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Experience

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# Poverty, Inequality, and Democracy

## THE LATIN AMERICAN EXPERIENCE

*Francis Fukuyama*

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One of the oldest debates in democratic theory concerns the degree to which the formal political and juridical equality offered by liberal democracies needs to be supplemented by substantive social equality—in terms of income distribution, access to social services, and ability to participate in public life. Any free society with a prosperous market economy will necessarily have to tolerate some degree of inequality, given the uneven distribution of talents within any population. Achieving even the imperfect level of social equality to which communism aspired required dictatorial control over individual choices. But there is a wide variance both in the initial degree of income inequality among liberal democracies, and in the degree to which these states redistribute income or invest in equalizing policies, such as universal education, in order to reduce these differences.

A case in point is Latin America, where many countries suffer from, in the words of James Robinson, the “birth defect” of high inequality. Their origins as extractive colonial states led to the exclusion of large parts of the population from the political system, leaving the excluded without the ability to protect their rights. Those who settled British North America, by contrast, were political participants from the beginning, with an interest in maintaining a democratic political order. In Asia, fast-developing countries such as South Korea and Taiwan began their high-growth periods with land-reform policies and then invested heavily in universal education. Latin American countries, by contrast, have undertaken relatively little redistribution and have failed to provide equal access to public services such as education and health.

A recent study conducted by the Organisation for Economic Co-operation and Development shows that in Europe income inequality as measured by Gini coefficients (a Gini number of 0 indicates absolute equality of income distribution, while a 1 indicates absolute inequality), declines from .46 to .31 after taxes and transfers, while in Latin America it declines from .52 to only .50. Fiscal policy across Latin America is often regressive, winking at tax evasion by the rich and granting generous subsidies to such reasonably well-off groups as middle-class pensioners and civil servants.<sup>1</sup> The result has

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been that the region’s initial inequality has reproduced itself with remarkable regularity over the generations.

This high level of inequality has had enormous consequences for the region’s long-term economic growth and political stability. Inequality delegitimizes the political system, gives rise to antisystemic social movements and political actors, and sets the stage for bitterly polarized social conflict and a zero-sum “fight for shares.” In the mid-eighteenth century, many parts of Latin America—the sugar island of Cuba, for example—enjoyed higher per capita incomes than Britain’s North American colonies. But Latin America’s growth was interrupted repeatedly by political crises fueled at their root by conflicts over the distribution of resources. Mexico’s period of growth under President Porfirio Díaz (1876–80 and 1884–1911), for example, was brought to an end by the Mexican Revolution in 1911, and the country did not recover fully until the 1940s.

Social cleavage similarly lies at the heart of Argentina’s weak rule of law. The 1930 military coup, which represented the first major break in Argentina’s constitutional order, occurred because the country’s landed oligarchy feared the rise of new, urban middle and working classes. The undermining of the rule of law started at the top, as the Supreme Court was forced to endorse the coup’s legality retroactively. Ultimately, the government’s suppression of popular movements seeking political participation paved the way for the rise of Juan Perón and Peronism, which sought to coopt the industrial working class in a corporatist system. But once Perón came to power, he showed just as little respect for the rule of law as the oligarchs whom he had replaced. Thus unlike in Britain, Sweden, and other European countries where political inclusion helped to mitigate class differences, in Argentina the political system served merely to exacerbate these cleavages.

The political crisis that has erupted in the Andean region of Latin

America over the past decade, bringing to power populist leaders in Bolivia, Ecuador, and Venezuela, is only the latest manifestation of the problem plaguing the region. Each of these countries had longstanding democratic traditions but at the same time was characterized by sharp social inequality. The Pacto de Punto Fijo restored democracy in Venezuela in 1958, after which a two-party condominium managed the political system, successfully distributing oil rents to networks of political supporters while doing little to improve the skills or competitiveness of the broader population. Thus when oil prices collapsed in the 1980s, so did stability, ultimately paving the way for the 1992 attempted coups (one led by Hugo Chávez) and Chávez's eventual election as president in 1998.

Both Bolivia and Ecuador have sizeable indigenous populations that have long felt excluded from the political and social system. Bolivia—whose first fully indigenous president, populist Evo Morales, was elected in late 2005—is characterized by a sharp polarization between the Altiplano, whose population is heavily indigenous and poor, and the prosperous lowland regions around Santa Cruz that have long been home to the country's elite. The 2006 election that brought populist leader Rafael Correa to power in Ecuador offered voters an unappealing choice between him and Alvaro Noboa, a banana magnate and one of the richest men in the country. All three populist presidents have been busy consolidating executive power, dismantling democratic institutions, reversing liberalizing economic reforms, and engaging in social policies that are broadly favored by the poor but are unsustainable in the long run.

The way that social inequality has destabilized Andean politics in the past decade requires closer examination, however, because its precise sources will determine the kinds of policies that can best ameliorate the problem. It is common to talk about the “social exclusion” of the poor, and particularly of indigenous communities, in Latin America. In a sense, however, the region's recent instability is a result of an expanding inclusiveness that has introduced a whole new set of social actors into politics. For example, there has been a substantial increase in overall educational achievement in the region: Secondary-school enrollment in Colombia increased from 12 percent in 1960 to 67 percent in 1996; in Peru, from 18 to 73 percent over the same period; and in Ecuador, from 12 to 50 percent between 1960 and 1994.<sup>2</sup> This marked improvement has been accompanied by large increases in electoral participation: In Peru, 45.3 percent of the population voted in the 2001 election, in contrast to only 14.9 percent in 1956; Bolivia went from 27.4 percent in 1960 to 35.4 percent in 2002.<sup>3</sup> The election of populist leaders such as Chávez in Venezuela and Morales in Bolivia would have scarcely been possible had elites retained their stranglehold on the political system and had political exclusion remained absolute.

The real problem that these countries face, however, is not exclusion per se, but the syndrome of political decay described by Samuel P. Hun-

tington in *Political Order in Changing Societies*.<sup>4</sup> That is, the process of modernization has mobilized new social actors who make demands on the political system that outstrip the system's institutional capacity. Weak public institutions—the court system, police, schools, and health care—fail to meet the demands placed on them, which creates a tremendous cynicism among the poor, who see a system controlled by elites and biased against them. The solution to the problem then is twofold: first, to build the capacity of the state so that it can effectively deliver basic social services to the bulk of the citizenry; and second, to incorporate these new social actors into the democratic political framework so that they do not undermine the institutionalization that has already taken place.

### An Obstacle to Economic Growth

In addition to the adverse political consequences of social inequality, economic development suffers as well. A high level of social inequality leads to a dearth of educated workers who can compete in an increasingly globalized economy. Much of Latin America has now achieved “middle-income” status in World Bank rankings, meaning that annual per capita income is in the range of US\$4,000 to \$5,000 in terms of Purchasing Power Parity (PPP). Now these countries face the problem of getting to the next level—an annual per capita income of between \$8,000 and \$10,000. Up to now, their growth has been based on commodity exports, low-skill manufacturing (textiles and *maquiladora* assembly work), and some higher-end manufacturing and services coming from increasingly competitive Latin American multinationals. **While commodities will continue to be an important source of growth, it will be increasingly difficult for Latin America to compete against Asia in low-skill manufacturing. At the same time, Asian countries are fast moving up the value-added chain, with China and India producing ever larger numbers of engineers and managers each year. With such stiff competition, Latin American countries must begin to invest more in education and training if they are to remain in the game.**

If we accept the proposition that substantial social inequality affects both economic growth and the quality of democratic politics, what is to be done about it? Certainly there is no simple solution to so persistent and serious a problem. A set of policy prescriptions that hopes to be of any use must outline at least some measures that can realistically chip away at the problem.

One possible solution is rapid economic growth, along with the integration of national economies into the global economy. Over the past three decades, hundreds of millions of people have been brought out of poverty in fast-growing countries such as India, China, and the nations of Southeast Asia. **Latin America's star economic performer, Chile, has**

also seen substantial reductions in poverty.

But while rapid growth reduces poverty, it often exacerbates inequality. China's impressive growth, for example, has not been shared equally among its people: Its Gini coefficient rose in the decade between 1994 and 2004 from .41 to .47, and the richest 10 percent of the population earns almost twelve times the income of the poorest. This disparity may well be related to the thousands of violent social protests that break out in China every year, only to be repeatedly and successfully put down by the PRC's authoritarian state. And for all of Chile's impressive gains in poverty reduction, there has been hardly any change in the degree of inequality over the past generation.

Of course, rapid economic growth of the kind seen in East Asia would in itself be desirable for Latin America. Apart from Chile, however, the region has never managed to achieve comparable results on a sustained basis. There has been solid growth from 2004 to 2008 (in the neighborhood of 4 to 4.5 percent, compared to 7 to 8 percent for many East Asian countries), but it has largely been the product of a global commodities boom fueled by explosive growth in other parts of the world. This type of commodity-driven growth carries political risks, since commodity prices inevitably fluctuate and the benefits often fail to trickle down to the broader population.

There are many reasons for this lagging performance, including rigid labor markets that drive large numbers of workers into the informal sector, weak judicial systems, and insufficient investments to upgrade the skills of the region's labor force. These problems are theoretically solvable, but not within a timeframe necessary to mitigate the social unrest driven by inequality.

This means, then, that stable democracy in the long run requires not just growth, but more targeted social policies in the areas of health, education, social security, and other domains. The state has an obligation both to provide equal access to public goods, and in some measure to seek remediation of preexisting social inequalities. Good social policy, however, is extremely hard to implement properly. In many ways, the Reagan-Thatcher revolutions that sought to roll back the scope of the state occurred because the modern welfare state had become too large and too dysfunctional. Europe today is facing a looming crisis of competitiveness because its labor markets are encumbered with regulations that were designed to protect workers, but whose actual effect is to raise unemployment. Transfer payments and subsidies come to be seen as entitlements; they create moral hazard and disincentives to work.

What is true for the wealthy countries of Western Europe is doubly so for poorer countries such as Brazil and Argentina, which tried to implement European-style worker protections back in the 1940s and 1950s when they were at a much lower level of development than their Euro-

pean counterparts. Part of the overbuilt state that neoliberal reformers were trying to dismantle decades later consisted precisely of social-welfare programs that had become excessively expensive and sometimes even counterproductive. As a result, many pro-market reformers were reluctant to address the need for social-policy reform, fearing that it would become an excuse to reopen opportunities for rent-seeking and other dysfunctional political practices.

## The Problem of Education Reform

The example of education nicely illuminates the difficulties in improving and equalizing social outcomes. Everyone wants better education for their children, and one of the most straightforward ways of leveling incomes over the long term, in theory, would be to improve the educational opportunities of poor children. Many of the East Asian fast developers invested heavily in education at all levels and successfully fostered highly competitive work forces on par with those in the developed world. Thus, allocating more resources to education *should* address social inequality, at least to some degree.

What should work in principle, however, is often very difficult to achieve in practice. In many countries, including the United States, there is a relatively weak correlation between higher spending on education and actual improvement in educational outcomes.<sup>5</sup> A large body of social-science literature dating back to the mid-1960s and the Coleman Report (a seminal study on educational opportunity in the United States) show that factors such as family and peers have a greater effect on educational outcomes than do average class size, teachers' salaries, libraries, and the like.<sup>6</sup> In a recent paper, Michael Clemens points to a natural experiment of sorts that occurred in 1992, when the New Jersey Supreme Court ruled that the state had to equalize per capita spending on education across all school districts. Over the next eight years, some \$25 billion was reallocated from wealthy, high-performing school districts to poor ones. Despite the massive increase in resources, however, there was only a marginal melioration in actual educational performance among New Jersey's poor.<sup>7</sup> Likewise, Brazil's 1988 Constitution mandates that 25 percent of the federal budget go to education,<sup>8</sup> and yet those resources have done little to improve outcomes—although here this is partly because resource allocation is heavily skewed toward higher education.

There are a number of reasons for this de-correlation between spending levels for education and educational outcomes. The most important have to do with what economists call agency problems—that is, the interests of the people hired to run a school system diverge from the interests of those who hired them in the first place. In many long-established educational systems, resources are controlled by well-entrenched interest groups such as teachers and administrators. Promotions and higher

salaries for teachers come to be regarded as something of a rent or an entitlement meant to benefit the adults rather than the children in the school system. Simply increasing teachers' pay or lowering student-teacher ratios may encourage more and better teachers to enter the system, but will not necessarily incentivize teachers to do their jobs more effectively. It was this kind of experience that has led many reformers to argue that teachers' unions, because of their tenacious desire to protect the status and privileges of teachers, are a particular obstacle to education reform. In many Latin American countries, the teachers' union is the largest union in the country, and often one of the most powerful political actors. These entrenched players have been strongly committed to maintaining the status quo on core policies, including the market share of private education, free public education, absolute job security, and preserving the nationwide scope of the union's representation.<sup>9</sup>

Prompted by the lack of correlation between spending and outcomes as well as the general difficulties of improving public educational systems, a number of public-policy specialists (many of them economists) have suggested alternative approaches to improving results. Many of these approaches incorporate market-like mechanisms to mimic the kinds of incentives that would exist in the private sector, such as vouchers that would allow parents to take their children out of poorly performing public schools, or competitive bidding to manage schools in the public system (charter schools).

The most common approach short of interschool competition is to try to establish pay-for-performance systems in which teachers and administrators' salaries are linked to measurable educational outcomes. Not surprisingly, however, both teachers and administrators fiercely oppose such schemes. Individualized incentive plans not only threaten the group solidarity of teachers as a whole, but are also very difficult to administer. Educators rightly point out that educational outcomes are difficult to quantify, because the kinds of standardized tests often used to measure performance are either inaccurate or can be gamed by schools and students. Moreover, many factors affect educational outcomes, of which teacher performance is but one. Thus it is unfair to penalize teachers for results over which they have limited control. Finally, the best-performing schools sometimes are not ones subject to market-like discipline, but rather ones characterized by a high degree of professionalism, idealism, and commitment.

The United States has been trying to improve the performance of its primary and secondary school systems for at least a generation now, with results that are far from decisive. Liberals have argued for putting more resources into the public system, while conservatives have argued for the introduction of more market-mimicking incentive systems. Neither resources by themselves nor incentives without resources will fix the problem. The perfect mixture of the two, however, is difficult to



determine, and political consensus on such a combination remains elusive. The same would hold true of any concerted effort to improve educational outcomes in Latin America. Fortunately, that has not deterred governments and thinkers from addressing educational policy.

Latin America has seen a number of innovative attempts to improve its educational systems. Chile, not surprisingly, has been a leader in adopting market-based systems; it established a voucher system in which private and public schools compete for students, with private schools currently enrolling about 40 percent of the total. The city of Bogota in Colombia has adopted a system of competitive bidding for the management of public schools. In other cases, decentralization has characterized the approach to reform, devolving power over school administration from central governments to municipalities. Local authority works more or less well depending on how the system of fiscal transfers is organized. If local government remains dependent on the central government for funding, or must constantly renegotiate the terms of its funding, its incentives for demanding better performance will be weakened. Meanwhile, fourteen countries in Latin America have adopted school-evaluation systems and created new institutions to carry out the evaluations.<sup>10</sup> A final approach has been to tie school attendance to cash-transfer payments to the poor, a system begun in Mexico and Brazil and now extended to Argentina, Chile, Colombia, Ecuador, Honduras, Jamaica, and Nicaragua. These programs have succeeded in improving school attendance, but their ultimate impact on educational outcomes is unclear. Again, the specifics of these programs' designs are critical, and the way in which they structure incentives will greatly affect their impact.<sup>11</sup>

A recent study by the Inter-American Development Bank argues that there are two kinds of education reform in Latin America—the first type expanding access to education by building new schools and enrolling more students, and the second improving the quality of the existing educational system. The study argues that while there is large consensus on the first goal, which accounts for the expanding school enrollments cited above, the latter is subject to a political stalemate pitting would-be reformers against the unions and other entrenched interests. The study concludes that “[n]ot a single case of significant alteration in any of these core policies [that is, those favored by the education establishment] has occurred anywhere in the region over the past decade and a half.”<sup>12</sup>

### **Addressing Pervasive Poverty**

While higher-quality education is clearly key to improving Latin America's global competitiveness and enabling it to make long-term progress in tackling social inequality, other social programs have addressed the problem of inequality much more directly. Conditional

cash-transfer (CCT) programs were first introduced in the mid-1990s in Mexico as the *Progres*a program and later expanded under the title *Oportunidades*. These programs provide means-tested cash transfers to poor families on the condition that they either seek prenatal care (in the case of expectant mothers) or put their children in school (for families with young children). The Mexican programs were designed with built-in controls to test their effectiveness, and a growing empirical literature indicates that they have done well in meeting their stated goals of increasing school attendance among children of poor families. As a result of the perceived success of the CCTs, they have been widely copied all over the region and now include the *Red de Protección Social* program in Nicaragua, the *Programa de Asignaciones Familiares* in Honduras, and the *Bolsa Familia* in Brazil. The *Bolsa Familia* now reaches some fifteen-million poor Brazilian families, and by itself accounts for perhaps 20 percent of the drop in Brazil's Gini coefficient between 1996 and 2005.

CCTs, of course, are not the whole solution to the problem of poverty, and are not without skeptics. They are only "smart" social policy if they are well-implemented. While they improve school-attendance rates, it is not clear that they actually increase educational achievement or the attainment of knowledge and skill. In other words, putting poor children in bad schools will not necessarily help them. Some critics have argued for dropping the CCTs' conditionality, on the grounds that poor families should know themselves how best to use marginal income.

The possible politicization of CCTs presents yet another complication. The long-term success of CCTs will depend on politicians' avoiding the temptation to use them for patronage purposes, doling out benefits only to those who are likely to support them. There is, unfortunately, some evidence that this has begun to happen in Nicaragua since Daniel Ortega's election as president in 2007. CCTs will work as advertised only if the selection criteria for program participation are objective—that is, if they are open to all who qualify based on a prior, agreed-upon mapping of poverty. There has been a consequent effort to make CCTs universal entitlements, which poses a different sort of danger by possibly locking in high expectations for government-funded subsidies. If CCTs evolve into a negative income tax, where everyone below the poverty line gets a cash subsidy, what long-term level of funding will be sustainable through the next economic downturn?

There are many other social sectors that need attention, including health care, pension systems, and unemployment insurance. Each country—indeed, each region and city within each country—will likely have to experiment with different initiatives. As can be seen from the examples cited above, there has been a great deal of mutual observation and imitation of workable programs across Latin America, which helps to generalize the results of successful decentralized experimentation. There are also

large swaths of the region that remain untouched by innovation or are still under the thrall of the dysfunctional social-support systems of the past.

If Latin America is ever to achieve stable democracy and higher long-term rates of economic growth, it must work to construct smart social policies. This must come about not by returning to the sclerosis-inducing entitlement programs of yesteryear, but by designing systems that maximize the incentives for the poor to help themselves. The so-called first-generation neoliberal reforms of the late 1980s and early 1990s focused on economic-policy changes such as privatization and tariff reduction. The second generation took on reforming government institutions (public administration, court systems, and the like). Renewed attention

to social policy constitutes a third generation of reform, which is now unfolding even as the agendas for the first two waves are not yet complete.

The first-generation reformers were, for understandable reasons, wary of any emphasis on new social programs, since past programs had given rise to the same bloated state sectors that the reformers were trying to discipline. Some argued that rapid economic growth would by itself begin to ameliorate many social problems by creating new avenues of upward mobility for the poor.

But there are two good reasons to take the social agenda seriously, one structural and one political. The structural reason is related to the analysis presented above: The development of formal democratic political institutions, along with long-term economic growth (although at a lower rate than that of the United States), has brought about many positive changes in Latin America. But the region's underlying social hierarchy continues to reassert itself and undermine progress in many ways, from the perpetual lack of a well-educated, competitive labor force to the populist politics that threatens political stability and good policy in several countries today. Without an effort to address this underlying problem, we can expect that the gap will replicate itself into the indefinite future.

The second reason is frankly political. Populist politicians such as Chávez in Venezuela and Andrés Manuel López Obrador in Mexico enjoy widespread popular support precisely because they are seen as caring about and advocating policies geared toward helping the poor. The kinds of pro-poor policies they put into place, however, are not smart policies that generate self-help incentives, but ones that increase the dependency of the poor on the state. (Indeed, that is one of the reasons that politicians like to promote such programs.) Thanks to rising energy prices in the early twenty-first century, Venezuela can for the moment afford such policies. Countries not similarly blessed will find

themselves facing fiscal constraints in short order; hence the temptation to return to the old, irresponsible macroeconomic policies of the past. Populism's weakness is not that it caters to the people; rather, its failing lies in offering only short-term solutions that actually worsen the long-term prospects of the poor.

It is therefore incumbent on anyone earnestly interested in democracy in Latin America to formulate a serious social-policy agenda—one that targets substantial resources at the crucial problems of health, education, and welfare, but does so in a way that produces real results. Finding out what works in this area will require becoming what William Easterly calls a “searcher”—a social-policy entrepreneur willing to experiment with new approaches, to learn from others, and, more important, to abandon initiatives that are not bearing fruit.<sup>13</sup>

## NOTES

1. See Javier Santiso, “Fiscal and Democratic Legitimacy in Latin America,” OECD Development Center, 27 October 2007.

2. Scott Mainwaring, “The Crisis of Representation in the Andes,” *Journal of Democracy* 17 (July 2006): 13–27.

3. Mainwaring, “The Crisis of Representation,” 19.

4. Samuel P. Huntington, *Political Order in Changing Societies; with a new Foreword by Francis Fukuyama* (New Haven: Yale University Press, 2006; orig. publ. 1968).

5. See the discussion in Ernesto Stein et al., comps., *The Politics of Policies: Economic and Social Progress in Latin America, 2006 Report* (Washington, D.C.: Inter-American Development Bank, 2005).

6. James S. Coleman, *Equality of Educational Opportunity* (Washington, D.C.: U.S. Department of Health, Education, and Welfare, 1966).

7. Cited in Michael Clemens, “A Skeptic’s Look at Two New Proposals to Fund the Millennium Development Goals,” unpubl. paper, Center for Global Development, Washington, D.C., 2006, 5.

8. *Mandatory Funding for Early Childhood Education: A Proposal in Brazil*, UNESCO Policy Brief on Early Childhood, No. 17, October 2003.

9. See ch. 10, “Two Kinds of Education Politics,” in Stein et al., *Politics of Policies*.

10. Juan Carlos Navarro, “Education Reform as Reform of the State: Latin America since 1980,” in Eduardo Lora, ed., *The State of State Reform in Latin America* (Stanford: Stanford University Press, 2006).

11. Carmelo Mesa-Lago and Gustavo Márquez, “Reform of Pension and Social Assistance Systems,” in Lora, ed., *State of State Reform*.

12. Stein et al., *Politics of Policies*, 223.

13. William Easterly, *The White Man’s Burden: Why the West’s Efforts to Aid the Rest Have Done So Much Ill and So Little Good* (New York: Penguin, 2006).