

Pro-Poor stimulus

LESSONS FROM THE DEVELOPING WORLD



BY MARTIN RAVALLION

The governments of many countries, rich and poor alike, hope to relieve the ongoing recession through a fiscal stimulus. There are macroeconomic as well as ethical grounds for believing that such a stimulus should favor the poor. Poor people tend to be more constrained—notably due to credit market failures—and so are most likely to engage in rapid consumption or investment when extra cash becomes available. A pro-poor stimulus is therefore likely to be a bigger stimulus.

Responding to a crisis invariably entails some difficult trade-offs. The most important in designing pro-poor stabilization policies is the trade-off between current and future poverty reduction.

Fiscal policies in developing countries have not generally been countercyclical, as too often the stimulus (if any) comes too late. Many developed countries, on the other hand, have built-in countercyclical stabilizers, which rely on progressive income taxes and committed social spending. These kick in when recessions hit and people begin suffering. The developing world is naturally envious of these more automatic and often pro-poor stabilizers.

Developing countries can also have automatic stabilizers, though the precise ways this is done will differ from the stabilizers traditionally found in (say) Western Europe. However, the flow of ideas about how best to respond to a crisis should not go exclusively from rich countries to poor ones. There are three reasons policymakers in countries like the United States might want to turn to poorer countries in looking for ideas about how to respond to the crisis. First, the developing world has had a lot more experience with crises of various sorts, including financial crises, famines, and natural disasters. Second, people in developing countries are familiar with the structural changes—fluidity in the composition and location of economic activity—that may well be an important part of the developed world's future in the wake of the current crisis. Third, governments in developing countries have experimented with a wider range of programs intended to protect the poor from various sources of risk, including financial crises. The programmatic details on the expenditure side of developing countries' public budgets provide a rich set of lessons, with both successes and failures having instructive value.

A crisis is an opportunity for learning and for reform. While political-economy constraints loom large (regardless of whether a country is rich or poor), crises can open up possibilities for serious reforms. Past crises in developing countries have at times led to the dismantling of failed social policies, such as generalized food and fuel subsidies that have come at a huge fiscal and economic cost and yet have had at best only a modest impact on poverty. The current crisis is an opportunity for developing countries to create more automatic and pro-poor stabilizers—recognizing that this is not the first, nor last, time they will be needed. But it is also an opportunity for developed countries like the United States to redesign their stabilizers, in some cases learning from the experiences of antipoverty initiatives in developing countries, though adapted to their new settings.

Responding to a crisis invariably entails some difficult trade-offs. The most important in designing pro-poor stabilization policies is the trade-off between current and future poverty reduction. This trade-off arises in most aspects of the policy responses to a crisis, including macroeconomic and financial sector policies, as well as social protection policies. There is a real risk that, for reasons of political expediency, responses to the current crisis will come at the expense of a consideration of longer-term implications. It is encouraging that welfare reform efforts in both rich and poor countries have increasingly emphasized the role of incentives for recipients to take actions, "co-responsibilities," that help them escape poverty without handouts. Such incentives also play an important role in pro-poor stabilization.

I will illustrate these points by discussing two classes of programs: targeted cash transfers and relief work schemes. These programs are best viewed as complements rather than substitutes. Relief work can provide extra income for those who are able to work, and can help address the chronic deficiencies in infrastructure and services in poor areas. Transfers can then be targeted to individuals who either cannot work (for example, due to physical incapacity or poor nutritional status) or should not be taken out of other non-work activities (notably school). Both types of programs face a number of challenges in design and implementation, and the United States can learn some valuable lessons from developing countries about how to meet those challenges.

Conditional Cash Transfers

A number of developing countries have implemented transfers targeted to the poor that come with certain co-responsibilities. These are called conditional cash transfer (CCT) programs. A typical CCT identifies eligible families using a set of readily measured proxy indicators of poverty. (The criteria are, of course, country-specific.) The transfer

payment is then made to parents (sometimes explicitly to the mother) conditional on specific desired and verifiable behaviors. For example, the transfers to parents may require that teachers verify that children are attending school regularly; conditions on health care and nutritional practices are also sometimes added. These co-responsibilities mean that the transfers reduce (often substantially) the cost of schooling and health care for poor families, including forgone income from child labor. Early influential examples of CCT programs were Bangladesh's *Food-for-Education Program*, Mexico's *PROGRESA* program (now called *Oportunidades*), and Brazil's *Bolsa Escola* (followed by *Bolsa Família*). A recent World Bank report, "Conditional Cash Transfers,"¹ reviews the large body of evidence on these programs, the bulk of which suggests that they are effective in improving children's schooling and health care, while simultaneously providing material relief to poor families. Importantly, CCTs have made redistribution in favor of the poor politically acceptable, particularly in Latin America, where inequality is worryingly high.

But aren't such programs particular to the chronic education and health problems plaguing developing nations? Not necessarily. The developed world has also started to notice the success of these "smart transfers." In 2007, New York City introduced a CCT, *Opportunity NYC*, which is modeled on these programs in developing countries (stemming from the participation of New York officials in a World Bank conference on CCTs). In addition to education and health incentives, *Opportunity NYC* includes incentives for adult skill development and training. Other U.S. cities trying to help protect their poor during this recession could usefully look at NYC's experiment in adapting the CCT idea to a developed-country setting.

Such programs strike a balance between reducing current poverty and reducing future poverty. The transfer itself has an immediate effect on poverty, but the conditional nature of the transfer aims to induce behavioral change that also translates into long-term poverty reduction. Behavioral change is a key element, insofar as the newly incentivized behaviors are demonstrably important to future prospects of escaping poverty.

CCTs have also tried to change the distribution of resources *within* households. The behavioral conditions can ensure that relatively more of the gains (often realized later in life) accrue to children and teens. By targeting the transfers to women in poor families, one can help reduce both current and future poverty, since transfers to women tend to benefit children more—in terms of their nutrition, health, and schooling.

There are many design issues to consider. The practices used for assessing eligibility and monitoring payments need to be technically feasible given local administrative capabilities, yet sufficiently sound to assure that the program achieves its aims. Local governments and community organizations can often help, as they tend to be better informed about who is in need. This can involve a trade-off, however, given that local governments are subject to local resource constraints and problems of local elites capturing resources intended for the poor.

An important challenge is making CCTs responsive to

changes in need. Design features, such as indexing benefits and compulsory regular updates to eligibility lists, can assure that a CCT helps provide an automatic stabilizer. Many countries have responded to various crises by expanding the coverage and increasing the benefit levels of CCTs. Mexico, for example, was able to help redress the adverse impacts of 2008's steep rise in food prices by implementing a one-time top-up payment to *Oportunidades* participants. Brazil has rapidly expanded the coverage of its *Bolsa Família* program in response to the current crisis.

The co-responsibilities are also a key design feature. Naturally, each program must be adapted to its context. In a poor country the desired behaviors might be completing primary school, while in a middle-income country the focus will tend to be on secondary school. In a developed country, such behaviors may well include postsecondary education and qualifications. Health care conditions will similarly vary—for instance, in the United States, co-responsibilities might include participation in "eat well, play hard" programs designed to prevent childhood obesity. The conditions may also need to change in a crisis. In poor countries, kids tend to be taken out of school to work in a recession, while in more developed countries they are more likely to stay in school at such times. Each country needs to identify the most relevant list of behaviors that need to be encouraged, and be willing to revise the list.

Workfare

One way to make safety net programs more flexible is to build in "self-targeting" features that encourage only those in real need to seek out the program *and* encourage them to drop out of it when help is no longer required. The classic example of self-targeting is a "workfare" program, for which the co-responsibility of those seeking relief is that they must work. The type of work differs, ranging from public works projects to regular private-sector work. Provided that a workfare program is designed and implemented well, it can be very responsive to differences in need. At any given time, the support tends to go to those who need it, since those who do not will have better labor market options. And when better work opportunities emerge, workfare participants will voluntarily opt out. Longer-term poverty reduction goals can also be served by a well-designed workfare scheme, through both asset creation or service provision and the fact that work requirements can help avoid social exclusion and welfare dependency.

Workfare has been widely used in crises and by countries at all stages of development. Famously, public works programs were a key element of the New Deal introduced by President Franklin D. Roosevelt in 1933 in response to the Great Depression. Workfare programs also reemerged in various forms in the U.S. since the mid-1990s as a key element of welfare reform. There has been considerable and diverse experience with workfare programs in developing countries. They played a crucial role in the Famine Codes introduced in British India around 1880 and have continued to be important to this day in the subcontinent. Relief work programs have additionally helped in

responding to, and preventing, famines in sub-Saharan Africa. During the East Asian financial crisis of the late 1990s, both Indonesia and Korea introduced large workfare programs, as did Mexico in the 1995 “peso crisis,” Peru during its recession of 1998–2001, and Argentina in the mid-1990s and during the 2002 financial crisis.

A famous example in the developing world is the Employment Guarantee Scheme (EGS) in Maharashtra, India, which started in the early 1970s as part of a (successful) effort to avoid a famine. EGS aims to assure income support in rural areas by providing unskilled manual labor at low wages to anyone who wants it. The guarantee means that people know it is there whenever they need it. In 2004, India introduced an ambitious national version of this scheme under the National Rural Employment Guarantee Act. The act promises to provide up to 100 days of unskilled manual labor per family per year to anyone who wants it in rural India. The scheme aims to provide much needed social insurance and to empower poor people.

Realizing the insurance and empowerment benefits for poor people depends crucially on the budget allocation to the scheme, which must be sufficient to cover the demand for work at the wage rate offered. If the scheme is under-funded relative to the wage rate set by the government (or, in what amounts to the same thing, the wage rate is set too high relative to the budget) then rationing of work will be required.

Research on these programs has indicated sizeable income gains to participants, net of their forgone income from any work they gave up to join the program, though the extent of those gains will naturally depend on local labor market conditions. There is less evidence, however, on how much in the way of assets such workfare programs generate. This can matter greatly to whether a workfare program is superior to simple cash transfers in terms of the impact on poverty for a given budget outlay. Here we encounter the trade-off mentioned above. Because workfare programs absorb large amounts of labor on specific projects during a crisis, it can be difficult to create durable assets. Although one wants to provide widespread relief during a crisis, the result is that asset creation does not occur to the extent one would want, and long-run poverty relief is thereby compromised. Balancing the long-run and short-run goals is difficult, as both are of value, even in a crisis.

Argentina’s *Trabajar* program illustrates the potential for a new wave of workfare programs that emphasize asset creation in poor communities. The program’s design gave explicit incentives (through the *ex ante* project selection process) for targeting the work to poor areas. There is typically much useful work to do in poor neighborhoods—work that would probably not get financed otherwise. Similar to CCT programs, this type of program aims to address current poverty as well as reduce longer-term poverty by creating assets.

Thus past experience in developing countries points to some key design features. An ideal workfare scheme will guarantee low-wage work on community-initiated projects. The work should be proposed by bona fide community groups in poor areas to assure that the relief effort is responsive to the needs of local communities and that the assets created are of value to the poor. The government should contribute to non-wage costs only if the community putting up the proposal is a designated poor area, as indicated by the best available “poverty map.” The government might finance up to, say, 15 days a month of work on community projects for any adult at a wage rate no higher than the market wage rate for unskilled manual labor in a normal year. Setting a sensible wage rate assures that the scheme is self-targeted, as the non-poor will rarely want to participate, while preserving incentives for participants to take up other work when the economy recovers. (As with CCTs, the right incentives are crucial for success.) The scheme would rely very little on administrative discretion in access to the program. As long as the guarantee is credible, it will help empower poor people and reduce the longer-term risks that they face, as well as provide much needed extra earnings.

Toward a Pro-Poor Stabilization Policy

Rich and poor countries can learn from each other about how best to devise smart social protection policies that provide rapid automatic stabilizers, thus simultaneously addressing the macroeconomic problem of a recession and the need to protect the poor. While there is much we still do not know about the impacts of safety net programs, the evidence from past evaluative research suggests that a significant share of the poorest can be protected in a crisis without damaging their long-term prospects of escaping poverty, indeed possibly even enhancing them. The developed world can usefully look to the experience of the developing world in how to promote desired behavioral change and improve infrastructure and services in poor areas, while also buffering some of the risks that inevitably emerge in any economy.

Martin Ravallion is Director of the World Bank’s research department. The views expressed here are those of the author and need not reflect those of the World Bank or its member countries. A fuller discussion of some of the issues raised here and references to the literature can be found in the author’s paper, “Bailing Out the World’s Poorest,” Challenge, March 2009, pp. 55–80.

Notes

1. Available at: <http://go.worldbank.org/UQEJK2J5Eo>