INTER-AMERICAN DIALOGUE

Social Policy

Protecting Latin America's Poor During Economic Crises

IN THIS BRIEF:

History tells us that economic crises cause large increases in poverty and slow down or reverse progress in key social indicators, such as infant mortality and average years of schooling. They may also increase income inequality. The most recent economic crisis will cause Latin America's GDP to contract around 2 percent in 2009. And it comes on top of the negative effects that rising food prices have had on the poor since 2006. Although it is too early to tell whether the impact of the crisis on poverty will be lasting, one thing is clear: the poor will suffer while the crisis lasts.

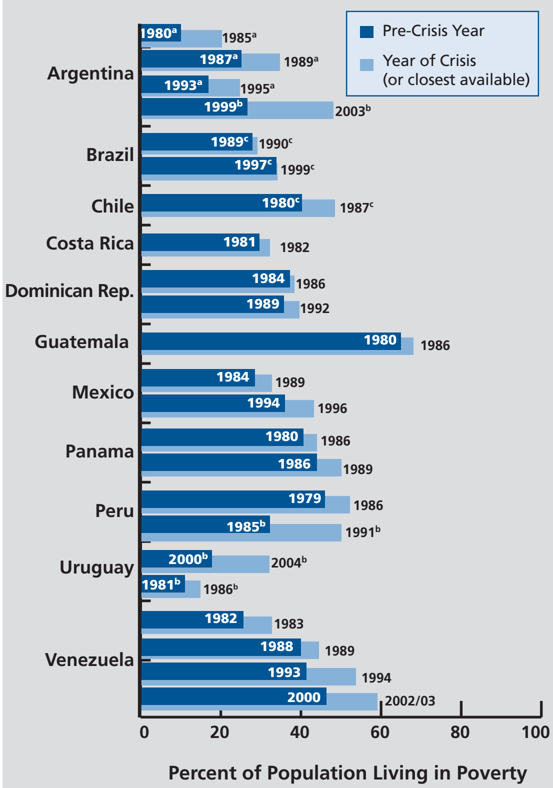
During economic crises, governments frequently adopt fiscal austerity measures without adequately considering their impact on the poor. Even when governments try to protect the poor, they often lack the information, resources and institutional capacity to do so quickly and effectively. Only a few have social safety nets in place and ready to scale up. In what follows, we discuss how past economic crises affected poverty, education and health in Latin America, and suggest a pro-poor policy response in three areas: the macroeconomic policy mix, the composition of fiscal adjustments and social safety nets.

How Economic Crises Affect Poverty, Education and Health

Poverty virtually always increases during economic downturns and can persist well into the post-crisis period. Figure 1 shows trends in poverty during past economic crises in several countries in Latin America. Poverty grew in every country and subsided only slowly in most. In some cases, chronic poverty may have also increased. As we shall see, income declines associated with recessions can reduce (irreversibly in most cases) the meager human capital (i.e., education, health and nutrition) of poor children and thus exacerbate the inter-generational transmission of poverty.

Economic downturns can cause education indicators to deteriorate. For example, although the increase in average years of schooling for 18 Latin American countries was 1.9 years from the 1950s to the 1970s, it dropped to 1.2 years in the 1970s and 1980s due to the debt crisis.[1] In Mexico, studies suggest that secondary school enrollment would have been 11 percentage points higher in 1991 had the economy grown during the 1980s at half the rate it grew throughout the 1970s instead of the zero growth experienced during the debt crisis. Also in Mexico, growth in gross primary enrollment fell from 0.44 percent in 1994 to 0.09 percent in 1995, the year of the so-called "Tequila" crisis. In Argentina, the contagion of the "Tequila" crisis caused growth in gross primary enrollment to decline from 2.2 percent in 1993 to 0.8 percent in 1996.[2]

Figure 1. Poverty and Crises, by Country



Source: Nora Lustig. Fall 2000. Crises and the Poor: Socially Responsible Macroeconomics. Figure 1. Updated by the author. Specific sources can be obtained from the author.
Note: [a] Greater Buenos Aires ; [b] Urban areas; [c] Metropolitan areas

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Economic shocks can also have adverse effects on the health and nutrition of poor households. For example, in Mexico, infant and preschool mortality caused by nutritional deficiency rose in the 1980s, reversing the trend from the previous decade. In Argentina, daily per capita intake of protein declined by 3.8 percent in 1995, and in Venezuela it decreased by 2.9 percent in 1994.[3] During the 1988-1992 economic crisis in Peru, the infant mortality rate increased by 2.5 percentage points, amounting to an additional 17,000 infant deaths.[4]

Because economic shocks can lead to lower investments in schooling, nutrition and health, they tend to hamper efforts by the poor to accumulate human capital, making it more difficult for them to grow out of poverty. This can be devastating for the poor and bad for the overall performance of the economy because lower levels of human capital slow down growth.

Avoiding economic crises should therefore be a top priority in any anti-poverty strategy. Governments should stress policies that reduce vulnerability to both internally and externally caused economic crises. These include avoiding over-expansionary fiscal and monetary policies, seriously overvalued exchange rates, unsustainable current account deficits, excessive expansion of credit to the private sector and lax regulation of the financial sector. Sound macroeconomic and financial management is the first step in protecting the poor. Even when governments manage their economies responsibly, however, crisis can be induced from the outside, as happened during 2008-2009.

A Pro-Poor Response to Economic Crisis

When crisis strikes, a pro-poor response should include the following five objectives:

1. Help poor households maintain their consumption.
2. Ensure that the poor do not lose whatever access they have to basic social services.
3. Prevent permanent reversals in the human, financial and physical capital of the poor.
4. Avert self-defeating behavior such as criminal activity, substance abuse, prostitution, and exploitative forms of child labor.
5. Protect the most vulnerable members within the household (children, women, the elderly, and the sick) from bearing the brunt of adjustment.

These objectives should be pursued in three key policy areas: the macroeconomic policy mix, the composition of fiscal adjustment and social safety nets.

The Macroeconomic Policy Mix

An optimal response to economic crisis should minimize any negative impact on the country's economic growth. Doing so will benefit all citizens, including the poor. Ideally, countries should be able to implement counter-cyclical measures to avoid (or at least soften) declines in economic activity.

Implementing counter-cyclical measures requires resources—either internal or external. Internal resources are generated by putting aside fiscal resources or international reserves during good times to use when times are bad. In Latin America, Chile appears to be the only country that established a "rainy-day" fund it could use during the recent crisis. More commonly, countries have not set aside their own resources to cushion adverse shocks, nor is it clear that doing so would be the best course of action. That is why multilateral institutions, especially the International Monetary Fund (IMF), were created. The more the IMF and the development banks help countries implement counter-cyclical measures, the less economic activity will decline and the less the poor will suffer.

Yet some countries, particularly those with badly managed public finances or extremely limited fiscal space, will still need to impose fiscal cutbacks to overcome the crisis. In these cases, the role of multilateral organizations should be to help make the adjustment gradual, avoiding sharp falls in economic activity concentrated in one or two years that can have a very negative impact on all citizens, and especially on the poor.

In sum, generating the space to implement either counter-cyclical measures or a gradual adjustment is a key ingredient in a pro-poor strategy for managing economic downturns.

The Composition of Fiscal Adjustment

How governments raise revenues and cut public spending has important implications for whether the poor are protected during economic crises. Programs that are important for the poor—such as basic education, preventive health care, targeted income or in-kind transfers, water and sanitation provision, rural infrastructure, slum upgrading, minimum pensions and workfare programs—should be relatively protected. Spending on programs that primarily benefit the non-poor (e.g., general subsidies on goods largely consumed by the non-poor such as gasoline or tuition-free tertiary education and investments in recreational infrastructure for the non-poor) should be either slimmed down or postponed during times of fiscal austerity.

In practice, fiscal austerity programs are often not pro-poor. In the interest of time, governments sometimes opt for proportional cuts to all programs so as to minimize bureaucratic infighting or secure legislative approval. Powerful interest groups may pressure effectively for protecting their programs. Often, governments lack the information necessary to target the poor effectively.

To address these problems, governments and legislatures should agree in advance on a ranking of programs in terms of their benefit to the poor, and apply those priorities when budget cuts must be implemented. Government agencies should be required to prepare assessments that help policy-makers identify effective pro-poor programs that deserve protection during a crisis. Multilateral lending institutions can play an important role in this process by advocating pro-poor fiscal austerity measures and adopting social conditionality requirements in their lending.

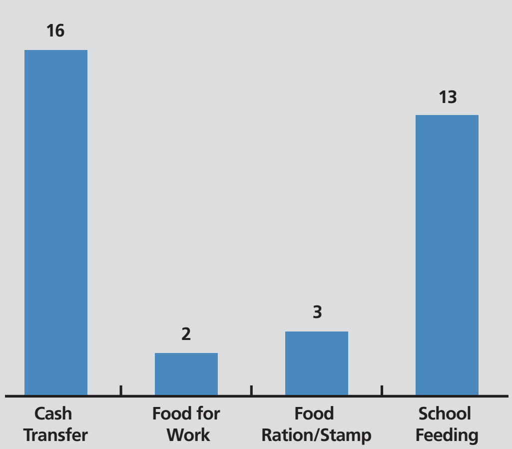
Social Safety Nets

Safety nets are crucial in protecting the poor during economic downturns. They can mitigate the impact on poor people's incomes (through workfare programs and cash transfers, for example) and help avoid irreversible damage to the human capital of the poor by enabling parents to keep their children in school, and receiving adequate healthcare and nutrition (through conditional cash transfers, school feeding programs, food-for-work, food rations, and fee waivers for essential social services). Safety nets should be established and operating before crises occur, rather than developed as ad hoc emergency measures.

Unfortunately, many countries still need to introduce or substantially improve their safety net programs. Figure 2 shows that, of the 17 Latin American countries for which we have data, all have some sort of safety net in place. However, many of the programs are limited in scale and unable to expand benefits and recipients sufficiently in times of crisis.

Examples of safety nets that work well can be found both inside and outside Latin America.[5] To be effective, safety nets should feature a wide range of programs, including workfare or public works programs, cash transfers (conditional or unconditional), scholarships for poor children, school feeding programs, food-for-work, food subsidies, social funds, and fee waivers for essential services. Which mix of safety net programs is appropriate will depend on the characteristics of the poor and the vulnerable, the type of crisis, and the government's institutional and administrative capacity.

Figure 2. Countries with Safety Nets in Latin America and the Caribbean



Source: Nora Lustig. Nov 2008. Thought for Food: The Challenges of Coping with Soaring Food Prices. Working Paper 155. Washington DC: Center for Global Development. Figure 17. Data from the World Bank.
Note: Countries without data are not included in this figure.

Some poverty reduction programs, such as the conditional cash transfers in Brazil (Bolsa Familia) and in Mexico (Oportunidades), simultaneously provide a consumption floor and protect the human capital of the poor, particularly of poor children. In order to act as "true" safety nets, however, these programs—which were developed to address chronic poverty rather than poverty resulting from adverse economic shocks—will need to add mechanisms to incorporate the "new" poor and increase the size of the benefits, and be able to roll the expansion back once the effect of the crisis subsides. The latter is not simple to implement.

During crises, incomes decline among other things because unemployment goes up. Unemployment exacerbates poverty among the already poor and causes some of the non-poor to become poor. Workfare programs, which offer wages in exchange for work, can function as effective safety nets.[6] These programs work best when the wages offered are low compared to market wages for unskilled workers, so that they self-target, appealing only to those who have few employment alternatives. These programs can be even more valuable if they are designed to provide training for unskilled and poor workers, and contribute to the social and physical infrastructure of poor areas.

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Governments are sometimes wary of introducing safety nets in the middle of a crisis because of their fiscal cost. However, the costs of safety nets need not be large (from 0.2 to 0.7 percent of GDP depending on country and program) even if they reach a large number of beneficiaries.

Summing up

Economic crises are particularly hard on the poor, because the poor have the least capacity to withstand a decline in income. The incidence and depth of poverty grow during economic crisis. Due to its negative impact on education, nutrition and health, economic crisis not only causes poverty to rise in the short term, but also contributes to the inter-generational transmission of poverty. Thus it is crucial that responses to economic crisis take the poor into consideration.

> "Developing a safety net system that helps the poor cope with economic crises... should be given top priority."

In particular, it is very important that countries be able to implement counter-cyclical policies or gradual fiscal adjustments. Here the role of organizations like the IMF is crucial: international financial organizations can provide resources to create space for the least painful macroeconomic response possible. If spending must be reduced, those programs that particularly benefit the poor should be protected. Finally, governments should adopt social protection measures that can shield the poor and near-poor from the effects of economic crisis. In general, Latin America has not established these instruments. Most existing anti-poverty programs were designed to address chronic poverty and lack the ability to expand when economic crisis causes incomes of the poor to fall, and the number of poor to rise. Developing a safety net system that helps the poor cope with economic crises and other adverse shocks should be given top priority in the policy agenda.

NOTES & REFERENCES

1. Behrman, Jere R., Suzanne Duryea and Miguel Székely. Nov 1999. Schooling Investments and Aggregate Conditions: A Household Survey-Based Approach for Latin America and the Caribbean. Working Paper 407. Washington DC: Inter-American Development Bank.
2. To be sure, economic downturns reduce the temptation to leave school and go to work by making jobs scarce. As a result, high school enrollments have sometimes increased during recessions. But for children in primary school, the negative effects of falling incomes appear to be more important, causing poor families to take children out of school or postpone enrolling them in first grade. Having social safety nets in place when an economic crisis hits would almost certainly increase enrollments and reduce drop-outs.
3. Lustig, Nora. Ed. 1995. *Coping with Austerity: Poverty and Inequality in Latin America.* Washington DC: Brookings Institution Press.
4. Lustig, Nora. 2000. Crises and the Poor: Socially Responsible Macroeconomics. *Economía: The Journal of the Latin American and Caribbean Economic Association* 1(Fall 1): 1-45. Washington DC: Brookings Institution Press.
5. See, for example, Grosh, Margaret, Carlo del Ninno, Emil Tesliuc and Azedine Ouerghi. 2008. *For Protection and Promotion: The Design and Implementation of Effective Safety Nets.* Washington DC: World Bank & Inter-American Development Bank. 2000. Social Protection for Equity and Growth. Washington DC: Inter-American Development Bank.
6. Lipton, Michael and Martin Ravallion. 1995. Poverty and Policy. *In Handbook of Development Economics: Volume 3*, eds. J. Behrman and T. N. Srinivasan. Amsterdam: North-Holland.

The Social Policy program is an innovative and rigorous approach to assessing and bringing public attention to Latin America's long-neglected social agenda. This is the first of a series of policy briefs that spotlight key issues of the social agenda for wider knowledge and understanding. We are pleased to recognize the assistance provided by the Canadian International Development Agency, the Norwegian Ministry of Foreign Affairs, the General Electric Foundation and the United Nations Development Programme for our work in social policy in Latin America and the Caribbean.

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