

A Strategy for Poverty Reduction

Washington, D.C.
March 1997—N° SOC-103

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Introduction

The distribution of income in Latin America has always been very unequal, implying that poverty has been far above what would be expected given per capita income. The debt crisis of the 1980s exacerbated the situation. Income fell, inequality increased and the number of people living in poverty rose by at least 40 million or 22 percent during the decade. The urban poor and those living in certain countries, such as Brazil, Peru and several of the smaller resource-dependent countries of Central America and the Caribbean, were hit the hardest by falling living standards. These countries accounted for 85 percent of the increase in poverty over the decade even though they contained less than one-half of the region's population in 1980. Urban poverty rose by almost thirty million, accounting for 70 percent of the total increase. Poverty reflected overall macroeconomic conditions. Those countries that adjusted early and then recovered, such as Costa Rica and Colombia, managed to reduce their poverty indices over the decade. By contrast those that fell into a destructive cycle of inflation and recession, such as Brazil, Argentina, Peru and Venezuela, or which were unable to find a successful growth strategy, such as Bolivia, Guatemala, Honduras and the Dominican Republic, had very large increases in poverty.

Now that a recovery from the crisis is underway in most countries, reducing or alleviating poverty has become one of the most pressing tasks facing the region and the Bank. The purpose of this paper is to provide a broad outline of a strategy for poverty reduction. It has two main sections, first a description of a strategy for the countries themselves, and second a discussion of the actions that the Bank should take to assist in the implementation of that strategy.

It should be noted at the outset that given the diversity of conditions in the region, no single set of policies can be applied to all countries. This paper spells out a general approach to the poverty problem.

But the specific details of how this approach can be applied in key sectors (such as rural development, microenterprise, indigenous people, social investment funds and gender) will be discussed in sector strategy papers. Country papers and poverty assessments will show how the approach can be applied under differing local needs and conditions.

To think clearly about the poverty problem, it is necessary to first agree on what is meant by poverty. The basic definition of poverty is a lack of access to or command over the basic requirements for a minimally acceptable standard of living. That is, a person is poor if he or she has insufficient food or a lack of access to some combination of basic education, adequate health services, clean water, safe sanitation systems and even a safe area in which to live. Economists typically use income as a proxy measure for poverty since income provides the means to guarantee adequate levels of all the other basic necessities. That is why most poverty strategies, including this one, devote so much attention to income generation as the main solution to the poverty problem.

From the income perspective, the basic strategy for eliminating poverty is to help the poor earn their way out of poverty. To do that the economy has to expand the number of jobs available to the poor and increase the productivity or earning power of the poor in those jobs. Most such jobs will be created in the private sector. The role of government is to choose policies which will induce the private sector to create better paying jobs for the poor.

But the government can and should do much more than this. In addition to providing a minimum safety net for the least fortunate, it can directly supply many of the basic necessities that define a minimum standard of living. Even when the private sector is unable to create enough good jobs to reduce the level

of poverty as measured by income, the government can guarantee basic education and access to health services for the poor. It can also build safe water and sanitation systems and guarantee public safety in poor neighborhoods. In short, the government, through the provision of public goods can directly improve the living conditions of the poor. This could go a long way toward reducing the social tension that

results when the market economy fails to increase the income of the poor.

Consider first the strategies that will help the poor earn their way out of poverty. All of these strategies will work by raising the wage or income that can be earned by unskilled, poor workers.

Economic Growth: A Necessary but Not Sufficient Condition for Poverty Reduction

Fundamental to the goal of increasing earning opportunities for the poor is an enabling environment of economic growth. The evidence is overwhelming that economic growth is a necessary condition for poverty reduction. Growth almost always increases employment, hours of work and the take-home pay of unskilled labor. Since the bulk of the poor are unskilled and earn their income from labor, growth can be a powerful economic lever for lifting people out of poverty.

If growth is a key, anti-poverty strategy, it follows that many policies which are not specifically targeted toward the poor may, in fact, be important components of the poverty strategy simply because they raise the growth rate. Policies that raise the rate of saving and investment, increase exports or modernize the industrial base are not generally considered poverty strategies because they are not targeted to the poor. Yet if they raise the overall growth rate in a labor-intensive way they may do more for the poor than targeted interventions.

Recent evidence suggests that, on average, countries can expect poverty to fall by between 1 and 2 percent for each 1 percent growth in per capita income. If a country were able to increase per capita income by 2 percent per year for a decade, it would reduce poverty by about one third. This demonstrates vividly the central role that growth has to play in any successful poverty reduction strategy. Any country which is able to develop a sustained growth trajectory will have implemented the most important element of its antipoverty strategy.

The evidence also clearly shows that the style of

growth matters too. In an open economy, a goal for policymakers should be to make sure that, while maintaining internal and external balance, the growth strategy they adopt maximizes the benefits that go to the poor. Job creation is crucial for poverty reduction. Growth that is labor intensive and creates jobs faster than the rate of growth of the labor force creates new employment opportunities that keep pace with new entrants. In addition, the real incomes of the families of unskilled workers are likely to rise as well because of the availability of jobs for secondary family workers and the reduction of involuntary underemployment. Furthermore, in the long run, real wages for the unskilled are likely to rise as well.

Consider the contrasting cases of two of the countries in the region. Between the early sixties and the late seventies the poverty level in Costa Rica fell by two-thirds in response to a 70 percent increase in per capita income. During the same period, the Brazilian economy grew twice as fast, but the level of poverty fell by only 45 percent. Economic growth in Brazil was skill-intensive and inequitable. The government of Costa Rica, on the other hand, invested heavily in the social sectors and, as a result, growth was labor intensive. But even in Brazil, growth was a potent force for poverty reduction.

Even if a country does nothing to increase the number of jobs available to the poor, it is still likely to make some progress in reducing poverty, provided that per capita income grows. For even if growth is not led by the sectors in which the poor work, it will still increase the demand for unskilled labor. People whose earnings increase hire more domestic help and use more personal services. Domestic industry will

expand, creating new job opportunities for the unskilled. Over time, provided that the rate of increase in jobs exceeds the rate of growth of the labor force, wages will begin to rise for the unskilled, even for those who continue to do the same jobs, simply because of the rise in the demand for unskilled labor relative to its supply. This is what could be called the trickle-down poverty reduction strategy, one in which growth is almost sure to be accompanied by rising inequality. Reducing poverty by relying on overall economic growth to indirectly increase the demand for unskilled labor is a strategy that stems from policymakers' inability or unwillingness to raise the productivity of the unskilled in a more direct way. It is the least proactive poverty strategy, and works mainly by default. We turn next to the things that government can do to make growth more beneficial for the poor.

INCREASING EARNING OPPORTUNITIES FOR THE POOR

There is a general conviction that employment creation should be a key element in any growth strategy targeted toward increasing earning opportunities for the poor. However since open unemployment is low in most poor countries, unemployment by itself is not a very important source of poverty. Unemployment is a luxury that most poor people cannot afford. Therefore job creation as a poverty strategy implies the substitution of good jobs for bad jobs and/or job growth significantly above the growth rate of the labor force.

How does a country substitute good jobs for bad jobs? Leaving aside education and training for the moment, there are two ways to do this: create new and more productive work, mainly in the private sector, that can be performed by the unskilled or raise the wages paid for the jobs the poor are currently doing.

Agriculture

Because many of Latin America's poor work in agriculture, making it a leading sector in a country's growth strategy, as Costa Rica did, should increase

the demand for unskilled labor. To that end, governments should assist the sector to develop new products and export markets. In addition, the government needs to eliminate artificial barriers and costs imposed on agriculture by sector-specific taxes or pricing policies for agricultural commodities. All of this will help the sector and the poor who work there.

The other way to help the poor who work in agriculture is to increase their productivity by giving them the complementary inputs and assets they need to produce more. In particular, access to sufficient land is a key determinant of rural poverty in many countries in the region. In Paraguay, for example, a recent survey found that rural poverty was limited to those with less than ten hectares of land. Seventeen percent of the poor were landless, and 56 percent had between one and five hectares.¹ To make matters worse, two thirds of peasants with land, do not own clear title to it. Any program which is serious about rural poverty has to address the problem of land access and titling.

One solution to the problem is to create a land market and help landless peasants acquire their own land. In countries where there is underutilized land, under current arrangements, land owners generally have little incentive to sell or subdivide because the opportunity cost of holding land is low. In particular, the tax on land is low. A serious effort at establishing a more equitable distribution of land would include a reform of the land tax to reflect the value of land in its most productive use more accurately. Such a reform would raise the cost to owners of holding idle land. Therefore, increasing the supply of land offered either for sale or rental. As a complementary policy, the government should devote the necessary resources to speeding up the process of land titling.

In countries where the total supply of land is limited, an alternative strategy is the development of land-saving technologies such as the use of irrigation,

¹ FIDA, "Fondo de Desarrollo Campesino-Región Nororiental del Paraguay," (Fondo Internacional de Desarrollo Agrícola, no date).

fertilizers, crop rotations, and better seeds. All of these technologies increase the productivity of a given plot of land, thus raising either peasant income or freeing peasant time to earn money in nonfarm activities.

Credit is another critical input for peasants. Clearly, if a large scale program of land purchases were to be organized, some sort of government or private sector credit system would have to be organized to finance purchases. In addition to credit for land purchases, a better credit system for working capital is also critical to raising the productivity of the *campesino*. At present in most countries there is little or no formal sector credit extended to small landholders. If peasants are going to purchase modern machinery, seeds, fertilizers and pesticides, they need more credit. That credit should not be tied to the production of any single crop, and it should be available from an agency other than crop buyers.

Campesinos need help in marketing what they produce. They need better systems for transporting their goods to market, and a more competitive system for selling their products. In many cases, the lack of appropriate transportation means that peasants face a monopoly buyer who may also be the source of whatever credit they can obtain to carry their families through to the next harvest. Under these circumstances they have little influence on the prices they are paid.

Campesinos also need assistance in managing more modern technologies. An effective system of extension, backed by research targeted to land-saving, labor-intensive technologies appropriate to small-scale farming, would yield a big payoff in poverty alleviation and the preservation of the natural resource base.

The unfavorable situation of the rural poor can be improved by strong government actions on several fronts. First, the government needs to support better marketing and credit facilities for small farmers. Second, it needs to commit resources to research on crops producible by peasants, and to an effective system of extension services to teach peasants how to

grow those crops. Third, government needs to explore the feasibility of small-scale rural development programs in poor communities with underutilized economic potential.²

The Urban Poor

The employment problem of the urban poor is more complex because, with the exception of construction, they are not concentrated in any particular sector. The urban labor force produces a range of goods and services determined by domestic demand, domestic capacity and the export market. Relative incomes are determined mainly by the relative supply and demand of different sorts of labor. Countries with a large number of poor people relative to national income have a large body of unskilled labor relative to the number of jobs earning above-poverty wages. There are only two ways to change that. One is to develop or expand activities that employ unskilled labor. The other is to increase the productivity of the poor by providing complementary inputs and training. Support for microenterprises, for example, moves toward both of these objectives.

Microenterprise

More than 80 percent of all businesses in Latin America and the Caribbean employ fewer than 10 people, which is the Bank's definition of a microenterprise. More to the point, microenterprises employ an estimated 50 million people, at least one-third of the labor force in the region.

Women-owned businesses are one of the fastest growing segments of the microenterprise sector. Between 30 percent and 60 percent of all microenterprises in the region are owned and operated by women. These businesses are also major sources of employment for low-income women and men. Micro-entrepreneurs, in particular, have limited access to services to expand their businesses and improve their

² A more specific strategy for alleviating rural poverty will be spelled out in a Bank strategy paper on rural development.

incomes.

From the street vendor, to the machine shop operator, to the seamstress and the peasant farmer, microentrepreneurs come in all types and their businesses come in many sizes. They are a diverse continuum of businesses which require different types of support. Given its flexibility and proven role in employment and income generation for the poor and for female heads of households, microenterprise support should be a key component of a labor-intensive growth strategy for the future.

Although economic reform in the region has opened up new opportunities for growth of the microenterprise sector, microenterprise activity is constrained by the policy environment in which it operates. Policy changes still have a long way to go to create a level playing field for the region's smallest economic activities. Improved business regulations, tax regimes and licensing requirements are some of the actions that would improve conditions for microenterprise development.

One of the critical barriers to the growth and development of microenterprises is lack of access to financial services and credit. Less than 5 percent of Latin American microentrepreneurs have access to formal financial services. Banks do not serve this sector well because most microenterprises lack the required collateral, and because of the high cost of servicing small loans. Expanding and diversifying sources of credit for this sector is a major challenge that can perhaps be met by strengthening the NGOs that work in this area, and by helping banks reach smaller clients.

Microentrepreneurs also lack access to nonfinancial services, including marketing, training in basic business skills (such as bookkeeping) and modern technology. The quality of training offered to microentrepreneurs is generally low. Training institutions which have been successful in reaching small business and teaching modern business practices should

be sought out and supported.³

Exports

Since national demand for goods and services producible by the unskilled is unlikely to be very changeable, there are few ways to make consumer demand more labor-intensive. But that is not true for exports. Exports are one of the most promising avenues to raising the demand for urban unskilled labor. Poor countries have a comparative advantage in the production of labor-intensive goods. Developing external markets for such products, reducing export taxes and assisting domestic entrepreneurs to expand their export sales are ways to increase the demand for unskilled domestic labor. If such policies are accompanied by training to upgrade skills, export promotion should also lead to wage increases for those workers.

Infrastructure

Another promising way to increase the labor intensity of demand in the economy is by increasing the construction of infrastructure. Construction, like agriculture, is a large employer of unskilled labor. Social investment funds are an example of this approach to increasing low-wage employment, but it does so on a fairly small scale. The scope for poverty alleviating infrastructure construction activity is far larger than that provided by social investment funds. The government, through its power to tax and finance large scale projects, is the one unit in the economy large enough to change the sectoral composition of domestic demand so that it is more labor intensive. One of the ways it can do this is by investing in the construction of infrastructure. However, the projects should not be simply "make-work" projects. Rather they should be social investments, such as the construction of water or sewer systems, that improve living conditions and health, or produc-

³ Specific actions to assist and strengthen the microenterprise sector are discussed in the Bank's Microenterprise Development Strategy (February 1997, N° MIC-103).

tive investments, such as roads, irrigation systems, reforestation and land reclamation, that increase the earning power of the poor. These are all win-win projects that increase the income of the poor while they are being built, and increase social welfare and/or worker productivity when they are completed.

Obviously there are an inflationary and balance of payments danger in this sort of program that has to be confronted directly. In the usual conditions prevailing in Latin America, such construction projects have to be financed through tax increases, not by printing money. Essentially, the government would be changing the composition of demand in favor of labor-intensive construction projects by transferring enough purchasing power from the private sector, through taxes, to offset inflationary and balance of payments pressure arising from the projects themselves. It should be noted that if the projects support productive activity, they may be an inducement to both exports and increased domestic production.

Less Developed Regions

In many countries there are regions and/or groups of people (such as indigenous communities) who benefit little from growth in the economy. For a number of reasons, the people in these regions or groups are not effectively integrated into the larger economy. Specifically, they lack access to the markets that are responding to growth. That may be because of cultural or ethnic factors, low levels of worker productivity, poor agricultural conditions, a poor natural resource base, bad transportation or national policies that discriminate against the region in question. In such cases, more needs to be done than simply promoting rapid labor-intensive economic

growth because growth, no matter how rapid or how labor-intensive, will not have much of an impact on the poor in these regions.

The strategy in these circumstances is to attempt to change the structural conditions that perpetuate poverty. Where the pockets of poverty are regional, the government should review macroeconomic policies that discriminate among regions. For example, regions that are highly dependent on agricultural exports are highly sensitive to changes in the real exchange rate. Large capital inflows to the modern sector which cause an appreciation of the real exchange rate are thus detrimental to these regions.⁴ In other cases, high tariffs that protect domestic manufactures discriminate against backward, natural resource producing regions. In still other cases, the net impact of central government finances and expenditure is biased against the region in question.

In the past, several countries in the region have embarked on big regionally integrated development programs to speed up growth in their less developed regions. None of these programs have been very successful, and the entire approach has fallen into disfavor. Nonetheless, given the magnitude of the regional disparities that continue to exist in some countries, and the large fraction of the poor living in less developed regions, the regional development approach should not be abandoned completely.

⁴ Note that this same real exchange rate appreciation will help the urban poor if they consume more than they produce of traded goods. That is likely to occur if the poor are consumers of food whose price follows the exchange rate and producers of urban services rather than exportable manufactures.

Human Capital Formation

In the final analysis, a country's most valuable resource is the potential of its people. Well-known shortcomings in the delivery of education and health services in Latin America and the Caribbean imply a tragic waste of human talent. There is no structural reason for allowing this situation, and its associated high economic costs to society, to continue. The problem is not that the task of providing children with basic health care and teaching them to read, write, and compute is that difficult nor, in most cases, that the needed resources are unavailable. Several low-income countries, such as Sri Lanka and Cuba (or Korea thirty years ago), have shown that it can be done. What is missing in the region is the political will to get the job done, starting with the organization of efficient delivery systems in these two crucial areas. Thus, the second component of the poverty strategy to increase the productivity or earning capacity of the poor is a massive commitment to upgrading education and health conditions in the region.

EDUCATION

A good education is a major factor in the economic success of individuals and in the development performance of nations. Individuals without a good foundation of basic education are likely to be confined to a life of low-productivity work outside the sphere of modern production that does not provide a level of income sufficient to keep them and their families out of poverty. This situation will be exacerbated in the future by rapid technological change and the opening of the region's economies to international competition. The low quality of the educational opportunities typically available to children of poor households is a major gear in the intergenerational transmission of poverty that plagues many countries. The gulf between the education available to the poor and to higher income families is at the root of the wide and

persistent disparities in income and social opportunities.

Education helps reduce poverty in at least three ways. First, it gives tomorrow's workers the skills they need to escape the low-wage unskilled labor trap by reducing the supply of unskilled labor and raising the average wage. Second, a more skilled labor force improves the international competitiveness of a country's products, boosting exports and economic growth. Third, improving the basic education level of the labor force improves the distribution of income by reducing the very large skill differentials enjoyed by the better educated, thus reducing the income gap. Education is a win-win policy for any government interested in poverty reduction. It helps to increase the growth rate by increasing the stock of human capital. At the same time it improves the distribution of income by equalizing the distribution of human capital and earnings.

The average education level of the Latin American labor force is far below what would be expected, given the level of per capita income in the region. Most of the region's children now have access to at least eight years of school. But problems of low school quality, and high repetition and drop out rates virtually ensure that most poor children will never develop their full potential. High school enrollments, for instance, lag far behind levels in Asia. The problem is particularly serious for girls in several Latin American and Caribbean countries. To make matters worse, many students' ability to learn is compromised by nutritional deficiencies, endemic disease and other crippling disabilities.

Raising the education level of the children of the poor has two components: keeping children in school longer and teaching them more while they are there. Raising the quality of schools available to the poor

should be a high priority for the countries of the region and for the Bank. But the problem of delivering quality education is compounded by the very high current repetition and drop out rates, now among the highest in the world. According to 1988 data, one in every two first-graders fails to be promoted to second grade, and every year, almost one-third of all primary school students repeat a grade. Between 10 percent and 15 percent of all children enter the system late, and by age 15 more than half of the students (55 percent) have dropped out. Because of successive repetition and attrition, an average student remains in the school system for seven years, yet completes only four grades.

In Latin America, only 54 percent of those entering primary school ever reach grade four. No other developing area has so low a continuation rate. Its effect is significant: it means that almost half of those who enter school do not stay long enough to acquire literacy and other basic skills. There is little data on completion rates for secondary education, but so far as we know, in 1989 only one country had secondary gross enrolment rates above 75 percent. These figures imply a tragic waste of human potential. Even the best high schools in the world will not be able to do much good if less than 30 percent of each age cohort attends them.

Why do so many poor children drop out? Research suggests three main reasons: bad schools, low family incomes and the low education level of their parents. Poor schools have very high rates of repetition and desertion. Undereducated parents tend to permit their children to drop out of school too early, which is one of the main reasons for the high intergenerational transmission of poverty. But that fact has a more positive implication as well. If countries succeed in significantly increasing the education level of just one generation of children, the premature dropout rate will permanently decline. For when they become parents, that generation will strongly encourage their children to take advantage of the opportunities that education provides. In this way, a big-push investment in education will pay permanent dividends in higher skills and lower poverty.

The other main reason for high dropout rates is low family income. Poor families need the income that can be earned by working age children. But when children are removed from school both they and societies are being deprived of the opportunity to develop long-term earning potential in order to help families survive in the short run. Recently, several attempts have been made to confront this problem. Several governments, some with IDB assistance, have begun to experiment with schemes which essentially pay poor families to keep their children in school. These programs serve two purposes at once. They get money to poor families which need it, and they provide an incentive for increased investment in human capital formation.

There is little doubt that investments in the human capital of the poor are a powerful tool for both reducing poverty and increasing the economic potential of a country. But it should also be understood that such investments take a long time before they start to have a significant impact on the earnings of the poor. In addition to taking a long time, formal education cannot easily correct the educational deficits of those who have already dropped out of school and joined the labor force. Even a successful education program which leads to a big increase in the average schooling of the young, in the short run will have only a small effect on the average schooling of the labor force simply because new entrants in any year comprise such a small fraction of that labor force.

The education strategy is a long-run solution to the poverty problem. If it is carried out long enough, it will dramatically shrink the group of poorly educated, low productivity workers who are the main poverty population. But that will not do much for today's poorly educated workers. For them, we propose a growth strategy which increases as much as possible the number of jobs available to the unskilled. This growth strategy, coupled with training programs for adults, is a short-run bridge to the time when the long-run investments in the education of the young begin to have a significant impact on the average skill level of the labor force.

HEALTH

The burden of disease and ill health is most severe for the poor. They suffer the greatest incidence of disease, they have the smallest amount of insurance protection when disease strikes a breadwinner, and their children are most likely to have their learning potential reduced by malnutrition and sickness.

Good health is both an end and a means. Because health is a key component of well-being, governments can improve the living conditions of the poor by providing access to health services, even if they cannot generate better income earning opportunities. But investments in health also raise productivity and the capacity to learn. Therefore, health expenditures for the poor can be justified both because they make the poor better off and because they raise earning power.

Latin America has quite favorable regionwide indices of health compared to those of most other developing regions. Yet, there is an enormous disparity in access to health services across the region. In Argentina, Chile, Costa Rica, Jamaica and Uruguay, more than 90 percent of the population has access to health services. This contrasts sharply with the situation in most of the countries with large indigenous populations. Of these, in only one does more than 50 percent of the population has access to the health system. In general, these countries have fewer doctors and hospitals, and those they have tend to serve mainly prosperous regions and cities, leaving large fractions of the population without access to health services.

In the health sector, the government's main role is to finance health services and interventions that benefit the broad community, and to provide subsidies to ensure that financial barriers do not prevent individuals from obtaining access to adequate health services. Given epidemiological patterns, improving the public health system will disproportionately benefit the poor with no additional targeting required. It will also pay for itself in increased earnings for the poor and in reductions in the burden of working time lost to disease.

GENDER AND ITS RELATION TO POVERTY

An important way to increase the income of poor families is by investing in the education, training and health care of women. We know that poverty is significantly higher in female-headed households. Moreover, a recent study by ECLAC shows that this source of poverty is growing in many countries of the region. In addition, women play a key role in reducing the poverty impact of recessions on families. Household surveys show that during recessions and structural adjustment the entry of women into the labor market buffers family income when primary earners lose their jobs or suffer a sharp decline in real wages.

The education of women has another extremely powerful effect on poverty. Many studies confirm that the higher the education level of women, the greater the education and nutrition level of their children. Educated women tend to make sure that their children are well prepared to earn a good living in the job market. Hence, investing in the education of women is a way of breaking the tragic inter-generational transmission of poverty.

Policies that improve the productivity of women in the labor market or enhance their ability to raise well-educated, well-nourished children should be part of any country's poverty strategy. This should include securing women's access to economic resources such as credit, training, child care and property rights. Also, acting to reverse the discrimination and segregation in the labor markets is a way to enhance the economic contributions of women and their access to the benefits of their work.

In the area of education, more efforts need to be placed in providing quality education for girls. While overall enrollment and completion rates for boys and girls are increasingly the same, girls in rural areas are overrepresented among the illiterate and dropouts, and their completion rates are lower than those of boys. This situation is worst in countries with numerically important indigenous populations. In such countries, the use of scholarships for girls is a prom-

ising instrument to reverse these patterns. Stereotypes of male and female roles still track girls to traditional occupational and career options. Educating girls is important because of the economic opportunities it

opens to them and the associated social gains (such as lower fertility rates, lower infant mortality, better health for all members of the family, and higher levels of education of children of educated mothers).

Other Measures to Improve the Welfare of the Poor

The measures proposed so far are intended to help the poor escape from poverty by improving their earning power. They all operate through the market and depend heavily on private enterprise. But there are causes of poverty that cannot be addressed in this way. The scope for government interventions to improve living conditions for the poor goes well beyond increasing income.

TRANSFER PROGRAMS

Transfer programs directly provide income, subsidies or services to the poor. But there is an important distinction to be made between different sorts of transfers. Some temporarily alleviate poverty by simply distributing money, goods or services to the poor. Others have an investment component that permanently increases the earning power of the poor. If a government is going to use transfers to the poor as part of its poverty strategy, it should be looking for those with an investment component that increases the earning power of individuals. For example, as already discussed, providing access to education for poor children allows them to permanently escape poverty. The type of transfers that contribute to a successful poverty strategy are those that contain a significant investment component in addition to the cash or goods that are provided directly to the poor. That is, one should be looking for projects or programs which help the poor in the short run because they receive an immediate transfer of resources, but which also help the poor in the long run by making them more productive.

Some promising examples of investment-type transfers are irrigation schemes and farm-to-market roads built by the unskilled, infant nutrition programs for poor families, subsidies for good child care or school

attendance by the children of the poor, and the construction of schools or health posts in poor neighborhoods. These programs provide temporary income supplements to the poor during execution while at the same time permanently enhancing their earning power or that of their children.

SOCIAL SAFETY NETS

Governments have a responsibility to define and to provide effective safety nets for those unable to care for themselves. There will always be families who are poor because the adults are disabled or retired, or the head of the family has few job skills. In addition, there are families who are poor because they have a large number of dependents relative to the earning power of working family members. This sort of poverty is unlikely to be curable by measures to improve worker productivity because the family has too few working members per dependent. Safety nets should adequately address the specific needs of these groups through the use of compensatory targeted programs within the constraints of the fiscal budget.

In addition, extended economic recessions, such as that of the 1980s, lower employment and real wages cause massive increases in poverty and inequality. In these circumstances emergency government actions to shield the poor are warranted. Governments have a responsibility for both the economic and social well-being of their people. In times of crisis, that is expressed by the commitment to spread the burden of adjustment to those better able to bear it.

INDIGENOUS GROUPS

Although estimates vary, indigenous groups comprise about 10 percent of the population of the region,

representing over 400 different ethnic groups, each with its own language, culture and strategy of adaptation to the natural environment. Recent studies have demonstrated high degrees of correlation between poverty indicators and ethnic affiliation: with very few exceptions indigenous people belong to the poorest strata of the population and are disproportionately represented among the poor.

However, the very notion of poverty requires some clarification. Despite the enormous heterogeneity among indigenous groups, they often share similar notions about development and progress and frequently object to being identified as poor. Within the indigenous world view, such concepts as poverty and wealth are not defined in economic terms but rather in terms of secure access to land and natural resources, spiritual well-being, harmony with nature and the community, and absence of conflict. Even though indigenous people want to improve their access to services and economic opportunities, meeting these needs is not always perceived as a top priority. Typically, indigenous people will respond to new economic opportunities only if they perceive they can do so without losing their cultural identity and social integrity.

Evidence from successful but often small scale grassroots development initiatives with indigenous groups suggests that this desire for the preservation or strengthening of cultural heritage and value systems is not a barrier to socioeconomic development, as has often been assumed in the past, but rather an opportunity or even a condition for long-term sustainability. To the extent that indigenous people are enabled to respond to economic development opportunities on their terms and with their active participation in the planning and decision making process, they will often do so enthusiastically. Strong community support mechanisms, respect for nature and profoundly participatory decision making processes, which are all typical of most indigenous societies, are strong assets when designing and implementing sustainable bottom-up development projects.

Given that in socioeconomic terms indigenous groups

represent such an important sector of the poor and extremely poor, it is paramount, especially in countries with large indigenous populations, to address the sociocultural dimension of poverty and to establish poverty reduction strategies that are based on a better understanding of the linkage between poverty and ethnicity. Projects should be based on a genuine dialogue with indigenous organizations so that they include indigenous views, aspirations and potential contributions in the design of social service delivery strategies, especially in the areas of health and education. Such projects should incorporate and strengthen indigenous health concepts and practices, and recognize bilingual multicultural education as an important vehicle for improving the effectiveness of education and training programs for indigenous groups.⁵

IMPROVEMENTS IN LIVING CONDITIONS FOR THE POOR

Continued rural migration to rural areas, the limited absorptive capacity of urban labor markets, the low skill levels of migrants and high rates of population growth ensure that urban poverty will remain a growing problem in the foreseeable future. In the long run, this could be overcome by a combination of training, education and a change to a more labor-intensive growth strategy. But in the short run, governments can do a lot to provide public goods and services that will improve the living conditions of the urban poor. The first and most important public services are quality health care and education, and adequate nutrition for the poor and their children. These services are strongly desired by the poor and also represent an investment for the future. Special attention should be paid to street children, a tragic symptom of violence and social disintegration.

Government should introduce programs to control violence in urban slums and guarantee access to the judicial system. In some urban areas this may well

⁵ More specific strategy proposals for indigenous people will be presented in a Bank strategy paper on this topic.

have more of an impact on the welfare of the poor than more conventional interventions. Governments should engage in projects that provide basic necessities and improve living and health conditions for the poor, which will reduce poverty as measured by basic needs. These include projects such as providing access to clean water and sewage services, and upgrading urban slums, which because of their labor-intensive nature also generate additional demand for unskilled labor.

In many countries, access to basic social services in rural areas is still unacceptably low. It should be a goal of government to remedy that situation. Using highly disaggregated poverty maps, social investment funds have been able to successfully build schools, health posts and small-scale water and sewer systems at a relatively low cost in underserved rural areas

where many of the poor live.

It is important to understand that building social infrastructure will do little to reduce poverty, if by poverty we mean lack of income. Experience with social investment funds is instructive in this regard.⁶ While the funds were successful in building schools and health posts, and while this reduced the level of unsatisfied basic needs, they had little impact on either employment or income. Nevertheless, these projects did increase the welfare of the poor, an impact which should be reflected in poverty measures.

⁶ See the recently completed IDB study *Report on Social Investment Funds: Issues and Recommendations*, (EVO/SDS, Nov. 1996).

Other Issues

POPULATION ISSUES

At the family level, there is strong evidence that poverty is related to family size simply because large families have a high number of dependents per worker. In addition, in large families there is a tendency for children to get less education, poorer pre- and post-natal health care and poorer nutrition, leading to impairments in their mental and physical potential. Large families also comprise a significant share of the poverty which is transmitted across the generations and which burdens the society with a growing number of unskilled workers.

For the economy as a whole, the question remains open as to whether population growth increases poverty. On the one hand, the Malthusian argument would suggest that the more people there are the less income there will be to go around. But on the other hand, well-educated people are a valuable resource that more than pay back the costs to society of raising and educating them. Nevertheless, in Latin America's poorer countries, the benefits derived from the contributions of relatively well educated residents are unlikely to offset the negative effects of population pressures. This is particularly evident in countries that are dependent on agriculture where a growing population is putting increasing pressure on the available supply of arable land. In such countries, successive generations of workers have smaller and smaller complementary inputs of land. This causes downward pressure on wages or incomes, more rural to urban migration, and a rising demand for urban employment which typically is very hard to provide. It also provides the raw material for increased urban violence.

At the same time, population pressures make it that much harder to upgrade human capital. Educational and health spending per child, already low compared

to countries with slower growth and higher per capita income, can barely be maintained, let alone increased. The problem is particularly serious in countries with a labor force that is rapidly growing and poorly educated because they have more ground to cover and fewer resources with which to do it.

As countries grow and urbanize, population growth declines. But for the poor countries of Latin America, the process is more like a treadmill in which high rates of population growth make it difficult to get this virtuous cycle underway. In these circumstances, government and private family planning programs may play a constructive role in a country's poverty strategy.

POLITICAL

A key determinant of the distribution of income and welfare in a society is the government. Typically, the poor are underrepresented in the government which is one reason why the incidence of public expenditure is regressive. This is unlikely to change unless the poor are empowered to defend their own interests. To do this, poor people need assistance in learning to deal with government authorities. They need to be helped to form local groups which can demand better schools and local health posts or which can support poor communities' efforts to get a higher fraction of government social or development expenditures than they do at present. NGOs and local community groups are a natural focus for this sort of activity. But an important supporting role could be played by social investment funds, given their success in establishing local contacts in poor communities. The FOSIS in Chile is following exactly this approach. It now devotes a significant portion of its budget to teaching representatives of poor communities how to make their needs and demands more effectively heard at the central government level.

INCOME DISTRIBUTION

Latin America has the most unequal distribution of income in the world. That means that it has a lot of poverty relative to its level of income. But there is a more causal relationship between the distribution of income and poverty. Inequality breeds violence and political instability. That discourages investment and reduces the growth rate of the economy. Inequality also reduces the amount of education that many families can afford to give their children simply because they are too poor. Both of these factors create a vicious circle in which the more unequal the distribution of income in a country, the less it is able to reduce the level of poverty.

A tempting reaction to this situation might seem to be the direct transfer from the rich of the small share of GDP that it would take to eliminate poverty. But no one advocates this method of poverty reduction both because it is not politically sustainable and because it would sharply curtail growth in a market economy

with freedom of capital movement. What we propose here instead is a growth strategy whose benefits are progressive and is accompanied by government social spending and tax policies that favor the poor. If this is achieved, much of the potential for destabilizing violence will disappear as poverty goes down. But the changes may not have much effect on the distribution of income, at least in the short run, as can be seen in the case of Chile. Between 1987 and 1992, Chile's poverty index fell by more than one quarter, but income distribution remained highly unequal and virtually unchanged. The fact that Chile's inequality was so insensitive to progressive social expenditures and to determined efforts to reduce poverty reflects the length of time it takes to reverse the conditions that give rise to inequality in the first place. Our reaction to the Chilean phenomenon is that poverty reduction is a more important short-run indicator of success than inequality because the poor are more interested in absolute improvements in their living standards than they are in their relative position in the income pyramid.

Bank Strategy

The Bank is committed to making a maximum effort to reduce the level of poverty in the region. It is usually assumed that this will be done through loans and technical assistance. Such a view of Bank activities is seriously incomplete because it overlooks another channel through which it can have an impact; namely, through the analysis and reform of policies that impact the poor.⁷ The Bank has an important role to play in poverty monitoring and assessment, country program formulation and policy research. These activities not only provide the information necessary to make loan programs effective instruments for poverty reduction, but also have an important influence on policy dialogue and decisions that affect the poor. Bank loans are a small fraction of targeted government expenditure in any country. If by its research and programming dialogue, the Bank changes priorities and perceptions in the region so that government policy is more progressive, it will have an impact on poverty far beyond that of loans.

FORMULATING EFFECTIVE POLICY FOR POVERTY REDUCTION

An effective and coherent policy of poverty reduction has to be based on the collection of basic information about the poor, country-specific poverty assessments and policy research on the poverty problem. These inputs are necessary instruments for creating an effective country program for poverty reduction.

⁷ For example it could be the case that a government subsidizes the importation of food. That could have a big impact on the rural poor. Or a government may permit the real exchange rate to appreciate by excessive foreign borrowing. That will hurt the poor if they are producers more than they are consumers of traded goods. One can think of many other examples.

Monitoring

Both the Bank and the countries of the region need better information about the consequences on poverty and other social indicators of their activities and programs. To do this, the Bank is committed to help in the development and maintenance of an adequate social and poverty data base. This will help the Bank assess the impact of its loans, and will help client countries measure the progress they are making in the social and poverty area. To that end, the Bank, in conjunction with the World Bank and ECLAC, has developed a project through which it will collect and maintain a set of social indicators and a collection of recent household surveys. In addition to providing basic information on changes in poverty and levels of education and health in the region, this information will be a valuable resource for those interested in an in-depth analysis of poverty, labor market conditions and human resource development.

Once a collection of household surveys is in place, the Bank will be able to monitor progress in poverty reduction in the region. Up to date surveys will provide the necessary data to maintain current estimates of poverty and the progress being made with what would be predicted if all families shared equally in growth. This comparison will provide a clear indication of which countries have a progressive growth strategy and are succeeding in reducing poverty.

The Bank should also begin to estimate and report on the poverty-related social expenditures of member governments so that it can keep track of the efforts being made by countries in the region. To do that, the Bank will need to define measures of the expenditures to include that are widely accepted. As a first approximation, poverty-related social expenditure could be defined as those in primary education and health care, nutrition programs, poverty-related

subsidies, social safety nets, and social investment fund expenditures. At the same time, the Bank should initiate a more detailed analysis of the targeting of these social programs to see how much actually reaches the poor and how targeting could be improved.

Policy Research

A development bank lends money, but ought to do much more than that. Along with its central role of lending, it has several parallel tasks which are difficult, critical and delicate. Intellectual leadership is required of a bank that wants to make a difference in poverty reduction beyond what can be obtained through its projects alone. To provide intellectual leadership, the Bank must put resources into policy research designed to better understand the factors and policies in each country which are central to its poverty problem. Some of that research will be contained in the poverty assessments and project impact studies described below. But the Bank also needs to support poverty-related policy research in centers in the region and in the Bank. This is an important way to generate wider understanding of issues in poverty reduction as well as to induce serious and careful consideration of policy solutions.

Among the studies that will be undertaken are: i) the targeting of social expenditures, particularly the social safety net, and ways to improve targeting; ii) the relationship of poverty to the labor market; iii) the alleviation of rural poverty; iv) the role of micro-enterprise in poverty reduction; v) infrastructure investment as a poverty strategy; vi) the collection of a set of best practice case studies of projects or policies that have had a significant impact on poverty; and vii) a study of the distributional impact of macroeconomic policies and their relationship to poverty under different structural conditions.

Poverty Assessments

The Bank will conduct periodic poverty assessments in countries which lack these assessments and have special or severe poverty problems. Two such analyses, one in Argentina and the other in Paraguay,

have already been carried out. A third one, focusing in Central America, will be completed in 1997. The focus of these poverty assessments should be on the policies and conditions in the country that are particularly significant for the poor, on the efforts the government is making in poverty reduction and on the actions that the Bank recommends be taken to reduce poverty.

Country Programming

For each country the Bank's approach to poverty alleviation should be expressed in the Country Paper and the Country Programming Document. These two papers bring together the results of poverty monitoring, poverty assessment and research to present a clear picture of what the Bank thinks the poverty problem is, what progress is being made in reducing it and what policies the Bank recommends. The Country Paper should estimate the resources that the government is devoting to poverty-targeted expenditures, and how the loan portfolio and future Bank projects are expected to contribute to the alleviation of poverty.

Poverty reduction is a national issue, but the problem has to be solved locally. The right attitude for the Bank in this critical task is to develop a partnership with its client countries in doing this. The preparation of the Country Paper and Programming Document offers an ideal opportunity since these papers are the result of policy discussions with client governments. During this dialogue, the Bank should use its analysis of the poverty problem to assist client governments to design a project pipeline with a poverty focus and to formulate policies which will have a significant positive impact on the poor.

IMPROVING THE POVERTY IMPACT OF BANK PROJECTS

Loans and Technical Assistance

The main direct channel by which the Bank will reduce poverty in the region is through loans and technical assistance. The Eighth Replenishment pledged as the Bank's goal that 40 percent of the

total volume of lending and 50 percent of loans would be devoted to projects that promoted social equity and poverty reduction. Over the first three years of that program (1994-96), the goal was exceeded as 44.7 percent of total lending or \$8.6 billion went into these projects. These figures imply a big change from past lending practice. Social equity lending never exceeded 35 percent prior to 1994, averaging about 22 percent between 1961 and 1992.

In addition to the social equity target, the Eighth Replenishment created a category of loans defined as poverty targeted. That definition has been interpreted as including all loans, regardless of sector, for which more than 50 percent of the beneficiaries are poor. The Bank offers an additional 10 percent financing to encourage these loans. Between 1995 and 1996, 40 percent of all loans and 36 percent of the loan volume were targeted to poverty reduction according to this criterion.

Looking toward the future, the Bank, in cooperation with its borrowers, will design a loan portfolio to support the policy guidelines for poverty reduction discussed above. It will place a strong emphasis on helping countries improve the quality and coverage of their education systems. In many countries of the region that will mean a concentration on primary school, in others with an adequate primary system, it will mean secondary education. The Bank will also support the expansion of primary health care and the reform of health systems. This policy focus is already being implemented in the Bank's most recent projects. In health and education there has been a significant increase in the volume of loans in the last two years. But even more significant than the total volume of lending is the shift in the type of loans that are now being made in these two social sectors. Education and health projects are now being designed with a greater component of modernization and reform. In addition, many of the loans have as their key objective the delivery of primary education or basic health care to previously underserved groups and areas.

The Bank will attempt to develop feasible support strategies for microenterprise because they create

employment and increase incomes in poor communities. To this end, the Bank announced a program (Micro 2001) whose aim is to create the conditions necessary for development of the sector through: i) a favorable policy and regulatory framework; ii) solid and sustainable institutions capable of providing the services that micro- enterprises demand; iii) better access to financial and nonfinancial services for low-income groups among the microentrepreneurs; and iv) continuous, permanent flows of resources for investment in microenterprise development. In the next five years the Bank plans to finance microenterprise operations of more than \$500 million.

The Bank will continue to support social investment funds where it can be shown that their investments in poverty stricken areas have had a significant impact on either the living conditions or earnings prospects of the poor. It will also explore the possibility of expanding productive infrastructure and rural development projects, and special programs for indigenous people. For countries caught in adjustment crises the Bank will also stand ready to help to develop and finance social safety net programs to protect the poor.

Improving Targeting Mechanisms Within Projects

Project managers should attempt to build in mechanisms which will increase the proportion of project benefits that go to the poor. Two examples are geographic targeting and means testing. Poverty maps, recently developed in connection with social investment fund projects, permit quite exact targeting of projects to poor communities. Means testing is more appropriate for cash transfer programs such as family allowances, food subsidies and pensions.

Another way to improve targeting is to empower the poor by giving them a greater role in the design and selection of projects. Community participation in project design should ensure that more of what is built is beneficial to the poor and desired by them.

Measuring the Poverty Impact of Bank Projects

If the Bank is going to focus so much of its lending program on poverty reduction, it needs to know what impact its loans are having on poverty. However, before doing that, project objectives must be clear. Many projects, particularly in the social area and the reform of the state, are not intended to raise the income of the poor but to improve living conditions. Thus, for projects such as slum upgrading, and provision of water, sewage or primary health care services, it makes little sense to measure project impact by reductions in income-based poverty indices. Rather, in such cases poverty measures should be based on lack of basic needs. The general point is that the impact measure to be used must depend on the type of project and its objectives.

For projects whose objective is increasing the earnings of the poor, project impact should be measured by an income-based poverty index. However, the difficulties of conducting such analyses are formidable. In the first place, poverty is affected by many things other than Bank projects and therefore no simple comparison of poverty before and after the project is defensible. Second, even if the first difficulty could be overcome, good baseline poverty data which can be compared to ex post poverty estimates are rarely available. Third, there is a conceptual problem in many projects of what benefits to include. Consider primary education projects, for example. In the short run some temporary benefits may go to workers employed in building schools. Permanent benefits, however, will accrue to the children whose education has been improved. The poverty impact of better education will not be realized until those children enter the labor force years after the project is completed, which places it beyond the time frame relevant for most impact studies.

It probably is not feasible to develop a consistent

impact monitoring methodology that can be applied to all projects. What can and should be done instead is to undertake qualitative analysis of a select sample of poverty-targeted projects. That analysis might be based on beneficiary questionnaires, in which case it would be anecdotal and descriptive. Or, for a smaller sample of projects, it could be based on a more sophisticated quantitative impact study to determine the effect of the project either on the income of the poor or on their unfulfilled basic needs.

FINAL CONSIDERATIONS

There is a tendency within the Bank to think that it is through loans, particularly those in the social sectors, that poverty can be reduced. That approach finds expression in the Eighth Replenishment targets on lending for social equity and poverty reduction referred to above. However, this view of the problem is too narrow. Poverty is a cross-cutting problem involving many areas in addition to the social sectors. Therefore, a successful approach to poverty should reflect that cross-cutting characteristic. All the operating divisions of the Bank have a role to play: the social divisions for projects in education, health and the provision of basic necessities; the environment divisions for projects in agriculture and rural development; the infrastructure divisions for rural road projects and other construction projects; the country departments for the analysis of conditions and policies that affect the poor; and the central departments for underlying research on the links between policy and poverty in different country settings. If we can bring all these potential sources of progress together in a coordinated attack on the causes of poverty, the Bank and the countries of the region will be able to make a significant contribution to improving the living standards of the poor.