Fifteen Years of Inequality in Latin America: How Have Labor Markets Helped?

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Household income inequality has declined in Latin America in the past decades, enhancing poverty reduction in the region. Although available evidence shows that labor income is one of the main factors behind these inequality trends, few studies have analyzed more closely the labor market dynamics that have led to a decline in total income inequality in some countries, but also to an increase in others. Using household survey data for a sample of 14 countries in Latin America from 1995 to 2009, this paper uses an extension of the Juhn-Murphy-Pierce (1993) methodology to decompose changes in labor income inequality into a quantity effect (capturing changes in workers' skills), price effect (returns to skills) and unobservable effect (other components of skills affecting labor income). Results show that falling returns to skills, for both years of education and experience is, on average, driving the decline in labor income inequality. The quantity effect, in turn, has been mostly inequality-increasing, attributable to a larger dispersion in years of experience, possibly linked to the region's demographic transition. Additional findings show that wage inequality, still high in the region, is coupled with inequality in terms of hours worked, and that quality of education is evermore a source of concern in the region.