

Social Spending, Distribution, and Equality of Opportunities: The Opportunity Incidence Analysis

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Summary. — This paper proposes an additional extension to the traditional Benefit Incidence Analysis (BIA) that links fiscal policies with the concept of equality of opportunities. This new approach, “Opportunity Incidence Analysis” (OIA), is then piloted on three countries, Zambia, Tajikistan, and Paraguay. Three main contributions stand out: first, OIA complements traditional BIA, but increases its analytical resolution by incorporating other circumstances to incomes alone. Second, opportunities and circumstances can be used to target public spending with higher precision. Third, microsimulations can be used to understand the cost-effectiveness of alternative spending interventions that seek to improve equality of opportunities.

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1. INTRODUCTION

It is well known that the composition and distribution of public spending and tax burdens affect poverty and inequality. A key result that emerges from the prolific literature on the links between fiscal policy and distribution¹ is what Lustig *et al.* (2011) call the “conventional wisdom.” First, the higher use of direct taxes tends to make the final distribution of income more equal—that is, direct taxes generally tend to be progressive. The reverse is true for indirect taxes. On the expenditure side, direct cash transfers, in-kind transfers, and expenditure programs in social sectors tend to be more progressive if they are adequately targeted and implemented. There are, however, multiple reasons why these general results may vary from country to country (Bastagli *et al.*, 2012; Lustig *et al.*, 2011), ranging from a host of economic and institutional factors—such as decentralization of public finance or extent of the informal sector—to long-term and short-term considerations—such as the lifecycle or emergence of a cadre of “new” poor during crisis periods (Fullerton & Rogers, 1991; Habib, Narayan, Olivieri, & Sanchez-Paramo, 2010).

In addition to context-specific considerations that question the conventional wisdom, there are also analytical concerns regarding the links between fiscal policies and distribution. Decades of distributive analysis of fiscal policies show that these analyses still overlook important distributional effects of other public policies and long-term and transitory crisis-related effects, and require more resolution in the identification of vulnerable groups (typically mashed in quintile and deciles of income, consumption, or wealth). Unfortunately, there are currently no methodologies that can factor in all of these dimensions. This study provides a framework to fill in some of these gaps, in concrete, the identification of vulnerable groups and the incorporation of longer term effects—those related with equality of opportunities—at the center of the incidence analysis.

The proposed framework shares the mechanics of traditional Benefit Incidence Analysis (BIA), but replaces its assessment of the distribution of outcomes (that is, income, consumption, or wealth) for that of opportunities. The new framework, Opportunity Incidence Analysis (OIA), groups

individuals by their distinctive circumstances rather than their reported income, consumption, or wealth. Interestingly, OIA does a better job at assessing distributional diagnostics than traditional BIA. Also, it does more than diagnostics: it can also provide specific policy advice in terms of targeting and public spending reforms.

Section 2 describes the concept of equal opportunities and links it conceptually with the analysis of fiscal policies. Section 3 presents the new OIA technique and compares it with traditional BIA. OIA is then tested using information from three countries, Paraguay, Tajikistan, and Zambia, all of which represent very different contexts, but share the data and capacity limitations that are typical of low- and lower middle-income countries. Section 4 shows that—contrary to traditional BIA—OIA can also be used for purposes other than diagnosis. This paper highlights two concrete policy applications for OIA: the first improves the resolution of existing targeting exercises, and the second simulates the impacts of alternative public spending reforms on the distribution of educational opportunities. Section 5 concludes with a discussion of how OIA adds to the existing body of work on equality opportunities and complements the policy debate.

2. TOWARD AN OPPORTUNITY INCIDENCE ANALYSIS

(a) *Equality of opportunities*

Relatively recent literature on equality of opportunities provides a promising extension to the traditional focus on

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equality of outcomes—related to incomes, consumption, health, and education—that has dominated distributive incidence analysis.² The framework of equality of opportunities is based on several key concepts: the *objective* is the goal that equal opportunities are expected to achieve (say, universal access to education), while *circumstances* are the attributes of an individual’s environment (either social, genetic, or biological) that affect the achievement of the objective, but are beyond the control of the individual and for which society cannot regard him or her responsible. *Effort* refers to individual behaviors and decisions that, together with circumstances, determine the extent to which an objective was accomplished. Equality of opportunities prevails when an objective or opportunity is achieved with the same level of effort across different circumstances.³

Achieving equal opportunities within a society can be conceptualized within a simple production function approach.⁴ Let us assume that the extent of equal opportunities in a given society is a function of:

$$Opportunities_{ij} = f(inputs_{ij}, policies_j)$$

where $i = \{1, \dots, n\}$ are the groups determined by all possible combinations of circumstances, and $j = \{1, \dots, s\}$ refers to access to each of several basic services or opportunities. Both individuals and governments provide inputs into this framework: individuals, or groups of them, provide different levels of effort; governments choose policies—broadly understood to include public spending, sectoral interventions, regulation, governance, and institutions—toward the achievement of an equity goal.⁵ Societies—either collectively, through democratic means, or else by elites’ choices—determine the extent to which equal access to basic services is a desirable objective. If this is the case, personal circumstances of individuals will not determine whether they have access to basic services: rather, only preferences and/or talent will determine access. If that is not the case, factors outside the control of individuals’ decisions, such as their gender or place of birth, for example, will affect their access to such basic services and, more broadly, equal opportunities.

Several strands of opportunities literature can be compared using this production function conceptual approach. More concretely, each strand emphasizes different aspects of the production function. Table 1 compares the similarities and differences of these strands. In the first approach, van der Gaer (1993), Ooghe, Schokkaert, and Van de Gaer (2007), Hild and Voorhoeve (2004), and Cogneau and Mesplé-Somps (2008) restrict the equality of opportunities concept to when distribution of expected earnings is independent of social origins (typically proxied by parental education and/or parental labor occupation) and, in some cases, of geographical location. A second and somewhat different analytical approach develops nonparametric statistical tests—particularly stochastic dominance tests—to conclude whether or not a distribution of incomes or consumption is compatible with equal opportunities. Leblanc, Pistolesi, and Trannoy (2008) define equality of opportunity as the situation where income distribution, conditional on social origin, cannot be ranked according to stochastic dominance criteria (again, social origin is defined by parental education and/or occupation).

A final approach estimates the Human Opportunity Index (HOI) developed by Paes de Barros, Ferreira, Molinas, and Saavedra (2008) and Molinas, Paes de Barros, Saavedra, and Giugale (2010) (see Appendix A). The HOI measures the extent to which a society progresses toward universal access to basic opportunities. The index synthesizes in a single indicator how close a society is to universal coverage

Table 1. Opportunities literature under a production function approach

Reference (representative reference)	Definition of equality of opportunity	Outputs (opportunities considered)	Production function specification	Circumstances considered	Role of public policies
Van der Gaer (1993)	Social origins do not affect individual earnings	Individual earnings	Parametric	Parental education; parental labor occupation; geographical location	Not a critical or explicit issue in the analysis. Approach limits the ability to test whether or not there is equality of opportunities across earnings
Leblanc et al. (2008)	No distribution of income by social origin stochastically dominates another	Individual incomes	Nonparametric	Parental education; parental occupation	Not a critical or explicit issue in the analysis. Approach limits ability to test whether or not there is equality of opportunities across incomes
Paes de Barros et al. (2008)	Equal access to basic services across different groups of individuals (defined by their circumstances)	Access to basic services such as education, health services, water, and sanitation, and access to electricity; in some cases, nutritional status or a life free of insecurity concerns	Parametric	Individual’s gender and age; household head’s age, gender, and education; geographical location; order and number of siblings in the household; and presence of parents in household, among others	Critical and explicit issue in the analysis. Public spending used to estimate the extent of equal opportunities. Simulations can be used to analyze the effects of policy reforms in the distribution of opportunities

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