



*Social Policy with Economic Responsibility / Economic Policy with Social Responsibility*

## Poverty and Inequality: Recent Trends

NORA LUSTIG AND OMAR ARIAS

Although the incidence of poverty decreased in Latin America and the Caribbean during the 1990s, population increases and greater income inequalities that had developed during the 1980s stymied the region's efforts to reduce the absolute numbers of poor people.

The incidence of poverty in Latin America was approximately 3 percent higher, and roughly 70 million more of its people were living in poverty, in 1997 compared to 1980. Although Latin America made some progress in reducing the incidence of poverty during the 1990s, this was tempered by population increases and the number of poor people continued to increase. Although a number of countries experienced a resumption of growth, it was not enough to produce notable progress in poverty reduction. This was partly due to increasing inequality of income during the 1980s, which was not reversed during the 1990s.

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## Crises and the Poor: A Recipe for Action

NORA LUSTIG

Macroeconomic crises have been a recurrent problem in Latin America over the last 20 years, and the income downturns associated with them are strongly correlated with rising poverty and inequality. During the 1980s, income per capita fell during at least one year in every Latin American country, a trend that continued throughout the region into the 1990s as well. The effects of income downturns on poverty are hard to reverse, since periods of economic growth do not have an opposite symmetrical effect. Economic crises not only affect current poverty, but make it harder for the poor to grow out of poverty.

For countries for which a household survey was available during a recession year, the incidence of poverty increased. The poverty rate several years after a recession is shown to have almost always been higher than the rate prevailing before the recession began. In Costa Rica, the Dominican Republic, Guatemala, Mexico, Panama and

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## Targeted Human Development Programs

ARIANNA LEGOVINI AND FERDINANDO REGALIA

Underlying the persistence of poverty in the LAC region are the enormous disparities in families' ability to accumulate human capital. Inadequate quality of educational and health services in marginalized areas is often pointed to as one of the factors limiting human capital accumulation among the poor. More recently, greater attention has been placed on the role of low-income families' resource constraints in absorbing the costs for providing nutrition, health care and schooling to their children. Programs that address poor families' resource constraints are designed to respond to their immediate needs by increasing current income and to pursue a long-term strategy to eradicate the causes of poverty by fostering investment in the human capital of the next generation.

This is the rationale for a new generation of social programs called Targeted Human Development Programs (THDPs), like the Brazilian Bolsa Escola, the Mexican Progresá, PRAF in Honduras, and the upcoming Red de Protección Social in Nicaragua, Beca Escolar in Ecuador and Programa de Apoyo al Desarrollo Humano y el Ingreso Familiar in Colombia. THDPs target poor and vulnerable families with school age children. To gain access to program benefits (in cash and in kind), families commit to investing in the human capital of their children, such as sending their children to school and ensuring regular attendance, demanding pre- and post-natal care, and attending nutritional courses.

Many positive externalities are believed to be associated with these interventions. Among these are the facts that educated children make educated parents who will look after their own children's education; that an educated citizenry

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Table 1. Poverty and Inequality Trends in Latin America, 1980-1996

Period	Poverty						Inequality		
	HC % Indiv.	Millions	HC % Hous.	Millions	HC % Indiv.	Millions	Gini coefficient	Quintiles (5/1) ratios	
Source:	LS		ECLAC		Wodon et al		LS & SH	Wodon et. al.	LS
1980	28	95	35	136	34 (1986)	138	0.52	0.54 (1986)	17.1
1990	35	148	41	200	38 (1989)	165	0.56	0.58 (1989)	21.3
1994	33	151	38	202	37 (1995)	177	0.55	0.56 (1995)	22.5
1996	...	...	36 (1997)	204	37	179	0.56	0.56	...

Based on Londoño and Székely (1997) (LS), ECLAC (1999), Wodon et al (1999), and Székely and Hilgert (1999) (SH). HC: head count ratio.

## Recent Trends

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Four recent studies provide a comprehensive set of poverty estimates for the region. Despite the differences in methodologies and poverty lines, the range of estimates from all the different studies indicate a reduction in the overall poverty rate in the region during the 1990s (Table 1). By 1997, between 36 and 44 percent of the region's population - 170-200 million people, most of them located in urban areas - were poor. This is down from the levels witnessed in 1990. After increasing significantly during the 1980s, inequality changed little during the 1990s and, overall, remains higher than it was before the debt crisis of the 1980s.

Characterizing recent poverty and inequality trends in the region is not free of ambiguity. The definition of income or consumption may differ across countries. This affects the comparability of measures across countries. Another important issue is the treatment of missing values (non-responses) or zeros in household surveys. The analyst must decide whether to throw out these observations, keep them and attribute a zero to the missing values, or impute a value following one of the methods suggested in the literature. The analyst must also confront the issue of whether to express income (consumption) in per capita terms or in adult equivalent units.

An additional serious problem arises from the possibility that income (consumption) might be underreported or misreported. In Latin America, national accounts figures for income (consumption) are 1.8 (1.2) times

higher than those recorded in the surveys, suggesting serious problems of underreporting. Some analysts choose not to correct for underreporting, while others impute the differences proportionally across households, or by dividing the income into subcategories, or according to other arbitrary rules. Different methods to correct for underreporting can lead to widely varying poverty estimates even when all other factors - the survey, the poverty line, the welfare indicator - are the same. All of this explains in part the differences observed in Table 1 across different authors.

These issues remind us that poverty and inequality estimates should be treated with caution. Measures of poverty - and of changes in poverty - can be subject to great variation depending on the methodological choices made by the analyst. Improving surveys is essential if we are to have adequate benchmarks to measure progress against poverty. To this end, the program for the Improvement of Surveys and the Measurement of Living Conditions in Latin America and the Caribbean (ISLC/MECOVI), an initiative of the IDB, World Bank, and ECLAC, provides financing, technical leadership, and coordination to improve the quality of national household surveys. The ISLC/MECOVI program can be found on the web at: <http://www.iadb.org/sds/document.cfm/19/english>.

*For further reading see Nora Lustig and Omar Arias, Poverty and Inequality Trends in Latin America and the Caribbean, Finance and Development March 2000.*



Inter-American  
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## Poverty and Inequality Advisory Unit

### Mission Statement

The mission of the Unit is to provide technical leadership for the Bank and its member governments' work in the area of poverty reduction, and to contribute to enhancing the quality of the Bank's lending and non-lending activities so as to increase their poverty reduction impact.

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## Peru's Fiscal Prudence and Transparency Law

In December 1999 Peru's Congress approved the "Fiscal Prudence and Transparency Law." The goal of the law is to enhance public finance management and contribute to macroeconomic stability, sustainable economic growth and social development. From a social protection standpoint, the law is important on three grounds:

1. **Responsible fiscal policy for crisis avoidance.** The law establishes fiscal rules for the deficit of the consolidated public sector, the growth of non-financial expenditures of the general government, and public indebtedness.

2. **Less pro-cyclical fiscal policy.** The law creates a fiscal stabilization fund financed by excess revenues collected by the central government during periods of growth, privatizations, and concessions.

3. **Protection of pro-poor spending.** The law establishes that the priority for use of fund resources is the cover spending in targeted poverty alleviation programs.

## 2000/I WDR Update

The consultative draft of the World Bank's 2000/I World Development Report is now available online at <http://www.worldbank.org/poverty/wdrpoverty/>.

This year's report, titled *Attacking Poverty*, focuses on the actions needed to reduce poverty in the early decades of the twenty-first century. The report finds that global trends present tremendous opportunities for poverty reduction, but in the face of equally tremendous risks of rising inequality, marginalization, and social unrest. The report explores the challenge of managing these risks and exploiting opportunities to reduce poverty.

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## Development Programs

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tends to strengthen civic institutions; that widespread primary and secondary education reduce inequalities; and that educated girls have lower fertility rates. THDPs engender a virtuous cycle where current transfers reduce current poverty and foster human capital accumulation, which, in turn, increases future earnings and future human capital accumulation.

The present value of the resulting rise in the flows of future income will largely offset the present costs of implementing the programs. For these results to come along, however, program design and implementation must ensure effectiveness. Critical elements of these programs include appropriate targeting, adequately set transfers, and strict enforcement of behavioral conditions.

If the objective is to reduce the current number of poor, the poor closest to the poverty line should be targeted. If the objective is longer-term poverty gap reduction, families with the lowest human capital endowments should be targeted first. If the program is to function as a safety net, more vulnerable families (those with high-income swing and those more likely to withdraw their children from school) should be given priority.

The amount of the transfer will depend on what objective a government emphasizes. It could be just enough to ease the resource constraint so that the family can afford to send the children to school, including the direct costs of attendance and the opportunity costs of a child's time. To reduce immediate poverty, the amount can be as high as to fill the gap between family income and the poverty line.

Enforcement should be strictly exercised and benefits withdrawn in cases of non-compliance. This not only ensures that the longer-term objectives of THDPs are met, but also that the transfer is not seen as an entitlement but as a payment for a "desirable" behavior on the part of the family.

One advantage of this kind of program is that the human capital investment that THDPs promote has long lasting effects without producing recurrent costs. Although a THDP should be thought of as a medium term program (to cover one generation of children), the program will engender sustainable benefits for any beneficiary cohort.

THDPs work best in conjunction with supply interventions that improve the quality of health care and education provision.

First year evaluation of Progresa in Mexico demonstrates that these programs achieve significant targeting efficiency, increase the enrolment rate and school attendance, raise the demand for pre- and post-natal care, expand the share of food consumption out of total family consumption (suggesting that indeed these families are resource constrained), and do not create distortions in the labor supply behavior of working age family members.

*For further reading see chapter 5 of Social Protection for Equity and Growth, Inter-American Development Bank.*

## Key to Success: Impact Evaluation

FERDINANDO REGALIA

**I**mpact evaluation is an essential tool to assess whether a social program is achieving its objective and how the beneficiaries' situation changed as a result of the program. This is particularly true in the case of social programs where many external factors affect final outcomes. Impact evaluation is a powerful device when conceived at an early stage of project design, because it helps refine program objectives and targeting mechanisms. When an impact evaluation is performed at an intermediate stage of project execution, very important lessons can be learned on how the design or the implementation of the program can be improved, i.e. a learning by doing process.

Impact evaluation tries to answer the question: what would have happened if the program had not existed? i.e., to establish a counterfactual. This is achieved by comparing a treatment group of program beneficiaries with a control group of non-beneficiaries in similar socioeconomic conditions. There are different ways of building a control group:

- **Experimental methods** randomly select some persons among the eligible individuals by means of a lottery and assign them to the control group. Whenever the lack of resources prevents the coverage of all equally eligible people or the program coverage is gradually extended randomization might be a feasible and ethical option.

- **Quasi-Experimental methods** construct control groups using econometric techniques, for example by selecting among the respondents of a large-scale, often national, survey those individuals whose observable characteristics are similar to those of the program beneficiaries (matching method).

The design of an impact evaluation is time and resource intensive. However, its cost is often modest relative to the scale of the program, usually in the range of 1 to 4 percent, particularly if in-country resources are used. The payoff is increased effectiveness of social spending and greater accountability.

*For further reading please see Ferdinando Regalia "Impact Evaluation Methods for Social Programs," SDS/POV Technical Note #2.*

## Events Calendar

The Unit has developed several initiatives to foster dialogue with member countries and advance research, policy proposals, and economic and social strategies to promote stability, growth, and equity in the region.

On November 8 and 9, 1999 the Unit organized the dialogue *Development for All* in Washington, D.C., a symposium featuring leading representatives of governments, political parties, the private sector, non-governmental organizations, environmental groups, labor and grassroots organizations, micro-enterprise, ethnic groups, and religious orders, as well as academics, artists, and opinion leaders in Latin America and the Caribbean.

In March 2000 the Unit will be organizing two more initiatives to be held at the IDB Annual Meetings in New Orleans. The *Social Equity Forum* (SEF), on March 24 and 25, 2000 is part of a three year series of meetings of high level policy-makers, prominent leaders from civil society groups, academics, and opinion makers from Latin America and the Caribbean, who have promoted equity-enhancing reforms.

The second event in New Orleans will be a seminar on *Socially Responsive Macroeconomics* on March 26. This workshop will bring together a group of leading scholars and policy-makers to discuss the link between macroeconomic events, income distribution and poverty. The seminar will also feature the presentation of the book on *Social Protection for Equity and Growth*, prepared by the Unit.

# Best Practices in Poverty Reduction

The following IDB projects were selected by the three regional departments as representative examples of effective poverty-targeted and equity enhancing lending projects in 1999.

In Brazil, the *Program of Reform and Social Protection* is designed to protect federal social spending levels on priority safety net programs while supporting the country's macroeconomic stabilization program. Specific objectives include supporting measures taken by the government to protect federal social spending in poverty targeted programs during the economic downturn; executing and deepening the reforms underway in the education, health, labor and social welfare sectors; and providing quick-disbursing funds to help meet social objectives while ensuring macroeconomic stability.

Honduras' *Program of Housing Post Hurricane* helps low income households whose housing was destroyed by Hurricane Mitch move into secure, permanent settlements. NGOs, local governments and cooperatives work with groups of households to identify suitable sites. These intermediaries design the resettlement projects, including activities such as the purchase, subdivision, and title registration of the land, installation of infrastructure, and the construction of permanent housing. A modest up-front subsidy for each eligible household, together with resources financed by intermediaries, is used to carry out the resettlement projects.

In Peru, the project for the *Development of the Health Sector/Maternal-Infants Insurance* introduces a health insurance scheme for mothers and infants to address maternal and infant mortality and morbidity. It is an important first step towards the process of modernization and reform of the Peruvian health system. The maternal and infant health care insurance is an integral strategy for financing and providing health care services seeking to eliminate the economic and socio-cultural barriers that prevent low-income mothers and infants from using maternal and child health care services, while also promoting improvement in the capacity and quality of those services.

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## Crises and the Poor

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Venezuela, poverty and inequality increased during the 1980s, as it did in urban areas of Argentina, Chile and Peru. And during the 1995 crisis, urban poverty and inequality in Argentina and national levels of poverty in Mexico rose sharply.

Because crises can have such a devastating impact on the poor, avoiding them should be at the center of any anti-poverty strategy. The lessons of the 1970s and 1980s were to avoid profligate fiscal and monetary policies, seriously overvalued exchange rates, and unsustainable current account deficits. In contrast, the lessons of the 1990s were to improve prudential regulation and supervision of financial intermediaries, introduce new standards for data dissemination, and implement corporate bankruptcy reform.

Even with responsible policy, macroeconomic crises are still likely to occur in emerging market economies. The government's priority during a crisis must be to restore equilibrium in the external accounts and stabilize the currency. However, the macroeconomic policy mix can have far different effects on the poor. Sharp contractions hurt everyone, but particularly the poor. Therefore, avoiding overkill—that is, unnecessarily large fiscal and monetary adjustment—is a sensible policy for the poor. Furthermore, the optimal policy path for the poor may differ from the optimal path for the economy as a whole. The poor may prefer a more gradual adjustment even at the expense of a slower recovery. The implication is that when policymakers adopt what is optimal for the economy as a whole, they should protect the poor with appropriate safety nets to compensate, even if partially so, for the costs the poor have to bear.

A socially responsible response to a crisis should include implementation of adequate safety nets for the poor. Protection for anti-poverty programs was introduced in the fiscal adjustment programs in Mexico and Argentina in 1995, and later in Bolivia, Brazil and Venezuela. There has also been progress in implementing consumption and income-smoothing safety nets on a more permanent basis, although most governments in the region still improvise their responses to the social impact of economic shocks.

It is often argued that during periods of fiscal austerity, governments should not be asked to put in place safety nets or protect items from being cut. But safety nets need not be expensive. Furthermore, governments could introduce mechanisms in their fiscal programming to make fiscal policy, particularly in the area of social spending, more counter-cyclical (see note on Peru). Saving revenues to deal with bad times is socially responsible. Protecting pro-poor spending during a crisis is not an easy task, since poor people tend to lack a political voice. One way to deal with this is by earmarking revenues for specific purposes such as protecting pro-poor programs. An alternative is to rank programs according to priorities at the time the budgets are approved. This would avoid some of the political scrambling when the time comes to make the cuts.

*For further reading Nora Lustig, "Crises and the Poor: Socially Responsible Macroeconomics," POVI SDS, Inter-American Development Bank.*

## Research and Publications

The Poverty and Inequality Advisory Unit has recently published a number of studies addressing issues such as social protection for the poor, the impact of natural disasters on poverty, safety net program design, and other current Unit research topics. Some highlights include:

- *Social Protection for Equity and Growth*, Poverty and Inequality Advisory Unit

This book provides policy recommendations to reduce the economic vulnerability of the poor to adverse shocks and help them cope with income downturns. The book outlines the set of policy interventions that can assist low-income and vulnerable individuals, households, communities and countries manage risk more effectively.

- *"Economic and Social Effects of El Niño in Ecuador, 1997-1998,"* Rob Vos, Margarita Velasco and Edgar de Labastida

This case study assesses the economic and social impact of El Niño by estimating the increase in rural poverty in the areas affected by the phenomenon. It finds that most of the economic costs of El Niño relate to losses of agricultural production and infrastructure damage, as well as increased health costs. The overall impact on the already high incidence of poverty in the affected areas could be as high as 10 percentage points.

- *"Crises and the Poor: Socially Responsible Macroeconomics,"* Nora Lustig

In light of the evidence that crises result not only in higher poverty rates but cause irreversible damage to the human capital of the poor, this paper concludes that crises avoidance and a pro-poor response to crises should be a major component of a poverty reduction strategy. It finds that socially responsible macroeconomic policy can protect the poor during crises and simultaneously contribute to lower chronic poverty.

All of these publications - along with many other published studies, working papers, technical notes, and information about Unit activities and events - can be found on the Unit's website at: [www.iadb.org/sds/pov](http://www.iadb.org/sds/pov). They can also be obtained by contacting the Poverty and Inequality Advisory Unit at: Inter-American Development Bank, 1300 New York Avenue, NW Stop E0421, Washington, DC 20577.