUTIVE SECRETARY OF THE ECONOMIC COMMISSION FOR LATIN AMERICA AND THE CARIBBEAN (ECLAC), IN CONVERSATION WITH THOMAS PIKETTY, AUTHOR OF “CAPITAL IN THE TWENTY-FIRST CENTURY”

Santiago, 15 January 2015

Mr. Piketty,

Welcome to the Economic Commission for Latin America and the Caribbean (ECLAC), the home of the United Nations in Latin America and the Caribbean. Speaking for myself and on behalf of ECLAC, I would like to thank you for accepting our invitation to join us today and fitting us in to your extremely busy schedule.

Allow me to congratulate you on the quality of your book, which is the culmination of 15 years of work.

Unfortunately, your visit has coincided with deplorable events grounded in intolerance and violence.

We are truly saddened by these events as we are pained not only by the loss of life involved, but also by the violation of the ideals of liberty, equality and fraternity.

Mr. Piketty, your presence at ECLAC is of enormous significance to us. The Commission is the longest-standing regional institution devoted to socioeconomic analysis in Latin America and the Caribbean.

Your presence here represents a key opportunity for collaboration and we would like to present to you some of our recent reflections on inequality in Latin America and the Caribbean, which are grounded in the interdisciplinary study of economic and social development from a structuralist viewpoint.

ECLAC has focused its work on analysing the many different facets of inequality, particularly with regard to the poor distribution of income and wealth. Structural roots combined with an interdisciplinary approach have been central to the Commission's work since its inception in 1948, when it was set up as a regional think tank with a mandate to study the economic and social development of the South, from the South. In this respect, we believe that the Commission's historical and current work dovetails with your own work and shares the same long-term view.

When you published your book in 2013, we presented to the countries of the region a policy proposal that placed equality front and centre.

Indeed, a little under a decade ago, we began a process of renewal that has given rise to what we have called the “trilogy of equality”

The first part of that trilogy, entitled *Time for Equality: Closing Gaps, Opening Trails*, was presented in Brazil in 2010 and consisted in a call to recognize equality as the overarching normative ethical principle and the ultimate objective of development.

We proposed that the time for equality had arrived, and that this equality should be understood as the full entitlement to rights. This proposal echoed the clamour of our Latin American and Caribbean societies.

Placing equality front and centre means breaking with the economic paradigm that has prevailed in the region for at least three decades. But a look at the reality of our continent makes this a moral imperative.

Our conviction is clear: we must seek equality for growth and growth for equality.

This is no easy path, but taking it can no longer be postponed. Instilling equality will require structural change aimed at closing critical social and production gaps and achieving compatibility between the economy, production, social dimensions and environmental sustainability.

Subsequently, in 2012, we presented in El Salvador, in Central America, the document *Structural Change for Equality: An Integrated Approach to Development*, which outlined the challenge of spreading capacity-building, technological progress, ample job opportunities and access to social benefits and safety nets throughout the production structure and weaving them into the very fabric of society. This means making qualitative changes to the production structure of the region's countries, in order to strengthen knowledge-intensive sectors in which domestic and external demand are expanding rapidly, thereby delivering productivity gains with more and better jobs. The region needs to move away from production structures centred on static comparative advantages and towards dynamic comparative advantages in knowledge-intensive sectors with an emphasis on technological progress.

In April 2014 in Peru, we presented the third part of the trilogy, *Compacts for Equality: Towards a Sustainable Future*, in which we held that if the region is to safeguard the social progress it has made in recent years and prevent future spates of restrictions and hardship, we must embark on a new, more sustainable growth path with greater equality by driving a renewed set of institutional and policy reforms.

We are now working on a fourth proposal, addressing territory, equality and the citizenry, to be presented in Mexico in 2016. We need to reach all territories, communities and people.

As you have said yourself, we must close the gap between economic theory and the analysis of daily realities in order to enable citizens to exercise their rights and demand full access to information, including fiscal and tax information. If I may cite your own words: “the distribution of wealth is too important an issue to be left to economists, sociologists, historians, and philosophers. It is of interest to everyone, and that is a good thing”.

Why have we tried to build our reflections and proposals around the premise of equality?

It is because Latin America and the Caribbean, despite its successes and failures, is not the poorest region in the world, but historically it has been and it remains the most unequal.

Today, advocating equality means reframing it in the light of lessons learned from history and of the current reality of living in the world, namely of experiencing globalization in all its forms. Equality and liberty bring greater humanity to the tasks of modernity.

Mr. Piketty, the neoliberal models applied in Latin America, particularly during the 1980s and 1990s, not only failed to achieve high and sustained growth rates, but they deepened inequalities, widened income distribution gaps and led to the privatization of goods, industrial processes and services that were of great public importance. The concentration of wealth reached disproportionate levels. Hence the need to proactively develop and implement public policies in the fiscal, production and social spheres.

I would like to highlight two of the many areas in which our work at ECLAC intersects with your own work, Mr. Piketty, and that of your colleagues: methodological issues and fiscal policy from a Latin American and Caribbean perspective.

Generally speaking, distributive studies tend to focus on the distribution of income or consumption rather than the distribution of wealth. In Latin America, the tradition has been to analyse income, which is the variable usually covered by household surveys in the region. Both income and consumption reflect resource flows, each of which has its limitations. Wealth is therefore probably a better indicator of households' access to resources, as it includes financial and non-financial assets that can be traded on the market. It is a stock variable, which, in turn, generates flows of income. Wealth is also a powerful means of intergenerational transmission, via inheritance.

In countries for which information exists, studies find that wealth is far more unequally distributed than income. In Latin America, surveys of this type are few: they have been conducted in Chile, Colombia and Uruguay. Moving towards the collection of information on wealth in the region thus remains a pending task and one which could provide significant input into the debate on the feasibility of and scope for implementing more progressive tax policies, including taxes on capital and on inheritance.

Despite a lack of systematic and continuous information on wealth and longitudinal data to analyse trajectories, the region does possess information on household income, and the quality of that information has improved in recent decades. However, it cannot be denied that household surveys, the main source of information for estimating inequality in income distribution, present certain data collection limitations.

Probably the greatest obstacle is the difficulty involved in quantifying the income of households at the top of the distribution, that is, of the richest. This may be caused by truncation (excluding the richest households from surveys), the underreporting of income or simply a greater propensity than other citizens not to participate in surveys.

Whatever the reason, the result is that income is underestimated in household surveys, and this affects measures of income inequality. Unfortunately, there is no satisfactory solution to these problems. One attempt to improve household income estimates has been to combine household survey data with data from the System of National Accounts. ECLAC has gone down this path in recent decades, adjusting the income data from household surveys to the data from national accounts.

Income data from household surveys have been corrected for non-response and underreporting by the Statistics Division of ECLAC. Underreporting of income is adjusted by multiplying the income from each source by a factor equal to the discrepancy with the figure for income per capita indicated in the national accounts. This practice raises average incomes and often modifies their distribution. In particular, it tends to increase inequality because the gap in capital income is attributed exclusively to the richest quintile.

These corrections accentuate a distinctive feature of inequality in the region, that being the large share of income captured by the highest stratum, that is, the richest 10% of households. On average, this group accounts for 32% of total income, although there is considerable variation around this value.

While in Uruguay and the Bolivarian Republic of Venezuela the share of the top decile is between 20% and 23% of total resources, in Brazil, Chile, Guatemala, Honduras and Paraguay, these percentages are close to 40%. This situation reflects the failure of tax systems to tax the income of the wealthiest sectors of the population.

At the other extreme, the stratum consisting of the poorest 40% of households averages 16% of total income. The lowest figures are for Honduras and the Dominican Republic (11.4 and 12.5%, respectively).

One option that has gained traction in recent years is to include other data sources in the analysis, particularly data on income and wealth from the fiscal records of tax administrations.

In addition to permitting the analysis of long-term trends in inequality—chiefly in developed countries with long-established systems of taxation—this information can be used to recalculate inequality indicators derived from household surveys by adding missing information on high incomes and may enable, depending on the legislative system of each country, income to be broken down by source.

These advances in measurement, along with this proposed research agenda, provide a window of opportunity for discussion of issues concerning the regulation and taxation of capital, as you pointed out yourself in the paper you wrote with Gabriel Zucman in 2013.

We believe that using information from tax records can significantly expand the scope of the studies on income distribution in the countries of the region and enables in-depth analysis of high incomes. This can also lead on to an exploration in greater detail of the tax rates actually paid by the rich and super rich, despite the limitations associated with such problems as tax evasion, avoidance and exemptions and changes in rates.

Despite the reduction in inequality in the region over the last decade, attributable mainly to the fairer distribution of labour income, Latin America remains the region with the greatest concentration of wealth in the hands of the few. One of its major challenges, therefore, is to implement public policies on income redistribution and to empower the State while ensuring legitimacy in the eyes of the public.

In this context, it is important to assess the role played by fiscal policy and to identify the instruments that are most effective in redistributing income and, on this basis, to make proposals for reforms to ensure that countries' tax systems and spending programmes are both more redistributive and more transparent.

ECLAC makes estimates of the impact of fiscal policy that are comparable with those of the Organization for Economic Cooperation and Development (OECD). The information used comes from the latest available survey of household income and expenditure in each country.

In order to ascertain how progressive or regressive personal income tax is, ECLAC estimates the average rates paid by each decile of the population. In our region the effective rate paid by individuals in the wealthiest 10% of the population is just 5.4% on average, with the highest earners paying as little as 1% to 3% in tax on their gross income in some countries and around 10% in others.

Although the maximum legal rates of personal income tax range between 25% and 40%, the effective rates paid by the top decile are very low as a result of tax evasion, avoidance, exemptions and deductions, as well as the preferential treatment afforded to capital income, which is taxed at a lower rate than labour income in some countries and not taxed at all in certain others.

The redistributive impact of income tax is therefore very limited, as is evidenced by comparing effective average rates with their effect on the Gini coefficient.

Income tax has the effect of reducing the Gini index by an average of 2% (or 1 percentage point), with certain variations from country to country. Simulations carried out by ECLAC of potential reforms to personal income tax using data from household surveys show that there is room for improvement in terms of its redistributive power.

If the countries of the region were to raise the effective rate paid by the top income decile to 20%, the redistributive effect of personal income tax would increase considerably. And if, additionally, these higher tax receipts were redistributed to the lower deciles, this would, in turn, have a significant impact on the Gini coefficient.

As has been stressed in numerous documents and forums, the relative and absolute weakness of income tax is the main structural problem affecting tax systems in Latin America.

Tax policy has prioritized efficiency, striving to ensure that income tax should have as small an impact as possible on private-sector decisions regarding savings and investment and, in some cases, moves have been made towards a tax base grounded in consumption rather than the traditional

income-based system. In so doing, the attributes of fairness and simplicity have been sacrificed. The main issue undermining the fairness of income tax is the preferential treatment afforded to capital income, which leads to an asymmetry in respect of the taxation of labour income.

In the past decade, several countries in the region have undertaken a series of tax reforms with a view to increasing receipts by raising rates, cutting down on exemptions, implementing dual taxation systems in some cases, modifying or introducing minimum rates and increasing oversight of the highest taxpayers. However, the impact of these reforms on the main indicator of inequality, the Gini coefficient, remains limited in most countries, as recent studies by ECLAC have shown.

Mr. Piketty, these are some of the topics that we wish to discuss with you this afternoon. ECLAC has a history of collaboration with the Paris School of Economics, with your colleague Mr. Bourguignon, and perhaps we could extend our relationship to your research team.

You have successfully placed economic reflection on inequality at the forefront of global public debate. And this is why we want to draw your attention to the work being carried out in institutions where a similar policy approach is being taken in this region.

Mr. Piketty, your solid work raises a number of important concerns and we would like to thank you for providing us with a useful tool in our shared efforts to demonstrate that inequality is not an inevitability.

A little over four decades ago, with his deep voice and shrewd gaze, Pablo Neruda received his well deserved Nobel prize for literature in Stockholm. Upon closing his acceptance speech, he paid tribute to Rimbaud, and I quote “only with a burning patience can we conquer the splendid City which will give light, justice and dignity to all mankind. In this way the song will not have been sung in vain.”

From the Chile of Neruda, who honoured another precociously gifted Frenchman, I wish to thank you, Thomas, for fanning the flames of that burning patience.

Many thanks, you have the floor.