Poverty and Policy: The Story So Far (Continued from page 3)

The policy solution was the introduction of compensatory policies with safety nets that targeted resources to the poor. This shift implied a deep change in the spirit of social policy. Under the third phase, or “the targeting generation,” poverty policies were compensatory and had to be small, specific, and tightly focused. The growth and development strategy of most countries had little to do with these policies. Social programs, although perhaps necessary, were viewed as a potential threat to public deficits and macroeconomic stability. Social policies and a country’s growth strategy became two separate things; they were opponents challenging each other for public resources.

The early 1990s marked a shift in the macroeconomic environment in Latin America. Most countries in the region turned positive economic growth while globalization took hold worldwide. The economic reforms of the 1980s implied opening up Latin American economies and exposing them to world markets; during the 1990s other regions of the world joined in the trend. Globalization made it clear that to survive in today’s world, countries had to be competitive.

This change in the economic environment had crucial consequences for social policy. If a country wanted to be competitive, having large segments of the population living in poverty was a strong disadvantage for productivity and social cohesion.

These developments brought the birth of a fourth generation of social policies. Programs such as Progresa in Mexico, Bolsa Escola in Brazil, or Chile Joven in Chile, all of which are a centerpiece in the social development strategy of their respective countries, have shifted away from the concept of offering only temporary safety nets to compensate the poor. Progresa provides cash transfers and a nutritional supplement to rural families in extreme poverty, but transfers are conditioned on children’s school attendance and regular checkups at health clinics. Bolsa Escola is a similar program that provides scholarships for disadvantaged children who complete a schooling cycle. Chile Joven is also a program of cash transfers, but in this case they are provided to young adults to encourage training. These programs, which are replicated across the region, have one important element in common: they provide assistance to the poor, but by including strong incentives to accumulate human capital. The spirit is that they help the poor, but they do so by equipping them with the tools that will allow them to help themselves in the new economic environment.

But, can these programs be regarded as the solution? There is a danger in confusing the implementation of programs of this type with the full social policy strategy of a country. These programs definitely have the capacity to improve the well-being of the poor, but they cannot be regarded as a solution to the poverty problem. For instance, they may help improve schooling levels among poor children, but if there are no opportunities to put human capital to work, they might not have the expected impact on the income-earning capacity of the disadvantaged. Relying on these programs as the full social strategy of a country is like throwing the poor a life-saver that may keep them temporarily afloat, but ignoring the storm that is drowning them.

Where should we go from here? Is there a fifth generation of social policy in the making?

Welcome to Latin America. These statistics come from Latinobarómetro 2001, an opinion survey carried out yearly in the urban areas of 17 countries in the region.

How can dissatisfaction be so high despite growth—albeit modest—and the increase in social spending in Latin America over the past decade? In the case of Latin America, the answer is that income inequality has swept away any of the benefits of recent economic growth for large sectors of society. A prime example of this phenomenon is Mexico. Between 1996 and 1998, GDP per capita increased 9.7 percent in real terms, which is a spectacular gain as judged by the country’s macroeconomic performance of the previous 16 years. However, poverty barely declined. In fact, the incomes of the poorest 30 percent of the population actually declined. The huge increase in mean income was due entirely to income gains among the richest 30 percent—particularly the richest 10 percent—of the population.

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Coming Soon...
Portrait of the Poor:
An Assets-Based Approach
Orazio Attanasio and Miguel Székely, Editors

Reducing poverty is the greatest challenge facing Latin American policymakers today. Traditional poverty reduction programs or safety nets have done little to alleviate the problem, largely because they address the consequences rather than the causes of poverty. Policymakers must learn to look beyond incomes and ask what prevents all people from having the same opportunities. This volume asks that very question and by redefining poverty, comes up with an innovative, assets-based approach to this pressing regional concern.

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consumption aggregates in the national accounts. Chile, the Dominican Republic, Panama, Uruguay and Brazil enjoyed the largest reductions. On the other hand, poverty increased during the 1990s in Peru, Mexico, Nicaragua, Venezuela and El Salvador. On average, the proportion of poor in the region fell. Figure 1 illustrates the evolution of poverty and inequality in the region as a whole throughout the 1990s. According to the figure, the share of poor declined by 10 percent in Latin America between 1990 and 1999. But as can be seen in Figure 1, the value of the Gini inequality index also increased by 3 percent.

In other words, had inequality remained unchanged, the poverty rate would have declined by more than it actually did. A gross idea of the effect can be obtained by estimating the poverty rate based on the income level in 1999 under the distribution of income of 1990. The conclusion is that instead of lifting 45 million individuals out of poverty in the region, growth should have lifted 90 million out. Thus, although the poor gained, they gained much less than they could have.

**How Good is Growth?**

Growth is a necessary condition for poverty reduction. But is it a sufficient condition? Does a rising economic tide in fact lift all boats, including those of the poor? The answer has important policy implications. If everybody is already sharing the benefits of economic growth, a redistributive policy is not needed. However, if economic growth leaves the poor behind, pro-growth policies may have to be tempered by other considerations. The question is, to what extent does economic growth increase the incomes of the poor?

There are many ways of measuring the effects of growth on the incomes of the poor. One traditional method is to look at the relationship between poverty rates and GDP changes. Another option is to simply define the poor as those in the lowest fifth of the distribution. Each approach produces results that inform the discussion, but both approaches have their problems.

On the one hand, using a purely absolute measure of poverty implies setting a poverty line. As a result, very similar people can be classified as totally different. For example, a US$2-a-day poverty line would classify as poor an individual with an income of one cent less, but would classify someone with an income of one cent more per day as non-poor. By this definition, gains for the second person would not count as gains for the poor. Why should a slightly higher income be ignored, though, merely because it is above an arbitrary cutoff point?

On the other hand, using a relative poverty line (such as the poorest 20 percent of the population) is hardly a coherent way to separate the have and the have-nots in all countries. This definition classifies as poor all individuals in the lowest 20 percent, regardless of their absolute standard of living.

**Where To From Here?**

It is time to start thinking about new ways of designing social policies in Latin America. A fifth generation of policies is needed. These policies must support the poor in a way that contributes to growth. Indeed, these policies should themselves be engines of growth and development. This can only be done if social policy is at the heart of the development strategy of a country, rather than an opponent constantly competing for public resources that may undermine macroeconomic stability. Therefore, the solution is not only compensatory measures, but policies that promote efficiency in the economic system and improve the productivity of the poor.

If we go beyond income, and ask who determines the income of each individual, it is possible to outline some of the elements of such a strategy. For instance, let’s say that the income of each person in society is the product of five elements. First of all it depends on the income-earning assets owned by each household member. Broadly speaking, assets can be classified into human, physical, and social capital. Secondly, it depends on the rate of use of the assets, since assets only generate income when they are put to work in the market. Thirdly, on the productivity of the poor. Investment opportunity is given basically by the existence of an efficient financial market that provides access to credit. Credit can be used to create economic activity and to take advantage of the economic environment to generate income.

The solution is not only compensatory measures, but policies that promote efficiency in the economic system and improve the productivity of the poor.

It includes transfers (public or private), gifts, etc. that individuals receive not because they are putting an asset to work, but because of other factors. The safety nets of the third generation of policies would enter into this category. Finally, each person’s income depends on the size of the household where the individual lives and on the way in which resources are shared within the household.

To simplify the scheme we can reframe the items listed above into two broad policy categories: (a) the capabilities that individuals have to obtain resources (all income-earning assets), and (b) the opportunities available to put income-earning assets to work (including the rate of use and prices). In this scheme, the role of social policy is to generate income-earning capabilities and to create opportunities for using them productively.

There are four types of capabilities that are clearly prone to policy action: education (formal schooling as a proxy for human capital), health, investment capacity, and housing and basic services. Education can be thought of as a measure of the human capital or skills that an individual can offer in the labor market, or that can be used to create his own employment. Health refers to the mental and physical capacity to perform economic activity. Investment capabilities are the inherent possibilities of individuals for creating their own economic activities through their own efforts, means other than their labor. Housing and basic services are measures of the availability of basic infrastructure to operate in society.

In terms of opportunity, the two clear areas of intervention are employment opportunities and investment opportunities. Employment opportunities refer to the conditions of labor costs and incentives in the labor market that influence the prices paid for different kinds of labor, and the demand for skills. Investment opportunity is given basically by the existence of an efficient financial market that provides access to credit. Credit can be used to create economic activity and to take advantage of the economic environment to generate income.

What is needed to improve capabilities and opportunities? Cash transfer programs such as Progresa or Bolsa Escola are certainly part of the answer. But the solution goes beyond these programs to health policy, incentives for saving, housing and basic services, labor market regulations, trade policy, the introduction of credit bureaus to expand access to credit, and even the promotion of alternative financial instruments such as leasing to avoid the restrictions imposed by the poor’s lack of collateral. In other words, it’s the economic environment as a whole. What is most interesting is that many of these items are rarely conceived of as part of social policy. They are normally viewed as part of the overall development strategy of countries. And after all, shouldn’t social policies and the development strategy of countries be one and the same?
Poverty: A Problem “in the System”

As innovative as the fourth generation of social policies is, it does suffer from an important limitation. Programs such as Progresa or Bolsa Escola do not change the economic environment or the underlying elements in the structure of the economy that are causing poverty, at least in the short or medium run. Having low human capital endowments is certainly one of the reasons why the poor have low incomes, but this is not the whole story. The factors generating poverty are, so to say, “in the system” since they are deeply rooted in the functioning of the economy. If the forces that are generating poverty are not dealt with, these policies will always be swimming against the tide, or will have a much smaller impact than expected.

In the case of Latin America, poverty is due less to an insufficiency of resources to satisfy basic needs, and more to inequalities in the distribution of such resources.

This suggests that much of the inequality is due not to personal factors or even to regional differences, but rather to aspects of the economic environment where individuals live. They are aspects that are deeply entrenched in the system and are reproduced at all levels. The reason why Brazil, Chile, Mexico or Colombia is so unequal is only in a small part due to regional differences. Regional differences are important, but inequalities within regions are even higher, and account for a much larger share of total inequality.

As explained in the 1998-99 IDB Report, “Facing Up to Inequality in Latin America,” the main reason why Latin American countries are so unequal is because of the huge income differences between the richest 10 percent of the population and the rest. So, if inequality and therefore poverty in Latin America is deeply entrenched in the economic system, it is highly unlikely that the poverty problem can be solved without modifying some fundamental elements of the system. Again, specific programs such as Progresa or Bolsa Escola can do much good, but the forces generating inequality will limit their impact.

What is happening in Latin America? Why hasn’t inequality declined? Why hasn’t poverty declined during the 1990s in line with economic growth? All these questions that worry Latin Americans are far from easy to answer.

A United Nations Development Programme (UNDP) collection of recent studies for 16 countries in Latin America concluded that trade reforms in not the main reason why growth has not benefited the poor (see E. Ganzura, R. Paes de Barros, L. Taylor, and R. Vos eds., “Liberalización, Desigualdad y Pobreza: América, Latina y el Caribe en los 1990”). Indeed, there are some countries where trade reform has in fact improved the lives of the poor, albeit only marginally.

One of the studies analyzes the effects of various reforms on poverty and inequality throughout the region and finds that financial liberalization impacts unfavorably on inequality, that is, it contributes to worsening income distribution and increasing poverty.

In the case of Latin America, poverty is due less to an insufficiency of resources to satisfy basic needs, and more to inequalities in the distribution of such resources.

In countries such as Brazil, which is among the most unequal in the world, inequality is reproduced in each of the 27 areas in which the country can be disaggregated. In contrast, in countries such as Taiwan, which have much lower inequality, low inequalities are also found in each city in the country. In keeping with this general conclusion, the standard deviation of the Gini index of the regions of any country tends to be very low (in general, under 10 percent).

The Research Department of the Inter-American Development Bank overcomes these problems by using an index that emphasizes the incomes of the poor without ignoring the incomes of the near poor (see J. Foster and E. Szczytko, 2001, “Is Economic Growth Good for the Poor?”). The effects of growth on income are evaluated by comparing GDP per capita growth with changes in the indexes that place more weight on the incomes of the poorest people.

The research evidence indicates that the incomes of the poor do not grow one-for-one with increases in average income, but considerably less. In fact, the gains are smaller at lower positions in the income distribution. This flies in the face of recent research that uses traditional methods for looking at the relation between poverty and growth and argues that the poor gain one-to-one with growth.

If the poor gain less than one-for-one with economic growth, then growth alone will solve the problem only slowly—if ever. As the IDB study suggests, there is a role for policies that take into account the distributional impact of growth, because growth alone will not do the trick.
In discussions of variables such as the rate of economic growth, which are widely used to evaluate countries’ performance and development, the data are rarely questioned because the countries follow international standards in producing these statistics; however, this is not the case for poverty. Although there has been great improvement in the availability of poverty indicators during recent years, poverty statistics are far from uniform in their quality and reliability. A conventionally followed, standardized methodology is still not available.

One example among many is the case of Mexico in 1994. Using exactly the same household survey data and a similar poverty line, the Economic Commission for Latin America and the Caribbean (ECLAC) reports a poverty rate of around 46 percent, while Londoño and Székely (2000) of the IDB report 20 percent. A World Bank study by Wodon et al. (2000) finds a poverty rate of 25 percent, while in the World Bank’s World Development Indicators (1999) the figure is 42.5 percent. In concrete terms, the difference between poverty rates of 20 percent and 46 percent is about 25 million individuals, representing potentially vast differences in assessing the country’s economic performance and standard of living. Depending on which figure is used, a given budget for social programs can be considered either appropriate or totally insufficient.

But who is right? It depends. At least five crucial choices must be made in computing poverty statistics, and depending on the choice, a totally different result can be obtained. The first of these choices is setting the poverty line or, in other words, the income level that distinguishes the poor from the non-poor. Next, an adult equivalence scale must be determined that accounts for the fact that different types of individuals in a household have different needs. Third, poverty is measured with different methodologies. The table summarizes the calculation of poverty rates under the following combinations: 2 different adult equivalence scales, 3 different ways of accounting for economies of scale in consumption, 5 methods for correcting for non-responses, 10 different adjustments for misreporting, and 6 different poverty lines; there are 26 combinations in all. The proportion of poor in Latin America and the Caribbean as a whole varies between 12.7 percent and 65.8 percent—that is, between 353 and 315 million individuals (a difference of 282 million) depending on the choice.

The most extreme cases are Colombia, Mexico, Ecuador, Venezuela, and Peru, where the difference between the smallest and largest poverty statistic is more than 50 percent of the population. In Brazil and Mexico, the range amounts to 80 and 315 million individuals, respectively. What most is striking is that all the choices vary within reasonable boundaries and are produced with exactly the same underlying data. Thus, there is no reason to reject a priori any of the 26 methodologies.

If we experiment with all possible combinations of the five choices mentioned, rather than varying one element at a time, we would end up with a list of at least 6,000 possibilities per poverty index. For practical purposes, though, it is obviously impossible to produce 6,000 statistics every time one tries to calculate poverty. Yet, it is still a serious problem, and judging by the minimal advances in recent years, it is likely to be with us for years to come.

It is time to think creatively. To do so, it is useful to first reflect on past policies and search for clues that may help redefine the poverty strategy.

Although social policy has varied widely from country to country, Latin America’s strategy for social development can be broadly classified into four phases. The first phase covers the period between the Second World War and the late 1970s. These were the “golden years” for Latin America. The industrial sector in most countries grew vigorously, fueled by the import substitution development strategy that prevailed then. During these years, the urban middle classes were expanding. All kinds of subsidies were granted for industrial production under the belief that industrialization was the best engine for growth.

This first generation of social policies was characterized by the fact that the provision of subsidies to goods and services open to the whole population. Its main beneficiaries were the expanding middle classes. Some of these subsidies—like those to food consumption—were justified as an indirect subsidy to industrial sector wages. Since high growth rates endured some sacrifices, and perhaps, substantial declines in living standards. Everybody would have to pay for the excesses of the past.

Unfortunately, growth did not resume immediately. Latin America went through a period of intense volatility and stagnation that lasted for nearly the entire decade, prolonging the population’s sacrifice well beyond initial expectations. At this point, the pendulum began to swing in the opposite direction. Some of the subsidies were removed, and the poor population. Its main beneficiaries were the expanding middle classes. Some of these subsidies—like those to food consumption—were justified as an indirect subsidy to industrial sector wages. Since high growth rates continued to the end of the 1980s, grew out of the acknowledgment that the poor

The second phase began in the early 1980s as Latin America faced new macroeconomic constraints. With a decline in oil revenues and declining GDP, the policy priority was to stabilize the economy at all costs. Subsidies were dismantled. It was hoped that once the macroeconomic situation was under control, growth would resume, and with it, the expansion of the middle classes. The import substitution strategy was replaced by the need for stabilizing the exchange rate and fiscal policies. These new policies were mainly aimed at reducing public spending and increasing trade openness.

The third phase, which began around the early 1990s, gradually moved beyond the acknowledgment that the poor

The lesson: whenever a poverty measurement is needed, or at least agreement on how each of the measurement issues explored here should be addressed. For other widely used welfare indicators such as those to food consumption—were justified as an indirect subsidy to industrial sector wages. Since high growth rates continued to the end of the 1980s, grew out of the acknowledgment that the poor

Table 1

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Source: Székely, Lustig, Cumpa and Mejía, “Do We Know How Much Poverty There Is?”

Research Department (RES) Inter-American Development Bank

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How Much Poverty is There? (Continued on page 8)
In discussions of variables such as the rate of economic growth, which are widely used to evaluate countries' performance and development, the data are rarely questioned because the countries follow international standards in producing these statistics. However, this is not the case for poverty. Although there has been great improvement in the availability of poverty indicators during recent years, poverty statistics are far from uniform in their quality and reliability. A conventionally followed, standardized methodology is still not available.

One example among many is the case of Mexico in 1994. Using exactly the same household survey data and a similar poverty line, the Economic Commission for Latin America and the Caribbean (ECLAC) reports a poverty rate of around 46 percent, while Londoño and Székely (2000) of the IDB report 20 percent. A World Bank study by Wodon et al. (2000) finds a poverty rate of 25 percent, while in the World Bank World Development Indicators (2009) the figure is 42.5 percent. In concrete terms, the difference between poverty rates of 20 percent and 46 percent is about 25 million individuals, representing potentially vast differences in assessing the country's economic performance and standard of living. Depending on which figure is used, a given budget for social programs can be considered either appropriate or totally insufficient.

But who is right? It depends. At least five crucial choices must be made in computing poverty statistics, and depending on the choice, a totally different result can be obtained. The first of these choices is setting the poverty line or, in other words, the income level that distinguishes the poor from the non-poor. Next, an adult equivalence scale must be determined that accounts for the fact that different types of individuals in a household have different needs. Third, is poverty measured with different methodologies. The table summarizes the calculation of poverty rates under the following combinations: 2 different adult equivalence scales, 3 different ways of accounting for economies of scale in consumption, 5 methods for correcting for non responses, 10 different adjustments for missreporting and, 6 different poverty lines; there are 26 combinations in all. The proportion of poor in Latin America and the Caribbean as a whole varies between 12.7 percent and 65.8 percent—about 53 percentage points. Thus, the number of poor is between 60.9 and 315.8 million individuals (a difference of 254.9 million) depending on the choice.

The most extreme cases are Colombia, Mexico, Ecuador, Venezuela and Peru, where the difference between the smallest and largest poverty statistic is more than 50 percent of the population. In Brazil and Mexico, the range amounts to 80 million and 260 million individuals, respectively. What most is striking is that all the choices vary within reasonable boundaries and are produced with exactly the same underlying data. Thus, there is no reason to reject a priori any of the 26 methodologies.

If we experiment with all possible combinations of the five choices mentioned, rather than varying one element at a time, we would end up with a list of at least 6,000 possibilities per poverty index. For practical purposes, though, it is obviously impossible to produce 6,000 statistics every time one tries to calculate poverty. However, it is necessary to choose one or a few statistics to estimate poverty. Obviously, some methodologies may be more appropriate than others depending on the circumstances, and the user of these statistics is the only one to judge which is most reasonable for a specific objective.

Nevertheless, there are three important conclusions from these results. The first is that, even when they are produced with high quality data, poverty statistics are meaningless if the choices and assumptions underlying their estimation are not made explicit.

The second conclusion is that no conventional or standard methodology for the measurement of poverty is widely accepted, statistics showing the number of poor in Latin America and the Caribbean as a whole varies between 12.7 percent and 65.8 percent—about 53 percentage points. Thus, the number of poor is between 60.9 and 315.8 million individuals (a difference of 254.9 million) depending on the choice.

The third conclusion is that a consensus on uniform poverty measurement is needed, or at least agreement on how each of the measurement issues explored here should be addressed. For other widely used welfare indicators such as the GDP of a country, such conventions have already been adopted. It is time to move along similar lines in measuring poverty.

The lesson: whenever a poverty statistic appears, it is important to ask what is behind the number. Otherwise, it is possible to say that the number of poor in Latin America is between 60 and 315 million individuals. And the number is a plausible answer, it says little about how much poverty there is. All Latin American countries have implemented social policies aimed at improving the plight of the poor. However, poverty is still a serious problem, and judging by the minimal advances in recent years, it is likely to be with us for years to come.

It is time to think creatively. To do so, it is useful to first reflect on past policies and search for clues that may help redefine the poverty strategy.

Although social policy has varied widely from country to country, Latin America’s strategy for social development can be broadly classified into four phases. The first phase covers the period between the Second World War and the late 1970s. These were the “golden years” of economic growth in Latin America. The industrial sector in most countries grew vigorously, fueled into four phases. The first phase covers the period between the Second World War and the late 1970s. These were the “golden years” of economic growth in Latin America. The industrial sector in most countries grew vigorously, fueled by high productivity sectors, and was the best engine for growth.

At this point, the initial expectations. It is time to think creatively. To do so, it is useful to first reflect on past policies and search for clues that may help redefine the poverty strategy. This first generation of social policies introduced to facilitate the protection of inefficient sectors rendered this strategy unsustainable. During the late 1970s and early 1980s, declining GDP, the policy priority was to stabilize the economy at all costs. Subsidies were dismantled. It was hoped that once the macroeconomic situation was under control, growth would resume, and with it, the expansion of the social sector. However, the poor in Latin America. The industrial sector in most countries grew vigorously, fueled by high productivity sectors, and was the best engine for growth.

Unfortunately, growth did not resume. Latin America was left with a period of intense volatility and stagnation that lasted for nearly the entire decade, prolonging the period of economic weakness. Some of these policies—like those to food consumption—were justified as an indirect subsidy to industrial sector growth. Since high growth rates had supported these widespread subsidies to consumption, there was a virtuous circle: on the one hand, the middle classes contributed to economic growth by migrating from rural areas and assisting an indirect subsidy to industrial sector growth. Since high growth rates had supported these widespread subsidies to consumption, there was a virtuous circle: on the one hand, the middle classes contributed to economic growth by migrating from rural areas and creating a market for industry. On the other, the policies introduced to facilitate the import substitution process contributed to improving the standard of living of vast sectors of the population by guaranteeing low prices for basic goods and by supplying subsidized services. In essence, the social strategy and the wider development strategy were one and the same.

Excessive reliance on subsidies and protection of inefficient sectors rendered this strategy unsustainable. During the mid-1980s, the world experienced a drastic shift, and declining GDP triggered the debt crisis that plunged Latin America into a deep recession. This set the stage for the second phase of social development policies.

The second phase began in the early 1980s as Latin America faced new macroeconomic constraints. With a growth rate of 2% and declining GDP, the policy priority was to stabilize the economy at all costs. Subsidies were dismantled. It was hoped that once the macroeconomic situation was under control, growth would resume, and with it, the expansion of the social sector. However, the poor in Latin America. The industrial sector in most countries grew vigorously, fueled by high productivity sectors, and was the best engine for growth.

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The third phase, which began toward the end of the 1980s, grew out of the acknowledgment that the poor generally have fewer means of protecting their incomes from unexpected shocks, and from the erosion of living standards. Everybody would have to pay for the excesses of the past.

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<td>1.0</td>
<td>27.4</td>
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</table>

Source: Székely, Lusting, Compaña and Mejía, “Do We Know How Much Poverty There Is?”, Mimeo, Research Department, Inter-American Development Bank.

Poverty and Policy: The Story So Far

Research Department (RES) Inter-American Development Bank
Visit our web site www.iadb.org/res

(Continued on page 8)
As innovative as the fourth generation of social policies is, it does suffer from an important limitation. Programs such as Progresa or Bolsa Escola do not change the economic environment or the underlying elements in the structure of the economy that are causing poverty, at least in the short or medium run. Having low human capital endowments is certainly one of the reasons why the poor have low incomes, but this is not the whole story. The factors generating poverty are, so to say, “in the system” since they are deeply rooted in the functioning of the economy. If the forces that are generating poverty are not dealt with, these policies will always be swimming against the tide, or will have a much smaller impact than expected.

In the case of Latin America, poverty is due less to an insufficiency of resources to satisfy basic needs, and more to inequalities in the distribution of such resources.

This suggests that much of the inequality is due not to personal factors or even to regional differences, but rather to aspects of the economic environment where individuals live. They are aspects that are deeply entrenched in the system and are reproduced at all levels. The reason why Brazil, Chile, Mexico or Colombia is so unequal is only in a small part due to regional differences. Regional differences are important, but inequalities within regions are even higher, and account for a much larger share of total inequality.

As explained in the 1998-99 IDB Report, “Facing Up to Inequality in Latin America,” the main reason why Latin American countries are so unequal is because of the huge income differences between the richest 10 percent of the population and the rest. So, if inequality and therefore poverty in Latin America is deeply entrenched in the economic system, it is highly unlikely that the poverty problem can be solved without modifying some fundamental elements of the system. Again, specific programs such as Progresa or Bolsa Escola can do much good, but the forces generating inequality will limit their impact.

What is happening in Latin America? Why hasn’t inequality declined? Why hasn’t poverty declined during the 1990s in line with economic growth? All these questions that worry Latin Americans are far from easy to answer.

A United Nations Development Programme (UNDP) collection of recent studies for 16 countries in Latin America concluded that trade reforms in many cases were the main reason why growth has not benefited the poor (see E. Gana, R. Paez de Barros, L. Taylor, and R. Vos eds., “Liberalización, Desigualdad y Pobreza: América, Latina y el Caribe en los 1990s”). Indeed, there are some countries where trade reform has in fact improved the lives of the poor, albeit only marginally.

One of the studies analyzes the effects of various reforms on poverty and inequality throughout the region and finds that financial liberalization impacts unfavorably on inequality, that is, it contributes to worsening income distribution and increasing poverty. This is not surprising given that the poor are less equipped to face unexpected shocks and have fewer mechanisms for protecting their liquid assets from inflation. It is important to understand why the liberalization of financial markets has tended to increase poverty and inequality in Latin America. Financial liberalization promotes greater capital flows, which tend to be associated with reductions in the price of capital goods, a relatively scarce factor of production in Latin America. If capital and skilled labor are complementary factors of production, while capital and unskilled labor are substitutes, a reduction in the price of capital will tend to generate greater demand for skilled labor and displace unskilled labor. If this is the case, the salary gap between workers with high and low educational levels would increase and worsen income distribution. There could even be an increase in poverty.

Surprisingly, in countries with high inequality, imbalances are reproduced at all levels. Figure 2 illustrates this. The figure reflects the lowest and highest Gini index for every region, state, municipality, and city of each country.

In countries such as Brazil, which is among the most unequal in the world, inequality is reproduced in each of the 27 areas in which the country can be disaggregated. In contrast, in countries such as Taiwan, which have much lower inequality, low inequalities are also found in each city in the country. In keeping with this general conclusion, the standard deviation of the Gini index of the regions of any country tends to be very low (in general, under 10 percent).

In the case of Latin America, poverty is due less to an insufficiency of resources to satisfy basic needs, and more to inequalities in the distribution of such resources.

Figure 2. Standard Deviation of Gini Coefficient by Country

<table>
<thead>
<tr>
<th>Country</th>
<th>Value of Gini Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jamaica</td>
<td>0.65</td>
</tr>
<tr>
<td>Bolivia</td>
<td>0.50</td>
</tr>
<tr>
<td>Brazil</td>
<td>0.45</td>
</tr>
<tr>
<td>Chile</td>
<td>0.35</td>
</tr>
<tr>
<td>Uruguay</td>
<td>0.20</td>
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</tbody>
</table>

In short, trade and financial liberalization have opposite effects on inequality and poverty. From an aggregate perspective, it seems that the regressive effects of financial liberalization are more significant than the moderately progressive effects of trade liberalization. Since these types of structural reforms generate winners and losers, it is not surprising that they are the object of intense controversy in these countries.

Living. This gives the same importance to someone in the lower 20 percent of the distribution in a rich country as to an individual in the poorest 20 percent in a very poor country, where clearly the income differences between the two are enormous. Moreover, this definition gives exactly the same weight to all the poor. Should a marginal increase in income for the poorest person have the same value as a marginal gain for the richest-among-the-poor? If the question is whether relatively poorer people gain more from growth, then the answer is clearly no.

The Research Department of the Inter-American Development Bank overcomes these problems by using an index that emphasizes the incomes of the poor without ignoring the incomes of the near poor. See J. Foster and S. Sztaylor, 2001, “Is Economic Growth Good for the Poor?” The effects of growth on poor incomes are evaluated by comparing GDP per capita growth with changes in the indexes that place more weight on the incomes of the poorest people.

The resulting evidence indicates that the incomes of the poor do not grow one-for-one with increases in average income, but considerably less. In fact, the gains are smaller at lower positions in the income distribution. This flies in the face of recent research that uses traditional methods for looking at the relation between poverty and growth and argues that the poor gain one-to-one with growth.

If the poor gain less than one-for-one with economic growth, then growth alone will solve the problem only slowly—if ever. As the IDB study suggests, there is a role for policies that take into account the distributional impact of growth, because growth alone will not do the trick.
consumption aggregates in the national accounts. Chile, the Dominican Republic, Panama, Uruguay and Brazil enjoyed the largest reductions. On the other hand, poverty increased during the 1990s in Peru, Mexico, Nicaragua, Venezuela and El Salvador. On average, the proportion of poor in the region fell. Figure 1 illustrates the evolution of poverty and inequality in the region as a whole throughout the 1990s. According to the figure, the share of poor declined by 10 percent in Latin America between 1990 and 1999. But as can be seen in Figure 1, the value of the Gini inequality index also increased by 3 percent.

In other words, had inequality remained unchanged, the poverty rate would have declined by more than it actually did. A gross idea of the effect can be obtained by estimating the poverty rate based on the income level in 1999 under the distribution of income of 1990. The conclusion is that instead of lifting 45 million individuals out of poverty in the region, growth should have lifted 90 million out. Thus, although the poor gained, they gained much less than they could have.

How Good is Growth?

Growth is a necessary condition for poverty reduction. But is it a sufficient condition? Does a rising economic tide in fact lift all boats, including those of the poor? The answer has important policy implications. If everybody is already sharing the benefits of economic growth, a redistributive policy is not needed. However, if economic growth leaves the poor behind, pro-growth policies may have to be tempered by other considerations. The question is, to what extent does economic growth increase the incomes of the poor?

There are many ways of measuring the effects of growth on the incomes of the poor. One traditional method is to look at the relationship between poverty rates and GDP changes. Another option is to simply define the poor as those in the lowest five percent of the population. Each approach produces results that inform the discussion, but both approaches have their problems.

On the one hand, using a purely absolute measure of poverty implies setting a poverty line. As a result, very similar people can be classified as totally different. For example, a US$2-a-day poverty line would classify as poor an individual with an income of one cent less, but would classify someone with an income of one cent more per day as non-poor. By this definition, gains for the second person would not count as gains for the poor. Why should a slightly higher income be ignored, though, merely because it is above an arbitrary cutoff point?

On the other hand, using a relative poverty line (such as the poorest 20 percent of the population) is hardly a coherent way to separate the haves and the have-nots in all countries. This definition classifies as poor all individuals in the lowest 20 percent, regardless of their absolute standard of living.

Given these numbers, it is not surprising that so many people are dissatisfied with their socioeconomic conditions in Latin America. This newsletter explores some of the deeper causes of this dissatisfaction and discusses some of the ideas behind what could be a new policy debate.

Where To From Here?

It is time to start thinking about new ways of designing social policies in Latin America. A fifth generation of policies is needed. These policies must support the poor in a way that contributes to growth. Indeed, these policies should themselves be engines of growth and development. This can only be done if social policy is at the heart of the development strategy of a country, rather than an opponent constantly competing for public resources that may undermine macroeconomic stability. Therefore, the solution is not only compensatory measures, but policies that promote efficiency in the economic system and improve the productivity of the poor.

If we go beyond income, and ask who determines the income of each individual, it is possible to outline some of the elements of such a strategy. For instance, let’s say that the income of each person in society is the product of five elements. First of all it depends on the income-earning assets owned by each household member. Broadly speaking, assets can be classified into human, physical, and social capital. Secondly, it depends on the rate of use of the assets, since assets only generate income when they are put to work in the market. Thirdly, on the productivity of the assets, since the income-earning assets are viewed as factors of production. The extent to which they generate income depends not only on the ownership and the rate of use of the asset, but on the price paid for factors of production. Depending on the extent to which factors are demanded and supplied, prices can be high or low, and depending on the degree of trade openness of each country, the price will be set by international forces or by national markets. The fourth element is the income received independently of income-earning assets. It includes transfers (public or private), gifts, etc. that individuals receive not because they are putting an asset to work, but because of other factors. The safety nets of the third generation of policies would enter into this category. Finally, each person’s income depends on the size of the household where the individual lives and on the way in which resources are shared within the household.

To simplify the scheme we can reframe the items listed above into two broad policy categories: (a) the capabilities that individuals have to obtain resources (all income-earning assets), and (b) the opportunities available to put income-earning assets to work (including the rate of use and prices). In this scheme, the role of social policy is to generate income-earning capabilities and to create opportunities for using them productively.

There are four types of capabilities that are clearly prone to policy action: education (formal schooling as a proxy for human capital), health, investment capacity, and housing and basic services. Education can be thought of as a measure of the human capital or skills that an individual can offer in the labor market, or that can be used to create his own employment. Health refers to the mental and physical capacity to perform economic activity. Investment capabilities are the inherent possibilities of individuals for creating their economic activities through a combination of strategies that mean other than their labor. Housing and basic services are measures of the availability of basic infrastructure to operate in society.

In terms of opportunity, the two clear areas of intervention are employment opportunities and investment opportunities. Employment opportunities refer to the conditions costs and incentives in the labor market that influence the prices paid for different kinds of labor, and the demand for skills. Investment opportunity is given basically by the existence of an efficient financial market that provides access to credit. Credit can be used to create economic activity and to take advantage of the economic environment to generate income.

What is needed to improve capabilities and opportunities? Cash transfer programs such as Bolsa Escola and Progresa in Mexico certainly are part of the answer. But solutions go beyond these programs to health policy, incentives for saving, housing and basic services, labor market regulations, trade policy, the introduction of credit bureaus to expand access to credit, and even the promotion of alternative financial instruments such as leasing to avoid the restrictions imposed by the poor’s lack of collateral. In other words, it’s the economic environment as a whole.

What is most interesting is that many of these items are rarely conceived of as part of social policy. They are normally viewed as part of the overall development strategy of countries. And after all, shouldn’t social policies and the development strategy of countries be one and the same?
Poverty and Policy: The Story So Far
(Continued from page 3)

The policy solution was the introduction of compensatory policies with safety nets that targeted resources to the poor. This shift implied a deep change in the spirit of social policy. Under the third phase, or “the targeting generation,” poverty policies were compensatory and had to be small, specific, and tightly focused. The growth and development strategy of most countries had little to do with these policies. Social programs, although perhaps necessary, were viewed as a potential threat to public deficits and macroeconomic stability. Social policies and a country’s growth strategy became two separate things; they were opponents challenging each other for public resources.

The early 1990s marked a shift in the macroeconomic environment in Latin America. Most countries in the region enjoyed positive economic growth while globalization took hold worldwide. The economic reforms of the 1980s implied opening up Latin American economies and exposing them to world markets; during the 1990s other regions of the world joined in the trend. Globalization made it clear that we would be able to survive in today’s world, countries had to be competitive.

This change in economic environment had crucial consequences for social policy. If a country wanted to be competitive, having large segments of the population living in poverty was a strong disadvantage for productivity and social cohesion.

These developments brought the birth of a fourth generation of social policies. Programs such as Progresa in Mexico, Bolsa Escola in Brazil, or Chile Joven in Chile, all of which are a centerpiece in the social development strategy of their respective countries, have shifted away from the concept of offering only temporary safety nets to compensate the poor. Progresa provides cash transfers and a nutritional supplement to rural families in extreme poverty, but transfers are conditioned on children’s school attendance and regular checkups at health clinics. Bolsa Escola is a similar program that provides scholarships for disadvantaged children who complete a schooling cycle. Chile Joven is also a program of cash transfers, but in this case they are provided to young adults to encourage training. These programs, which are being replicated across the region, have one important element in common: they provide assistance to the poor, but by including strong incentives to accumulate human capital. The spirit is that they help the poor, but they do so by equipping them with the tools that will allow them to help themselves in the new economic environment.

But, can these programs be regarded as the solution? There is a danger in confusing the implementation of programs of this type with the full social policy strategy of a country. These programs definitely have the capacity to improve the well-being of the poor, but they cannot be regarded as a solution to the poverty problem. For instance, they may help improve schooling levels among poor children, but if there are no opportunities to put human capital to work, they might not have the expected impact on the income-earning capacity of the disadvantaged. Relying on these programs as the full social strategy of a country is like throwing the poor a lifesaver that may keep them temporarily afloat, but ignoring the storm that is drowning them.

Where should we go from here? Is there a fifth generation of social policy in the making?

Welcome to Latin America. These statistics come from Latinobarómetro 2001, an opinion survey carried out yearly in the urban areas of 17 countries in the region.

How can dissatisfaction be so high despite growth—albeit modest—and the increase in social spending in Latin America over the past decade? In the case of Latin America, the answer is that income inequality has swayed away many of the benefits of recent economic growth for large sectors of society. A prime example of this phenomenon is Mexico. Between 1996 and 1998, GDP per capita increased 9.7 percent in real terms, which is a spectacular gain as judged by the country’s macroeconomic performance of the previous 16 years. However, poverty barely declined. In fact, the incomes of the poorest 30 percent of the population actually declined. The huge increase in mean income was due entirely to income gains among the richest 30 percent—particularly the richest 10 percent—of the population.

Another example is Chile, proclaimed the greatest economic success story in Latin America for the past decade. Between 1992 and 1996, Chilean GDP per capita expanded more than 30 percent in real terms. During the same period, moderate poverty registered a substantial decline from 20 to 16 percent—a 20 percent reduction in the proportion of poor. But income inequality also increased during the period. In fact, had income redistribution remained the same as in 1992, the proportion of poor people would have actually declined to 10 percent, rather than 16 percent—that is, the poverty rate would have been cut by one half, instead of by 20 percent.

These are only two examples of a regional phenomenon. No country in Latin America for which data on income distribution are available can boast a decline in income inequality during the 1990s. The countries where inequality increased the most were El Salvador, Argentina, Nicaragua and Bolivia. In these countries, the Gini index showed an average yearly change similar to the increase registered in the United States during the 1980s that caused such concern among scholars and the general public.

In terms of poverty, in 12 out of 17 countries with available data, the proportion of poor declined during the 1990s. The poverty line is defined as under US$2-a-day and survey incomes are adjusted to make them equal to private incomes (Continued on page 2)