

OVERVIEW

LEFT BEHIND

CHRONIC POVERTY
IN LATIN AMERICA
AND THE CARIBBEAN

Renos Vakis, Jamele Rigolini
and Leonardo Lucchetti



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This booklet contains the Overview as well as a list of contents from the forthcoming book *Left Behind: Chronic Poverty in Latin America and the Caribbean*.

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A successful decade with challenges ahead

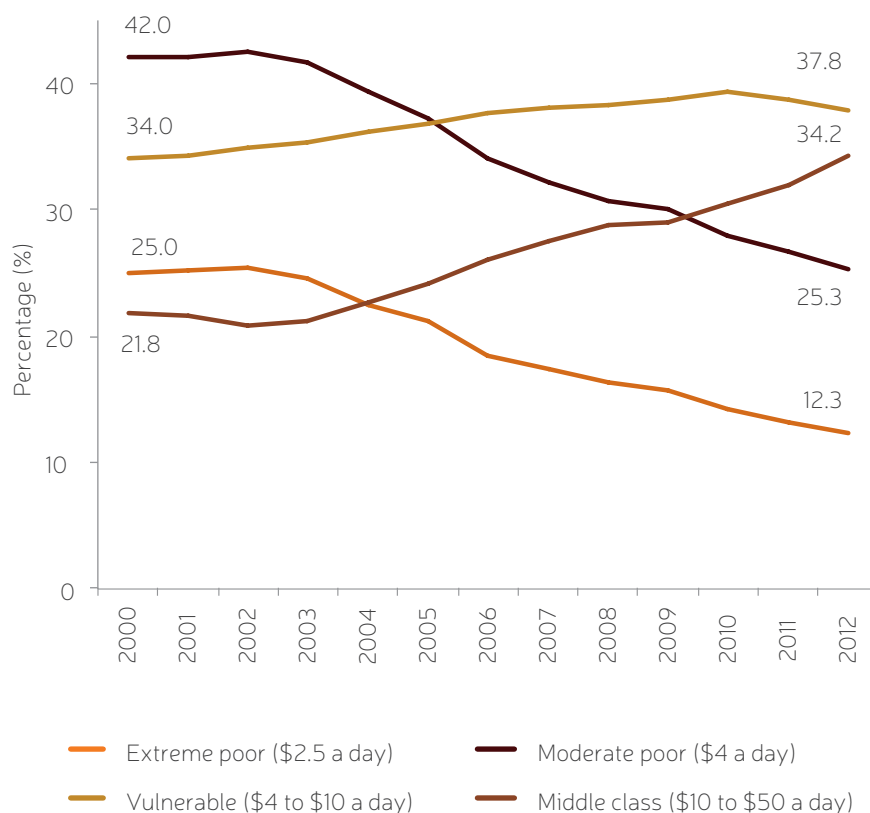
BY MOST MEASURES, the 2000s were one of the most impressive decades for economic development in Latin America and the Caribbean (LAC). With the exception of 2009, the region's gross domestic product per capita grew consistently at an average rate of 2.5 percent between 2000 and 2012. During the same period, and despite being one of the most unequal regions in the world, inequalities reduced substantially. The regional Gini coefficient for per capita income, for instance, decreased by an unprecedented five percentage points, from 0.57 in 2000 to 0.52 in 2012.

Sustained economic growth, joint with substantial reductions in income inequality, led to remarkable increases in the incomes of those at the bottom of the income distribution. Accordingly, poverty in LAC decreased by more than 16 percentage points within a single decade, from 41.6 percent in 2003 to 25.3 percent in 2012. Furthermore, extreme poverty was cut in half, from 24.5 percent to 12.3 percent (Figure 1).¹ Overall, a remarkable 70 million people moved out of poverty: the strongest poverty reduction performance of the region in decades.

Another facet of the dramatic reduction in poverty was the emergence of a large middle class,² which increased from about 23 percent of the population in 2003 to 34 percent in 2012, and in 2010 for the first time exceeded the number of people living in poverty (Figure 1). Nevertheless, LAC is not yet a middle class region: most people exiting poverty did not join the ranks of the middle class, but the ranks of a “vulnerable” class that remains at risk of falling back into poverty. The predominance of the vulnerable class in LAC is changing the social policy dialogue in the region, where recent concerns have focused on how to establish more integrated safety nets for people who have managed to exit poverty but still remain vulnerable (Ferreira et al 2012).

In spite of these dramatic advances, one in four Latin Americans today remain poor. Those who experience shocks that cause them to fall temporarily into poverty are considered to be the “transitory poor”. However, many people are born into poverty and never escape their poverty status: these are the “chronic poor”. The chronic poor have not benefitted much from the impressive growth rates of the 2000's and may have fallen into the cracks of the social assistance system; they have been left behind. Furthermore, the prospects of them escaping poverty in the near future are weak. GDP growth has slowed significantly, from about six percent in 2010 to an estimated 0.8 percent in 2014. As a result, improved labor market prospects may not prove to be sufficient for the chronic poor to escape poverty.

Figure 1: Poverty, vulnerability, and the middle class in LAC (2000-2012)



Source: World Bank (2014) using SEDLAC data (CEDLAS and the World Bank). Note: Estimates of poverty, vulnerability, and the middle class at the regional level are population-weighted averages of country-specific estimates. Poverty lines and incomes are expressed in 2005 US\$ PPP per day. PPP = purchasing power parity.

Nonetheless, while economic growth alone may not be sufficient to lift the chronic poor out of poverty, some policies could. This book studies chronic poverty in Latin America and the Caribbean. It identifies the chronic poor, explores their lives, and evaluates factors that may prevent them from escaping poverty. Based on a deeper understanding of chronic poverty in the region, the book concludes by discussing policy design elements that could be integrated into development and social assistance policies in order to more effectively support the chronic poor.

A framework to study chronic poverty

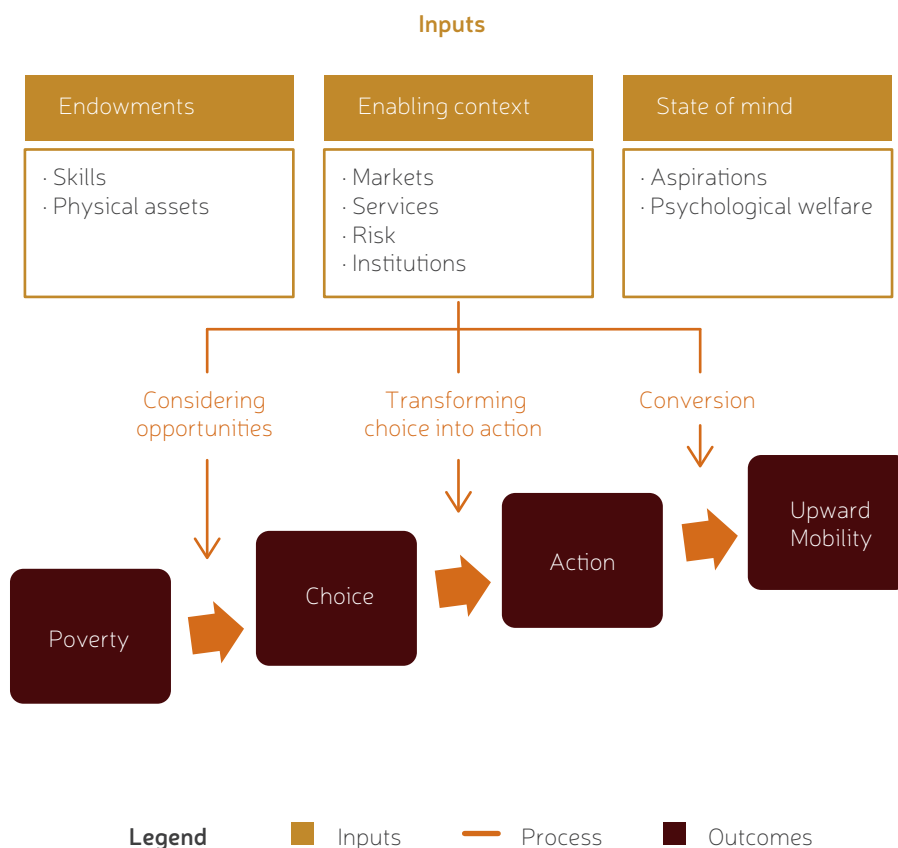
STUDYING CHRONIC POVERTY INVOLVES BOTH CONCEPTUAL and empirical challenges. Conceptually, chronic poverty is a notion that involves both a welfare and a time dimension: it is therefore complex in nature. In this book we use a simple conceptual framework to order our thoughts of what characterizes and drives chronic poverty. The framework involves the close interaction of two features: a set of *inputs* that influence the *process of upward mobility*. The first concept draws from existing literature on poverty traps, while the second draws from Sen's capabilities approach (see also Carter and Barrett 2006, and Cord and Lopez-Calva 2012).

Figure 2 summarizes our framework. We divide inputs into endowments, the enabling context, and the state of mind. First, poverty exists and persists due to constraints which prohibit the optimal accumulation and use of existing endowments, such as skills and physical assets. Second, an enabling context is also a necessary input: poverty chronicity may arise not because endowments are low per se, but because of factors that affect the returns to those endowments differentially. In other words, households with similar endowments that live in different contexts may face different trajectories in life.

The third input is *the state of mind* which plays a central driver of chronic poverty. An emerging field of research studies the ways in which the state of mind may affect people's life trajectories and the resulting implications for social policies, and as such we give it special attention (see also the 2015 World Bank's World Development Report). Behavioral factors are especially important in understanding chronic poverty, as it has been established that the condition of poverty places additional and excessive pressure on people, influencing their state of mind and decision making process in a more pronounced way than for wealthier people. These constrained mental resources influence the process of decision making in a wide range of ways, which may perpetuate poverty across generations. Constrained mental resources can lead to placing greater focus on short-term rather than long-term problems, even if focusing on long-term issues would lead to better outcomes over time (Banerjee and Mullainathan, 2010). For example, the fact that people in poverty must devote much of their mental resources to tackle survival - problems associated with their basic needs can lead to underinvestment in their children's upbringing.

Another key aspect of the state of mind is the role of aspirations, or the presence of forward-looking goals and a preference to attain them (Locke and Latham 2002). Sen's capability approach makes it clear that a weak capacity to aspire can reduce the capability to act in order to achieve the desired outcomes. For instance, a weak capacity to aspire is associated with a limited temporal horizon that could translate into low savings, opting out of good investments, or

Figure 2: From chronic poverty to upward mobility: inputs and the process



engaging in adverse behaviors. “*Hopelessness destroys both the will and the ability to invest in one’s future and oneself*” (Duflo 2012). Put differently, poverty may generate poverty.

Inputs are relevant insofar as they influence the process of upward mobility. Understanding such a process is therefore also important. The first step is to “engage in decision making.” Consider the decision making process involved in choosing to participate in an income generation opportunity. An individual may ultimately not consider a given opportunity for several reasons, including: the person i) does not know that the option exists, ii) determines based that the opportunity falls outside of his or her abilities, or iii) has low aspirations that cause him or her to think that this endeavor is likely to fail, despite one’s best efforts. The context could also amplify these effects via the presence of social norms: local peer effects may accentuate low informational flows and the formation of aspirations.

After considering an opportunity, there is a need to transform choices into “actions.” The differences between the two stages are subtle but important: considering participation begins a lengthy process in which an individual evaluates costs and benefits towards ultimately deciding whether or not to take action. The decision to take action is also affected by endowments, context, and the state of mind.

The final part of the process of upward mobility is the conversion (the more traditional part of the overall process), where again all three inputs play an important role. In general, the productivity of the investment will depend on individual ability and effort; hence, endowments such as skills and assets are central. An enabling context will also by design affect the returns: for example, an uninsured weather shock may reduce yields by destroying part of the harvest. Finally, the state of mind may also affect outcomes in this stage of the process: positive peer effects and social norms (themselves partly driven by context) may improve motivation and effort, which in turn enhance the likelihood of success (Macours and Vakis 2014).

Note that the framework remains silent on the ways in which these various elements interact with one another. There are many ways in which low levels of endowments, a disabling context, or a suboptimal state of mind can affect the different stages of the process, giving rise to a state of chronic poverty induced by different channels. This highlights the policy challenges involved in both the identification of the chronic poor as well as the design of effective policies for poverty reduction.

Measuring chronic poverty in the absence of longitudinal data

In addition to conceptual challenges, studying chronic poverty in Latin America and the Caribbean also presents an empirical challenge: the almost complete lack of longitudinal data in the region. Thus, an important contribution of this book is its methodological approach to the measurement of chronic poverty. In order to capture chronic poverty between 2004 and 2012 in Latin America, we rely on an innovative technique originally proposed by Dang et al. (2014) and improved by Dang and Lanjouw (2014), which uses information contained into repeated cross-sectional data to construct “synthetic” panels. The book contains several validation exercises that suggest that although synthetic panels are far from being a substitute to actual panels, they are among the most accurate remedies in the absence of longitudinal data.

Five facts about chronic poverty in Latin America and the Caribbean

BEFORE DELVING INTO THE DRIVERS OF CHRONIC POVERTY and their implications for policy, we discuss five stylized facts that largely characterize chronic poverty in the region. Together with our conceptual framework, we then rely on these facts to structure the policy discussion.

Fact 1: One out of five Latin Americans lives in chronic poverty

By 2012, one in five Latin Americans had been chronically poor since 2004, representing more than 130 million people (Table 1). The table also indicates that out of 100 poor people in 2004, only half escaped poverty, while about eight percent of the non-poor also fell into poverty.

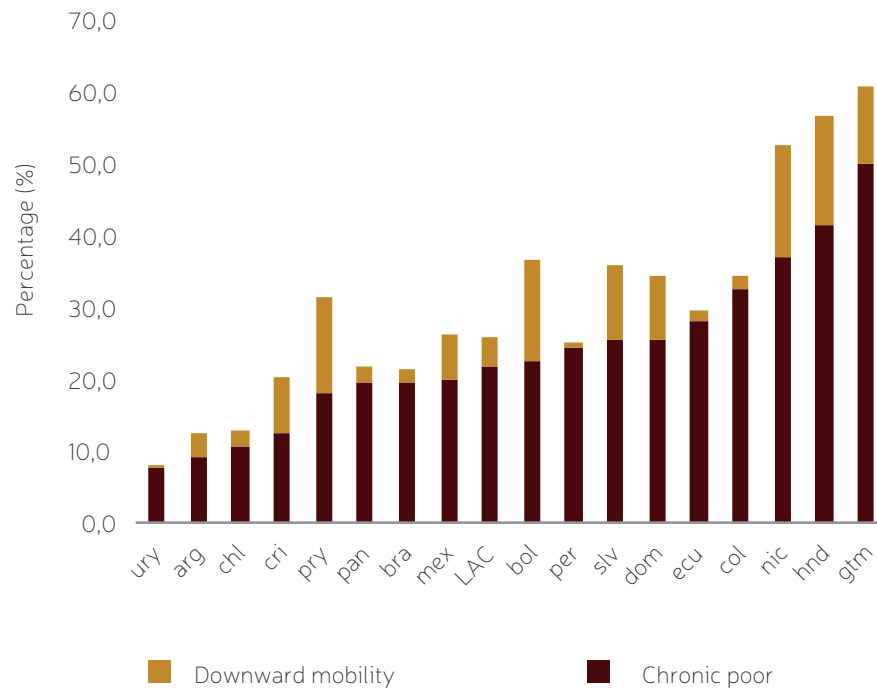
Chronic poverty and downward mobility both vary considerably across countries. Figure 3 splits the total poverty estimates between the proportion of chronic poor and those that became poor between 2004 and 2012 for each country. Uruguay, Argentina and Chile have the lowest rates of chronic poverty, with rates around 10 percent. On the other extreme, Nicaragua, Honduras, and Guatemala have rates of chronic poverty significantly higher than the regional average of 21 percent, ranging from 37 percent in Nicaragua to a shocking 50 percent in Guatemala.

Table 1. Mobility in Latin America (population shares, 2004-2012)

Year 2012				
Year 2004		Poor	Non-poor	Total
	Poor	21.6	23.4	44.9
	Non-poor	4.2	50.9	55.1
	Total	25.7	74.2	100.0

Source: Authors' calculations using SEDLAC data [CEDLAS and the World Bank]. Note: Estimates of poverty at the regional level are population-weighted averages of country-specific estimates. Country-specific figures come from 2004 or 2012 surveys, or the nearest year in cases in which 2004 and/or 2012 data are unavailable. "Poor" = individuals with a per capita income lower than US\$4. Poverty lines and incomes are expressed in 2005 US\$ PPP per day. PPP = purchasing power parity.

Figure 3. Poverty in LAC decoded: chronic and downward mobility (2004-2012)

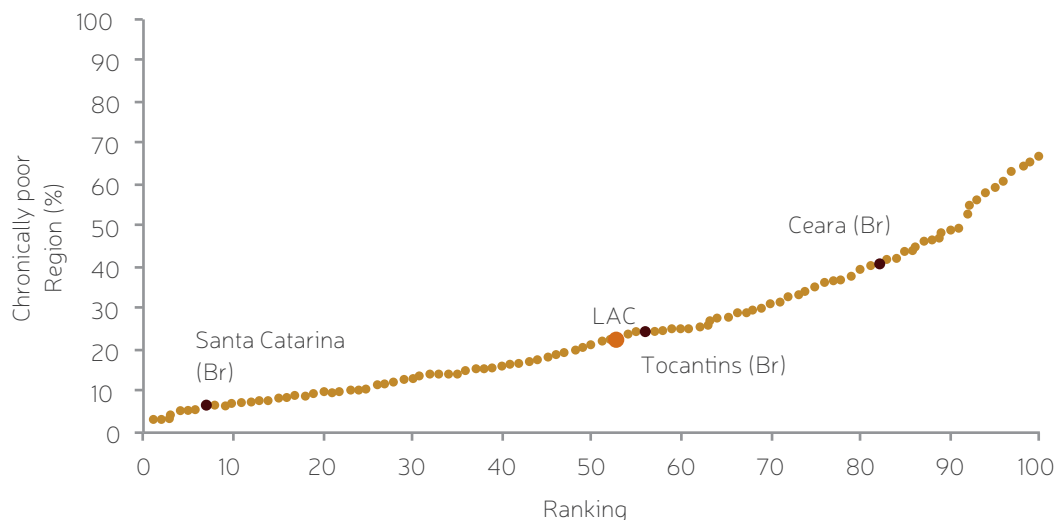


Source: Authors' calculations using SEDLAC data (CEDLAS and the World Bank). Note: Country-specific figures correspond to 2012 surveys, or the nearest year in cases in which 2012 data are unavailable. "Poor" = individuals with a per capita income lower than US\$4. Poverty lines and incomes are expressed in 2005 US\$ PPP per day. PPP = purchasing power parity. Total poverty does not necessarily match country-specific poverty rates since these are estimated based on the synthetic panel approach which uses a sub-population of households with adult household heads [see section 2 for more details].

Fact 2: Chronic poverty tends to be geographically concentrated

Geographic context characterizes chronic poverty to a great extent. Figure 4 presents chronic poverty rates at the level of subnational regions for every household survey that is representative at that level of disaggregation (for a total of 168 regions). Chronic poverty appears to vary considerably both across and within Latin American countries, with some regions showing incidence rates higher than sixty percent, while others have rates of less than ten percent. Taking Brazil as an example, *Santa Catarina* has a chronic poverty rate of about five percent, which is lower than the national average of 20 percent and close to the average for Uruguay, the best performing country in Latin America in terms of chronic poverty. By contrast, approximately 40 percent of the population in *Ceara* is chronically poor, which is twice the national average and comparable to Honduras, a country with one of the highest chronic poverty rates in the region. Finally, chronic poverty in *Tocantins* is similar to the regional average for Latin America and the Caribbean.

Figure 4. Sub-national chronic poverty in LAC (2004-2012)



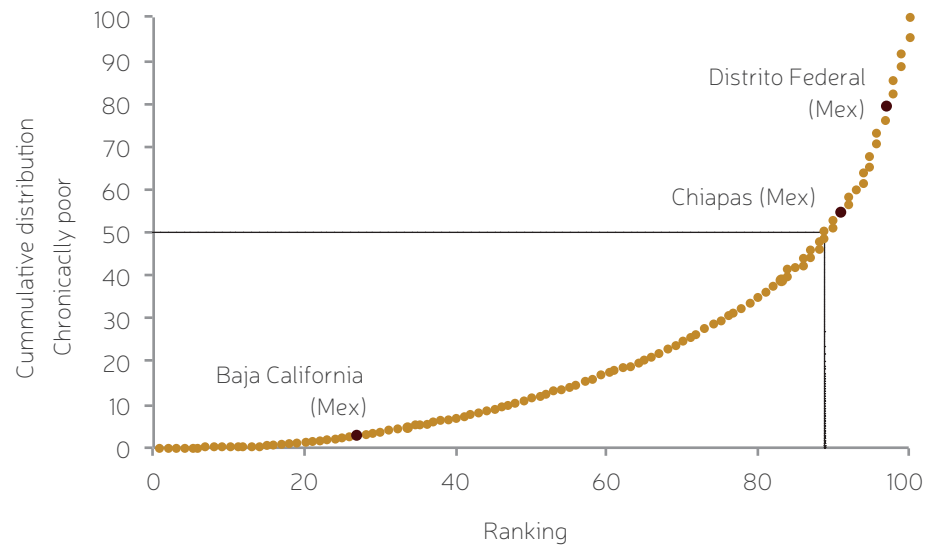
Source: Authors' calculations using SEDLAC data (CEDLAS and the World Bank). Note: All figures come from 2004 or 2012 surveys, or the nearest year in cases where 2004 and/or 2012 data are unavailable. Selection of the regions varies depending on the level of representativeness of surveys. The vertical axis presents the proportion of chronic poor in every region, while the horizontal axis presents ranking of regions based on their chronic poverty rates. "Poor" = individuals with a per capita income lower than US\$4. Poverty lines and incomes are expressed in 2005 US\$ PPP per day. PPP = purchasing power parity.

However, looking exclusively at poverty rates only provides half of the picture, as a large number of the chronic poor may reside in densely populated areas with relatively low rates of chronic poverty (i.e. regional and national capitals).

Figure 5 presents the cumulative distribution (a Lorenz curve) of chronic poor households across subnational regions (the vertical axis), sorted by the contribution of each region in terms of the absolute number of chronic poor (the horizontal axis). The figure shows that a large share of the chronic poor population is indeed concentrated in just a few regions in LAC: 20 of the 187 regions we consider - the dashed horizontal line - contain 50 percent of the chronic poor population in the continent (the dashed vertical line).

Moreover, the regions where the majority of the chronic poor reside are not necessarily the regions with the highest rates of chronic poverty: in Mexico, for instance, while the incidence of chronic poverty at the *Distrito Federal* is equal to the LAC regional average, its large population implies that in absolute terms the Mexican capital hosts almost 3 percent of LAC's chronic poor, putting it 6th (at the 97th percentile) in its contribution to the total number of chronic poor households in Latin America. In contrast, Baja California [Mexico] is home to only 0.2 percent of the region's chronic poor (34th percentile), despite exhibiting higher rates of chronic poverty.

Figure 5. Most of the chronic poor reside in a few regions in LAC (2004-2012)



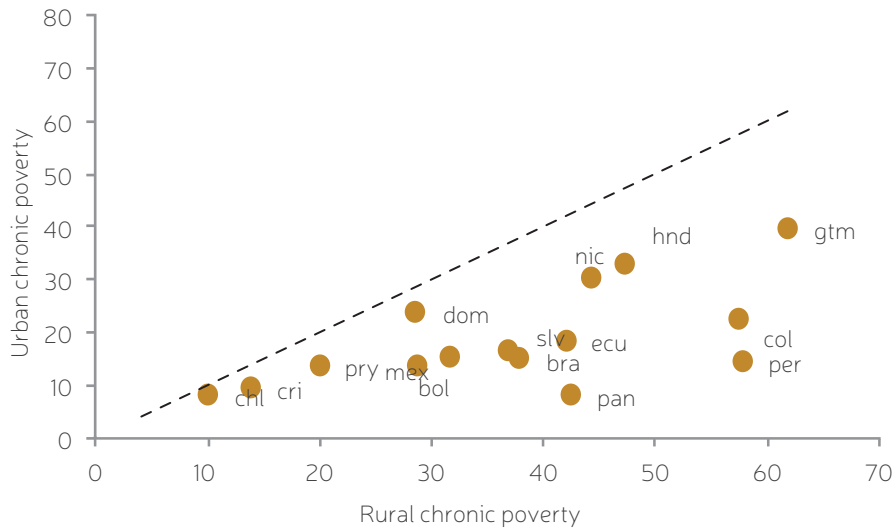
Source: Authors' calculations using SEDLAC data (CEDLAS and the World Bank). Note: All figures come from 2004 or 2012 surveys, or the nearest year in cases in which 2004 and/or 2012 data are unavailable. Selection of the regions varies depending on the level of representativeness of surveys. The vertical axis presents the cumulative distribution of chronic poor in every region, while the horizontal axis presents ranking of regions based on the number of chronic poor that they host. "Poor" = individuals with a per capita income lower than US\$4. Poverty lines and incomes are expressed in 2005 US\$ PPP per day. PPP = purchasing power parity.

Fact 3: Chronic poverty is as much an issue in urban as in rural areas

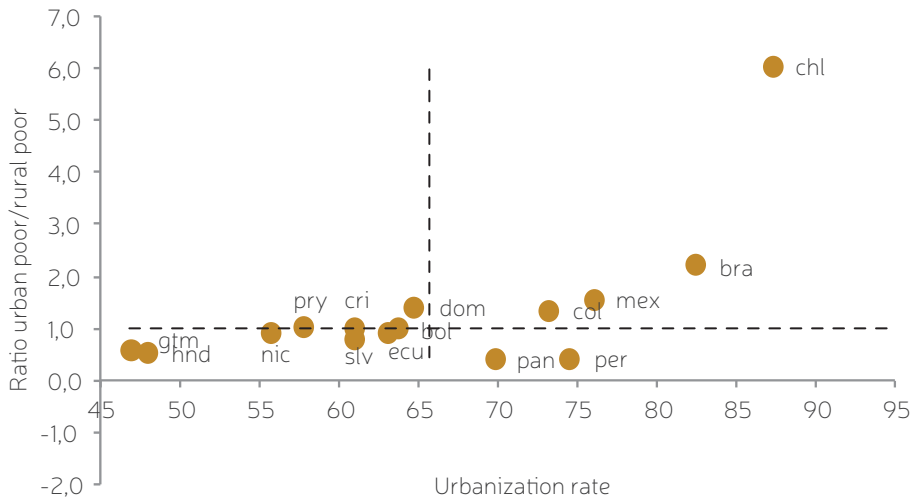
Residing in rural areas is often associated with higher poverty persistence (Figure 6a). For example, in Bolivia, with overall chronic poverty rates of around 20 percent, rural poverty chronicity is three times as large and more than 20 percentage points higher than in urban areas.

Nevertheless, despite the much higher rates of chronic poverty in rural areas, chronic poverty is as much an urban as a rural issue. Considering the absolute number of people, urban areas in many countries contain higher numbers of chronic poor between 2004 and 2012 than rural areas. Figure 6b presents the ratio of the absolute numbers of chronic poor in urban relative to rural areas (vertical axis) against the level of urbanization (horizontal axis). Numbers higher than one indicate more urban chronic poor compared to rural. The figure shows that in at least five countries (Chile, Brazil, Mexico, Colombia and the Dominican Republic), the number of urban chronic poor surpasses the number of rural chronic poor, and the number of urban and rural chronic poor is approximately equal in many other countries. In Brazil, for example, for every one chronic poor household in rural areas, there are two that live in urban areas.

6a. Rural chronic poverty rates higher than urban



6b. But many urban settings host more chronic poor in absolute numbers



Source: Authors' calculations using SEDLAC data (CEDLAS and the World Bank). Note: All figures come from 2004 and 2012 surveys, or the nearest year in cases in which 2004 and/or 2012 data are unavailable. Panel (a) plots the urban chronic poverty rate on the vertical axis and the rural chronic poverty rate on the horizontal axis. Panel (b) plots the urban to rural chronic poverty ratio in the vertical axis and the country wide urbanization rate in the horizontal axis. "Poor" = individuals with a per capita income lower than US\$4. Poverty lines and incomes are expressed in 2005 US\$ PPP per day. PPP = purchasing power parity. Dash vertical line represents the level of urbanization in LAC.

Nevertheless, the rural chronic poor tend on average to live under worse conditions than the urban poor. Chronic poor households in urban areas tend to have relatively better economic opportunities and tend to be smaller in size than chronic poor households residing in rural areas. Additionally, chronic poor heads of households in urban areas have on average six years of education, compared to less than four years of education on average for their rural counterparts.

Fact 4: Economic growth was not sufficient to lift the chronic poor out of poverty

The impressive economic growth of the 2000s had little positive impact on the lives of the chronic poor for two main reasons. First, countries with the highest rates of chronic poverty grew the least. For example, Guatemala grew less than one percent per year, with approximately 50 percent of the initial poor still mired in poverty in 2012. On the other hand, Panama grew 6 percent annually, with only 20 percent of the population trapped in poverty between 2004 and 2012.

Second, chronic poor households tend to be poorer than originally poor households who managed to escape poverty, rendering economic growth insufficient to lift them out of poverty. Panel (a) in Figure 7 presents the initial and final income levels of those who exited poverty between 2004 and 2012. Those who were initially poor in 2004 but escaped poverty by 2012 earned initially a per capita income of \$3 a day in 2005 PPP terms, and their net increase was almost \$3, leading to a median income of \$6 a day in 2012. These trends are generalized in almost all of the 17 countries in this analysis. Meanwhile, panel (b) shows that although the chronic poor also experienced income growth during this period, with median incomes growing from \$1.50 to \$2.70 per day, this income growth was not sufficient to lift them out of poverty.

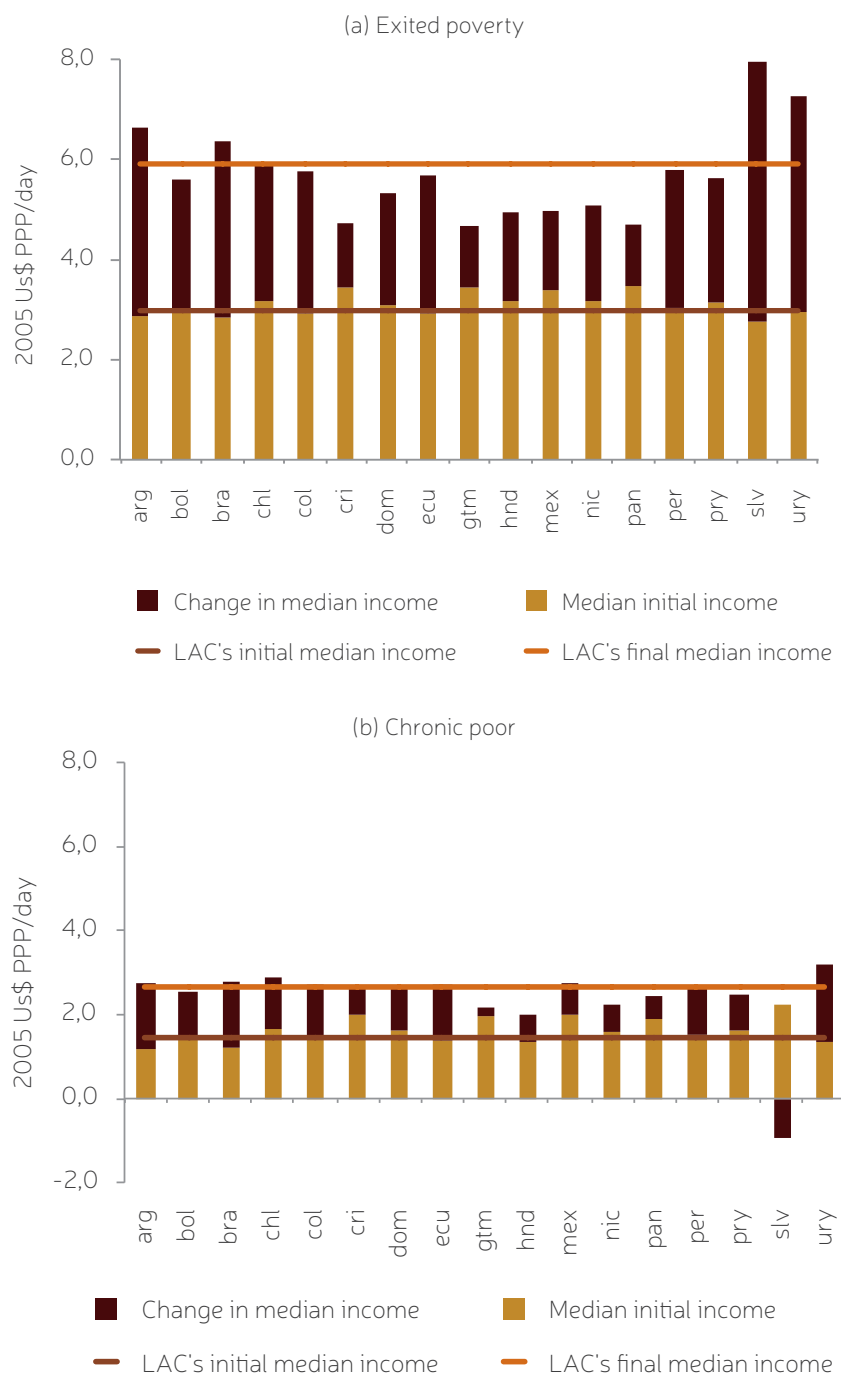
Equally important, income growth for the chronic poor was systematically lower than for those who escaped poverty. For the whole region, the chronic poor experienced an annualized income growth rate of 7.9 percent, compared with 9 percent among those that escaped poverty.

Fact 5: The chronic poor have limited income opportunities

Labor income was by far the biggest driver behind the strong reduction in poverty observed between 2004 and 2012 in the region. Unfortunately, it appears that the chronic poor face stronger barriers to enter the labor force and rely relatively more on non-labor incomes. They are also more active in low productivity or subsistence sectors.

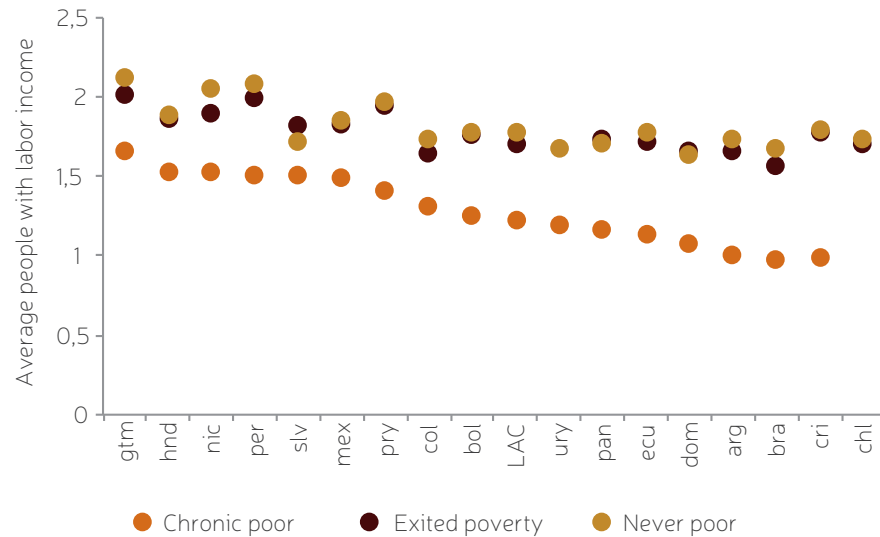
Figure 8 shows the number of labor income earners in a given household for 2012. A clear pattern emerges: in every country there were fewer labor income earners among chronic poor households, compared to poor households who escaped poverty as well as non-poor households. On average, chronic poor households have 20 percent less human resources to generate income relative to other households. In contrast, there does not appear to be a large difference in the number of labor income earners between the never-poor and those that managed to exit poverty.

Figure 7. Median income change in LAC and by country (2004-2012)



Source: Authors' calculations using SEDLAC data (CEDLAS and the World Bank). Note: The figure shows lower-bound mobility estimates using the Dang et al. (2013) technique. Panel a shows the median initial income and median income change of those originally poor who escaped poverty. Panel b shows the median initial income and median income change of those originally poor who remained poor. "Poor" = individuals with a per capita income lower than US\$4. Poverty lines and incomes are expressed in 2005 US\$ PPP per day. PPP = purchasing power parity. Horizontal lines show overall mobility in Latin America, weighted using country-specific population estimates.

Figure 8. Number of labor income earners in the household by poverty group



Source: Authors' calculations using SEDLAC data (CEDLAS and the World Bank). Note: Estimates are from 2012 surveys, or the nearest year in cases where 2012 data is unavailable. "Poor" = individuals with a per capita income lower than US\$4. Poverty lines and incomes are expressed in 2005 US\$ PPP per day. PPP = purchasing power parity.

A similar story emerges when we look at female labor market participation. Gender equality is crucial for poverty reduction, as higher economic opportunities for women can enhance broader productivity gains and households' economic perspectives (World Bank 2013). However, although Latin America has been the region with the largest increase in female labor force participation since the 1980s, with the entry of more than 70 million women into the labor force, it does not appear that the chronic poor benefited greatly from these trends. In 2012, female labor force participation was lagging significantly among chronic poor households in almost every country, with participation rates 16 percentage points lower than for the non-poor.

In addition to more limited labor force participation, the chronic poor also tend to work in lower productivity sectors. For instance, an analysis of sectoral employment of the chronic poor across subnational regions shows that regions with a high concentration of people employed in agriculture also tend to have higher rates of chronic poverty, while high tech industry, services, construction, and retail are more likely to employ more people in regions with lower rates of chronic poverty.

How low endowments, a disabling context and a depressed state of mind can prevent upward mobility

IN THIS SECTION, WE RETURN TO OUR CONCEPTUAL FRAMEWORK and focus on certain key drivers of chronic poverty. Particular attention is paid to interactions between endowments and the enabling context, as well as to the role of the state of mind in limiting aspirations and hampering the process of upward mobility.

Low endowments account for some (but not all) of the chronicity of poverty

Table 2 presents descriptive characteristics of the chronic poor in 2004. In order to put these in perspective, we compare them with two other relevant groups: those who escaped poverty during the decade and those that remained non-poor throughout the 2004 to 2012 period. Interestingly, while the initial endowments of the chronic poor are markedly different from those of the non-poor, they are similar to the initial endowments of those who escaped poverty. Although the chronic poor were on average somewhat poorer than those who escaped poverty, as mentioned above, Table 2 shows that other characteristics are fairly similar between the two groups.

The primary difference between the chronic poor and those who escaped poverty is with regards to access to services. In 2004, only 79 percent of the chronic poor had access to water, compared to 89 and 95 percent for those that escaped poverty and the non-poor, respectively. Similarly, only 58 percent of the chronic poor had a minimum level of assets,³ compared to 78 and 90 percent for the other two groups, respectively. Services, however, represent one aspect of the context in which households live, which appears to play a large role in the chronicity of poverty.

Table 2. Initial conditions: socio-economic characteristics by economic groups in Latin America in 2004

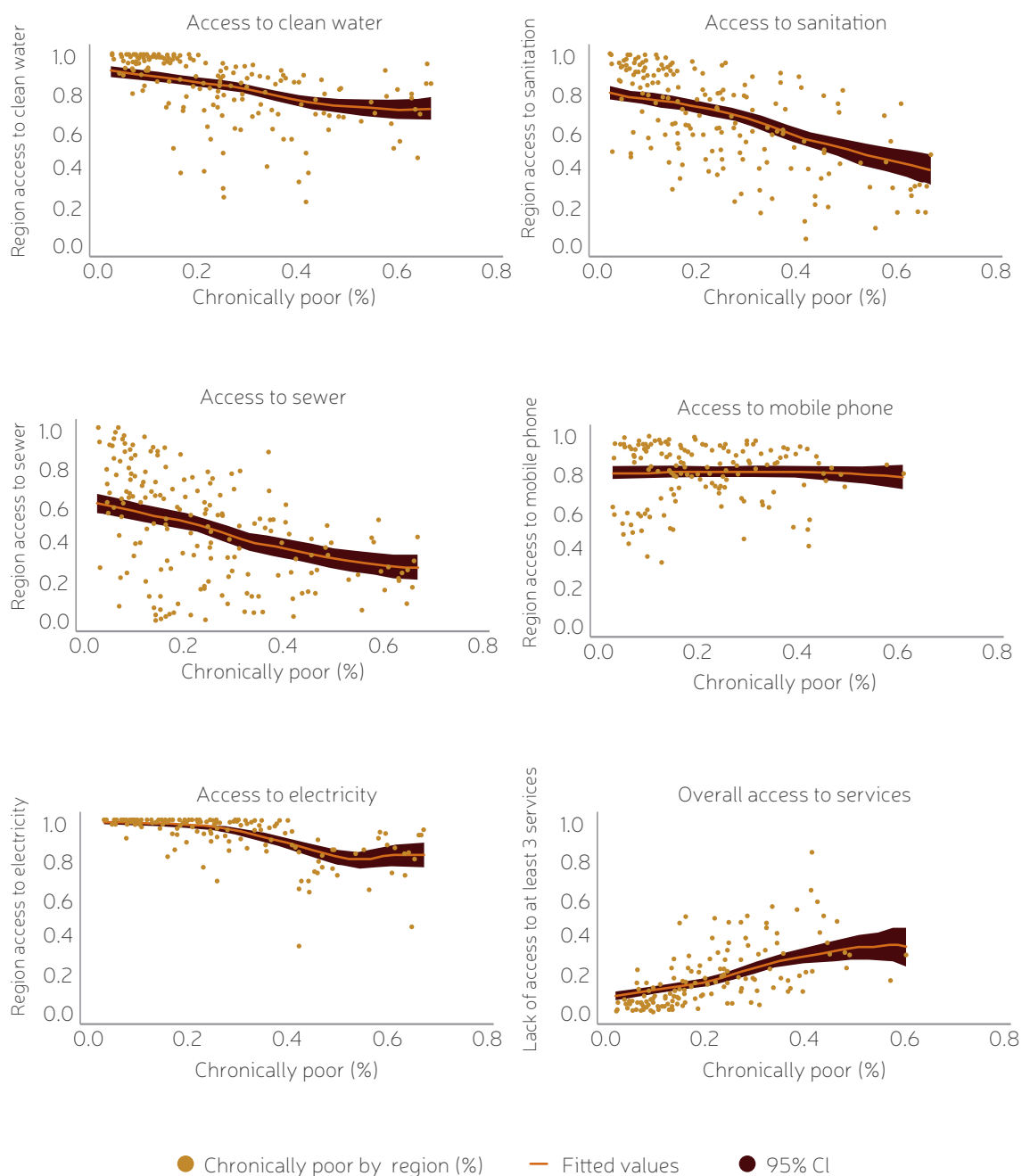
Characteristics	Chronic poor	Escaped poverty	Never Poor
<i>Demographics</i>			
Household size	4.78	4.89	3.61
Age 0-12	1.97	1.86	0.87
Age 0-15	2.35	2.32	1.11
Age 13-18	0.65	0.79	0.47
Age 19-70	2.13	2.20	2.24
Age 70+	0.03	0.03	0.03
Age of the HH. Head	37.84	40.01	40.76
<i>Education</i>			
Years of education of the HH. Head	6.02	5.10	9.20
<i>Access to services</i>			
Drinking water	0.79	0.89	0.95
Shelter	0.67	0.80	0.91
School attendance	0.91	0.95	0.98
At least 5 years of schooling	0.89	0.94	0.98
Sanitation	0.53	0.67	0.87
Electricity	0.92	0.98	0.99
Assets	0.58	0.78	0.90

Source: Authors' calculations using SEDLAC data (CEDLAS and the World Bank).

The disabling context matters a great deal

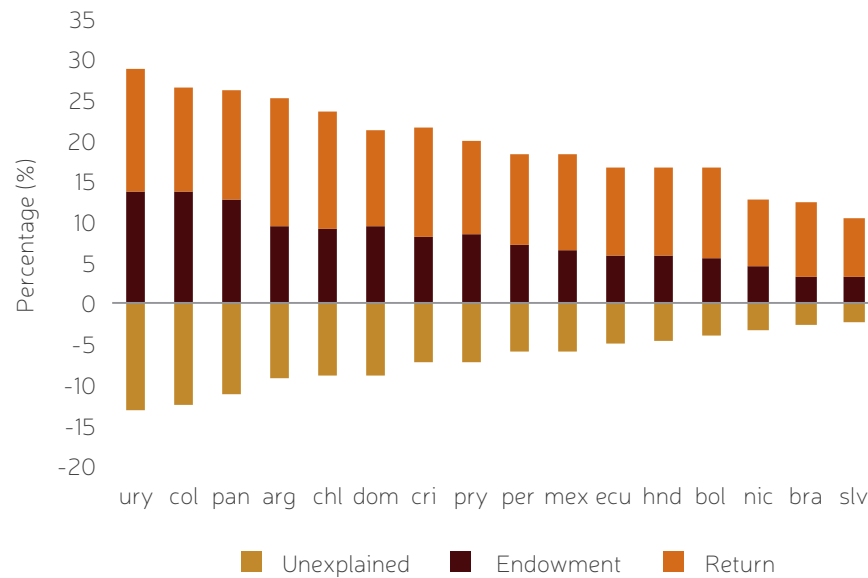
The context in which people live has an impact on their opportunities as well as on the returns to endowments and characteristics. Accordingly, we can observe a positive association between higher rates of chronic poverty and availability of services. Figure 9 relates chronic poverty rates with access to services, measured as the percentage of the population in each subnational region across Latin America that had access to certain services in 2012. Regions with lower rates of access to clean water, sewage systems, or sanitation facilities tend to have higher rates of chronic poverty. Similarly, the chronic poor are more likely to reside in regions with lower coverage of electricity or mobile communications (even though these correlations are weaker, partly due to improvements in the accessibility of both services during the last decade). It also appears that services complement one another as drivers of chronic poverty: as the last panel in Figure 9 shows, households with no access to three or more basic services are also more likely to reside in regions with higher levels of chronic poverty.

Figure 9. Access to services at the subnational level and chronic poverty



Source: Authors' calculations using SEDLAC data (CEDLAS and the World Bank). Note: Estimates come from 2012 surveys, or the nearest year in cases in which 2012 is unavailable. "Poor" = individuals with a per capita income lower than US\$4. Poverty lines and incomes are expressed in 2005 US\$ PPP per day. PPP = purchasing power parity. Selection of the regions varies depending on the level of representativeness of surveys. The vertical axis shows the proportion of households with access to a given service in every subnational region, while the horizontal axis presents the percentage of people in each region who are chronic poor.

Figure 10. Endowments and their returns explain the majority of the difference in incomes between the chronic poor and those that escaped poverty



Source: Authors' calculations using SEDLAC data (CEDLAS and the World Bank).

The importance of both endowments and context as drivers of chronic poverty raises the question of the relative importance of each factor. While the answer is necessarily context-specific, a simple decomposition of differences in income between the chronic poor and those who escaped poverty shows that *returns* to endowments (which are dependent on context) matter at least as much, if not more than endowments (Figure 10).

Supporting individuals is therefore necessary, but may not be sufficient if their context does not provide them with the scope to embrace opportunities. Without an enabling context, chronic poverty may prevail, as people will be unable to effectively utilize their endowments. Thus, regional development efforts must be implemented in conjunction with social policies focused on improving context. Thus far, we have associated context with services; in fact, *all* external factors that influence returns to endowments and households' decisions should be considered aspects of the context in which households reside. While the universe of relevant external factors is too numerous to be reviewed in its entirety, we next discuss two key factors: institutions and uninsured risk.

Institutions

The type and quality of national and local institutions have a strong impact on welfare in general and chronic poverty in particular. It is easier for the poor to escape poverty if their voices are heard

and taken into consideration. Thus, the poor must be represented by leaders that understand the challenges and the needs that they face. Local governments, services, and social programs must also be staffed by qualified civil servants who discharge their duties so as to address the needs of the poor, rather than posing as additional obstacles.

The foundation for such an institution is an inclusive social contract that recognizes every citizen as equal and supports efforts to provide equal opportunities to all. Without such a solid foundation, it is nearly impossible to eradicate poverty. Robinson (2014), for instance, looks at the evolution of the social contract in Colombia – both over time and across regions – and documents various channels through which poor governance and elite capture of the political process pose significant obstacles to poverty.

However, a strong and inclusive social contract is in itself insufficient to guarantee strong institutions. In order to operate effectively and support citizens, institutions must function well at three levels: 1) there must be sufficient bureaucratic capacity to deliver good services, 2) the state must have credibility in the enforcement of the legal framework and justice system, and 3) institutional processes must be transparent and follow clear accountability rules (Fukuyama 2012).

The importance of bureaucratic capacity is often greatly underestimated. Social programs often have low impact on the chronic poor because they reside in poorer regions where there is lower capacity to effectively implement social programs. For example, Loayza, Rigolini and Calvo-Gonzalez (2014) study the ability of Peruvian municipalities to spend additional budget streams generated from mining revenues. They find that while poorer municipalities spend a larger share of the additional budget allocated to them (signifying greater need), with all else held equal, municipalities with lower average educational attainments have a lower ability to spend the additional budget. In a similar vein, Galasso (2011) studies the impact of *Chile Solidario*, a complex social intermediation service that aims at tailoring assistance to the needs of the extreme poor, finding that the impacts of the program are significantly higher when extreme poor families are assisted by social workers with positive performance assessments.

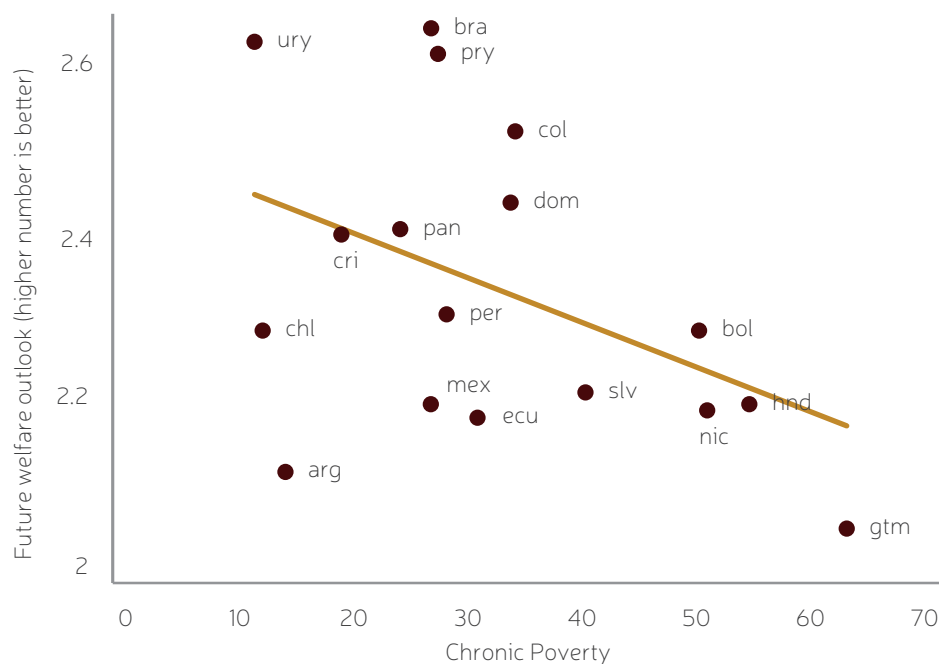
Uninsured risk as a cause of chronic poverty

The chronic poor in the region also face disproportionately high levels of uninsured risk. For example, there is a positive correlation between countries with higher chronic poverty and the prevalence of natural disasters. In the absence of some form of insurance and savings, shocks can have long-term implications and exacerbate chronic poverty, particularly if repeated. Shocks can lead to reductions in welfare by directly depleting assets, triggering coping mechanisms involving the decapitalization of productive assets, and depleting human capital. Shocks can also lead to slow recovery or even poverty traps, with evidence increasingly establishing that shocks can impact welfare on a long-term basis.

A depressed state of mind is a strong barrier to upward mobility

The depressed state of mind and lowered aspirations of the chronic poor can be a strong obstacle to upward mobility. This relationship likely goes both ways: poverty leads to a depressed state of mind, which in turn lowers aspirations and the chances for upward mobility, potentially perpetuating a vicious cycle of poverty. Such a relation can be observed at various levels. At the country level, expectations about the future are lower in those countries where the incidence of chronic poverty is higher (see Figure 11). For example, Guatemala, Nicaragua and Honduras, the countries with the highest chronic poverty rates in the region, are also among those countries with the lowest levels of positive expectations for the future.

Figure 11: Future outlook and expectations are correlated with chronic poverty



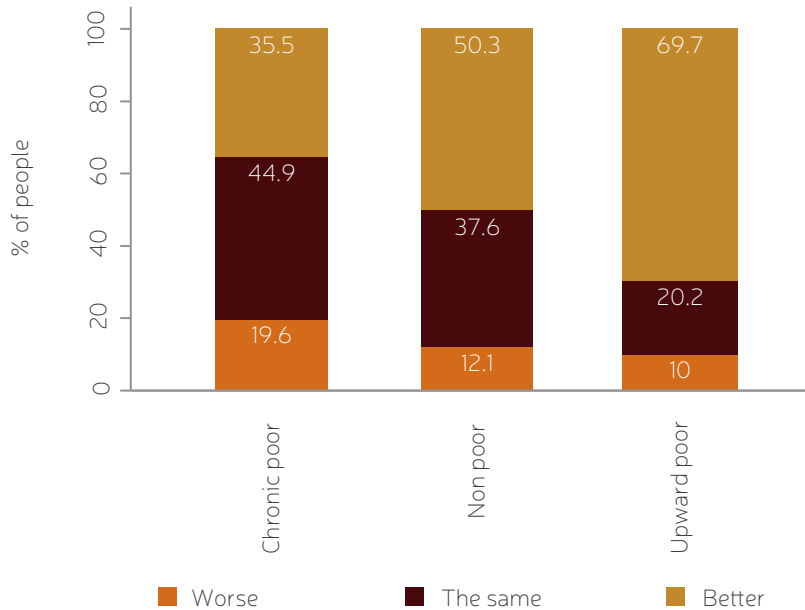
Source: Chronic poverty comes from authors' calculations using SEDLAC data [CEDLAS and the World Bank]. Data on expectations of wellbeing ("Do you think that in the next 12 months your economic situation will be better/same/worse?") come from LAPOP 2010.

Similar trends can also be observed at the regional level: people living in provinces where the incidence of chronic poverty is higher tend to be more pessimistic about their economic prospects, indicating that location and context may play a role in influencing not only returns to endowments, but also attitudes and aspirations.

Differences in perceptions about the future across socioeconomic groups are also striking. For example, the chronic poor in Latin America are the most pessimistic about their future outlooks, with one out of every five expecting their economic situation to worsen in the next

year, a rate twice as high as the rate of those who exited poverty or who were never poor (Figure 12). The chronic poor are also half as likely to expect their situation to improve in the future compared to those who exited poverty. Perhaps unsurprisingly, people who exited poverty are the most optimistic, even among those who were never poor, consistent with causal evidence on how positive events can affect people's outlook in life.

Figure 12: The chronic poor are especially less optimistic about the future

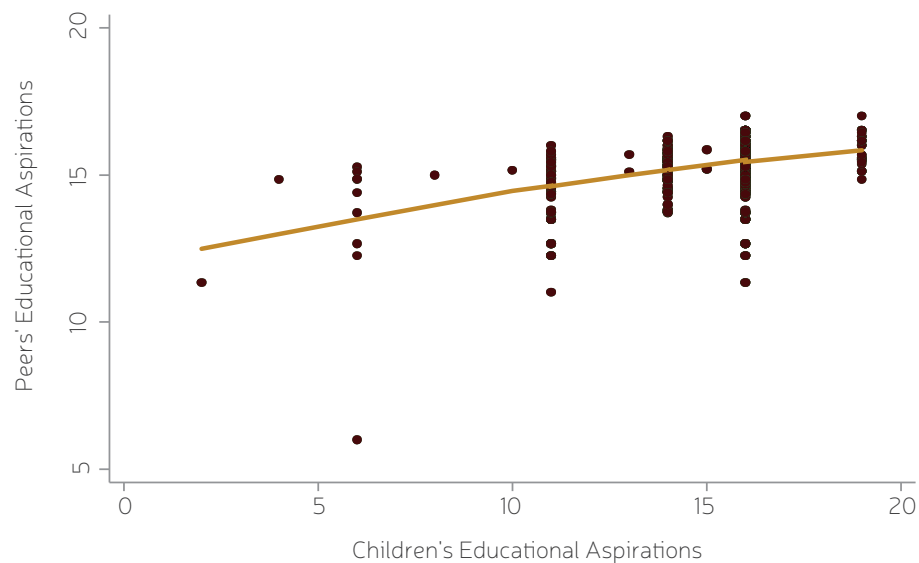


Note: Percentage of people thinking that their economic situation in 12 months is going to be worse/the same/better. Poverty is defined by an asset index: poor are in the bottom tercile of the asset index distribution. Subjective Chronic Poor: those who are in the bottom tercile of the asset index distribution and feel that their economic situation is the same/worse than in the past 12 months; Non-poor: those who are in the top two terciles of the asset index distribution and feel that their economic situation is the same or better than in the past 12 months. Upward Poor: those who are in the bottom tercile of asset index distribution and feel that their economic situation is the better than in the past 12 months. Data source: LAPOP 2010.

Social norms and peer effects also influence the state of mind, behaviors and aspirations. Paraphrasing Appadurai (2004) and Ray (2006), "Aspirations are socially determined, and thus the capacity to aspire is inherently unequal between rich and poor. This has the consequence that the poor lack the aspirational resources (or capacity) to act and change the conditions of their own poverty." The poor might therefore choose not to invest in the future, in part because of their own experiences, but also because those that are close to them may suggest that escaping poverty is not a feasible option. Breaking such a transmission channel is essential. Just as context matters for the physical aspects of chronic poverty, the behavioral context also matters, and thus learning about the positive experiences of others can be beneficial to one's own aspirations.

Increasing the aspirations of poor children is of particular importance. Figure 13 plots the educational aspirations of Peruvian children against those of their peers, defined as children of a similar age residing in the same community. The relationship is strong: children living in communities where the aspirations of their peers are high in terms of the level of educational attainment also have higher aspirations (and vice versa), suggesting that social interactions can offer a mechanism that can trigger positive changes in the decision making process.

Figure 13: Transmission of aspirations through peers



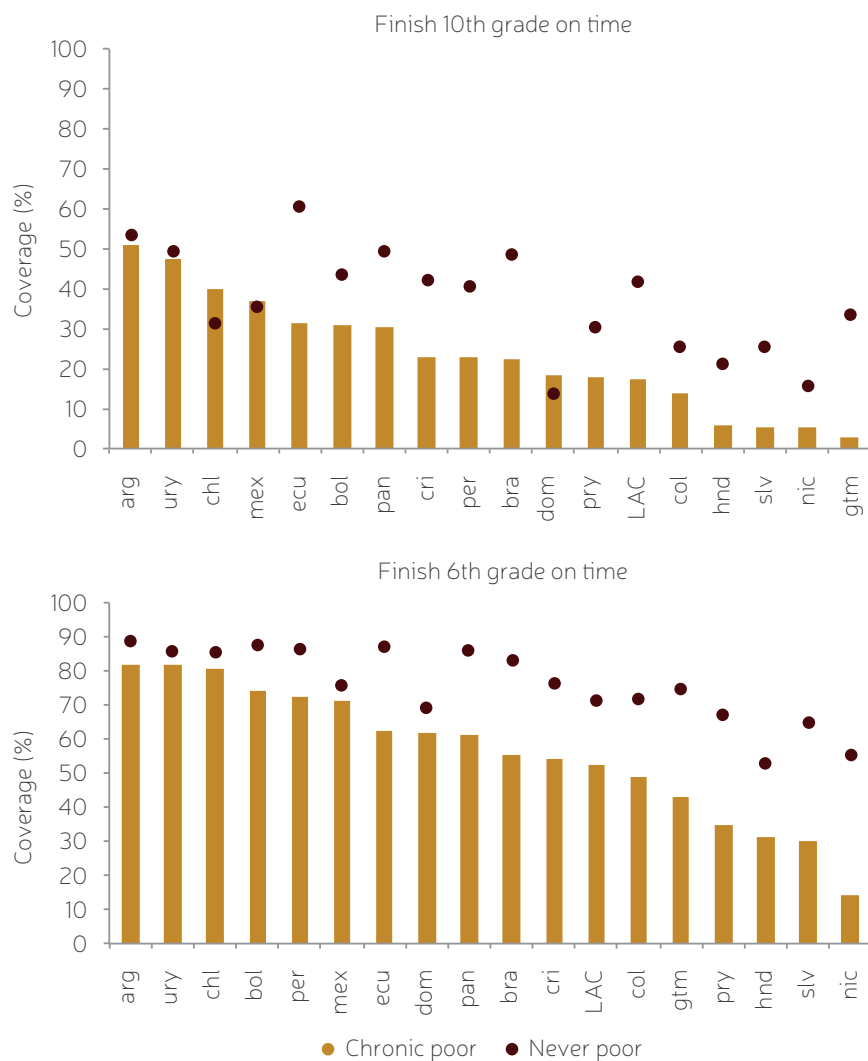
Note: Children's educational aspirations in years. Data are from the Young Lives Survey. Old cohort, pooling together Round 1 and 2 (age 12-15). Peers defined as those children of the same cohort living in the same community (N=85).

Intergenerational transmission of chronic poverty

Chronic poverty is also transmitted from parents to children. Morally, the context into which children are born should not affect their chances of success in life or their ability to improve their endowments. Nonetheless, children born into contexts of poverty are less likely to have access to the opportunities available to non-poor children, which creates a channel for low mobility and poverty persistence across generations.

Differences persist along the schooling ages. Figure 14 shows the 2012 incidence of finishing primary and middle school grades between children from chronic poor families and children from families that were never poor. In all countries, children from chronic poor families are severely disadvantaged in schooling outcomes. For example, in the case of Peru, a child from a chronic poor household has a 34 percent probability of finishing middle school on time, compared to 60 percent for children from never poor families.

Figure 14. Intergenerational transmission of chronic poverty



Source: Authors' calculations using SEDLAS data (CEDLAS and the World Bank). Note: All figures come from 2012 surveys, or the nearest year in cases in which 2012 data are unavailable.

The state of mind also appears to impact the intergenerational transmission of chronic poverty. For instance, using data from the Young Lives Surveys, we find that children's educational aspirations are not only affected by the aspirations of their peers but also by the aspirations of their parents, which tend to be lower among the chronic poor.

From diagnosis to policies: design elements supporting the chronic poor

CHRONIC POVERTY IS A COMPLEX PHENOMENON, and as such, there is no single approach with which it can be eliminated. Moreover, policies must be consistent with a variety of country-specific factors, including the social contract and political vision in society, existing budgets, bureaucratic capacity, and the overall institutional setting (including existing social programs). In recognition of the complexity and specificity of policy design, we refrain from presenting a comprehensive review of all factors affecting chronic poverty or concrete recommendations for the design of policies supporting the chronic poor. Instead, we offer elements of policy design that should be collectively taken into consideration in the design of social protection programs.

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Improving endowments and the enabling context

We begin first by synthesizing findings on endowments and the enabling context that are relevant for policy design. We then investigate an area of increasing relevance in the policy arena: the coordination of poverty reduction efforts to build social protection systems that effectively assist the poor.

Supporting the chronic poor vs. improving the environment they live in. The environment in which people live matters at least as much as their skills and characteristics, if not more: for instance, the same chronically poor family living in a remote district of the Andean *sierra* or Amazon *selva* might not be poor if they were to live in São Paulo, Bogota, or Lima. Returns to skills and characteristics depend very much on local environment and available opportunities. Given an equal level of skills, access to paved roads results in more trade and better opportunities to sell one's products. Industrialization brings manufacturing jobs, which generally offer higher wages than the agricultural sector. Areas with universal health coverage are better able to help people cope with one of the most damaging types of shocks. Better policing reduces crime rates and improves the profitability of local businesses. Thus, an optimal social policy should balance direct support to the chronic poor with broader investments that improve the environment in which they reside.

Address the intergenerational transmission of chronic poverty. The context where a child is born should not affect her or his chances to succeed in life. Nonetheless, malnutrition, poor stimulation, fragile health, absent parents, and a risky or violent environment are factors that

keep people mired in poverty and limit their ability to develop to their full potential. Furthermore, these differences become amplified over time; thus, by the time that social programs finally reach the adult population, some of the chronic poor may no longer have the skills and/or mindset necessary to escape poverty. For policymakers, it is therefore both a challenge and an opportunity to break the chronic poverty cycle early in the life cycle. The emerging policy dialogue and integration of early childhood development into the social development agenda in the region is therefore welcome and should be further expanded.

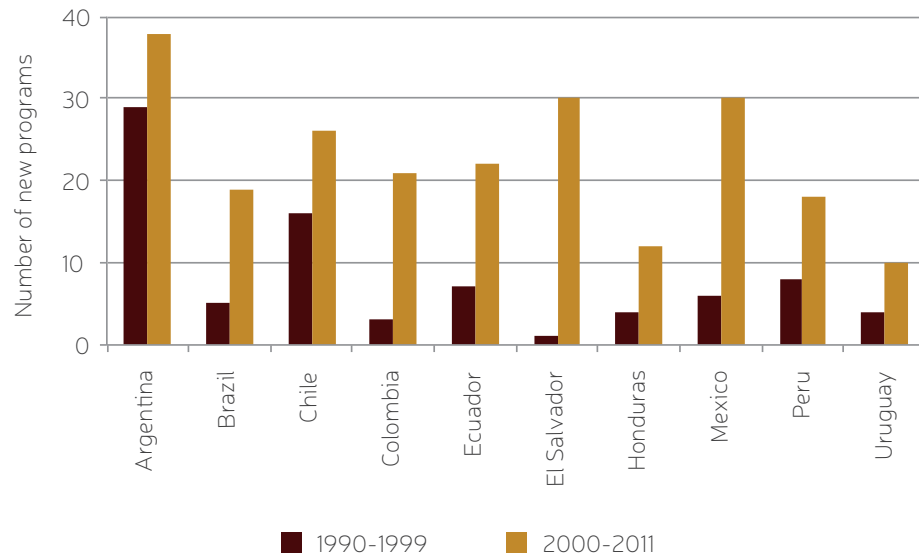
Limited labor income: both a cause and a consequence of chronic poverty. Boosting labor income is among the few ways to sustainably lift people out of poverty. The limited and often sub-optimal labor income opportunities of the chronic poor can pose a significant obstacle to chronic poverty reduction. As such, comprehensive poverty reduction programs should include labor income promotion strategies such as training and labor insertion programs. As the discussion above indicates, large inequalities early in life can result in fewer skills and aspirations in adulthood, severely weakening the potential impacts of income generation programs. Income promotion strategies alone cannot therefore be expected to eliminate chronic poverty.

Coverage and geography: focus on urban as well as rural areas. Many social programs base geographic coverage decisions on the incidence of poverty; as a result, many programs operate mostly in rural areas where poverty incidence is the highest. However, this report has shown that in many instances, even if the incidence of chronic poverty is higher in rural areas, more chronic poor families live in urban areas. Expanding programs to reach urban areas will require addressing issues beyond coverage and identification: the urban poor are more mobile than the rural poor, making them more difficult to identify and support. The rural and urban poor also have different sources of income, in addition to facing different types of shocks and sources of vulnerabilities that may keep them in poverty. Overall, supporting the urban poor may be more challenging than supporting the rural poor; however, greater complexity should limit efforts to reach the growing number of the urban chronic poor.

An urgent policy agenda: the coordination of poverty reduction efforts

After decades characterized by a truncated social contract that disregarded the needs of the poor, Latin America is now moving towards creating more inclusive societies. The advances of the last decade have been admirable and improving the living conditions of the poor through better services and social programs has been high on almost every political agenda. Consequently, most Latin American countries experienced a dramatic surge in the creation of new social programs in the 2000s, and social spending is on the rise. The surge in social program creation has been dramatic: the rate of establishment of new programs increased by six-fold in Colombia, while El Salvador went from nearly zero to thirty programs (Figure 15).

Figure 15: Creation of new social assistance programs by decade



Source: World Bank's LAC Social Protection database and Cerutti et al 2014.

Nevertheless, in addition to the generosity of the social assistance programs, better alignment of policies and initiatives under a systematic and coordinated approach is needed to address chronic poverty. Coordination implies that social assistance programs will not only need to have clear and measurable goals, but will need to be included into a comprehensive poverty reduction framework in which programs and initiatives are able to communicate and collaborate with one another.

Coordination is needed at all levels. At the level of the state, there must be a broad agreement that social programs are not populist initiatives but effective social inclusion tools. To achieve such a consensus, the generosity of benefits and type of programs may need to be adjusted to societal perceptions of the scope of mutual help and solidarity. At the level of the executive branch, ministries and programs must be given adequate resources and technically competent program staff that are shielded from political pressures should be appointed. Furthermore, poverty reduction strategies should ensure that ministries and agencies are not only given clear and measurable goals to which they are held accountable, but that they work towards these goals in a coordinated manner.

Unfortunately, more often than not, programs, agencies, and ministries do not coordinate with one another, substantially limiting the effectiveness of poverty reduction efforts. In order to cope with these issues, many countries in LAC have established coordinating agencies. These agencies take many forms: from supra-ministries (Ecuador) and ministries (Peru), to agencies within a ministry or the presidency (ANSPE in Colombia). The extent to which they are effective in the coordination of social policies depends greatly on the institutional and financial power that they wield, as well as the extent to which they develop clear strategies and institutional arrangements.

It is crucial to *design policies with clear, specific and measurable objectives*, as well as define clear competencies and accountabilities in the implementation of each intervention. It is also important to *provide incentives to coordinate* that go beyond goodwill, building an accountability system that rewards performance. On the advocacy front, there is a need to *show strong evidence of the benefits of coordination* for social policy in order to cease being perceived as an inefficient expense and to become a central pillar of countries' development efforts. Finally, *coordination must happen not only at the top, but also at the local level*. Civil servants, teachers, doctors, and suppliers must be rewarded and benchmarked against measurable achievements (as opposed to inputs). Recognizing that coordination is costly, countries should attempt to establish the degree of coordination that maximizes benefits while minimizing costs.

Addressing the process and the state of mind

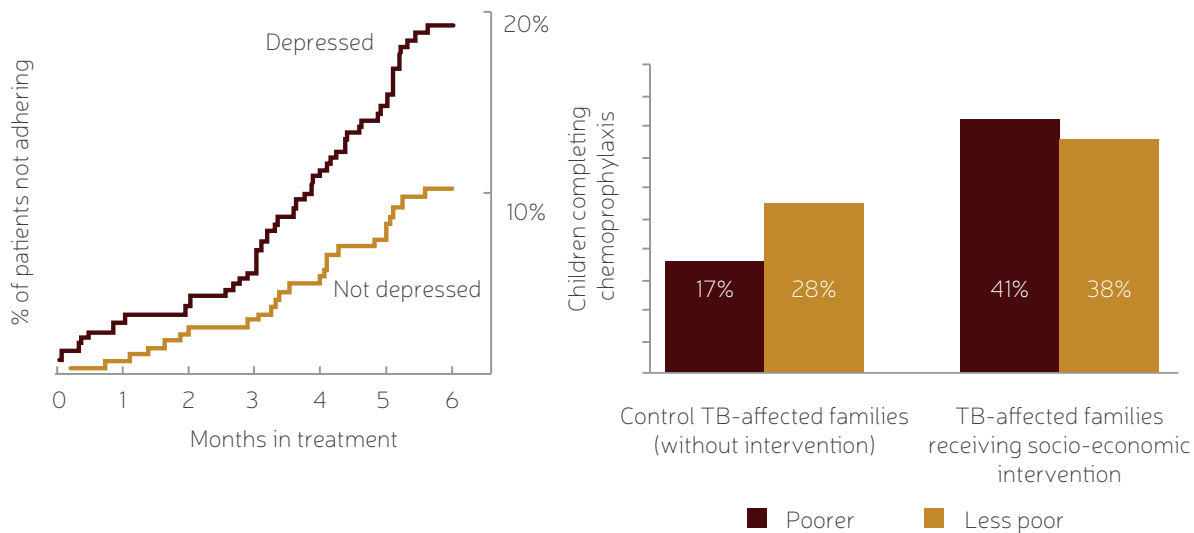
Strategies of addressing the state of mind and low aspirations of the chronic poor must be mainstreamed into policy design. If their state of mind remains unaddressed, the chronic poor may easily fall through the cracks of the social safety net system by failing to register for social programs or to comply with co-responsibilities.

Social programs have various strategies at their disposal to assist the poor in overcoming low aspirations or a suboptimal state of mind. In Peru, for instance, the national tuberculosis prevention and treatment program provides free treatment to patients with tuberculosis, assists patients with health insurance registration, offers tuberculosis screenings, and provides preventative vaccination shots to children. Despite the free provision of services, early evaluations of the program showed low adherence to treatment (which generally requires taking a daily pill of 6 months), which can increase the chances of recurrence or of developing multi-drug resistance. The majority of the tuberculosis-affected population reside in the slums of Lima, where chronic poverty, stress, and depressed aspirations are the norm. Qualitative research also documents how members of tuberculosis-affected households were more likely to feel stigmatized, to cry, and to be moderately or severely depressed. Depression had a large impact on behavior: tuberculosis patients who were depressed at the time of diagnosis had a 43 percent greater likelihood of abandoning treatment before they were cured.

In order to address these issues, the *Innovative Socioeconomic Interventions against Tuberculosis* (ISIAT) project team designed a package of support activities, aimed at helping tuberculosis patients to overcome the stigma of the illness while also exploring income-generating opportunities. In addition, the project integrated clinical psychologists into the team who worked directly with patients in small groups or community workshop activities, leading to a reduction in depression. In communities receiving the ISIAT intervention, rates of completion of the 6-month treatment needed to prevent tuberculosis nearly doubled (see Figure 16). Furthermore, the impact on the poorest households was the highest, even though treatment

uptake rates were the same as for other affected families. While various underlying mechanisms of behavioral impact may have played a role, it is clear that integrating issues of stress and depression directly into the design of the program was instrumental in its success.

Figure 16: Integrating treatment of depression improves TB outcomes in Peru



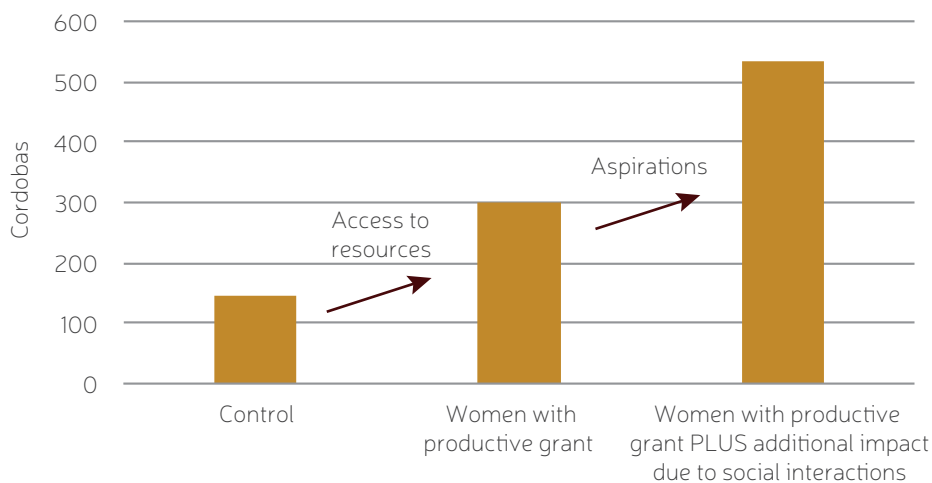
Source: Karlin et al. (2014, left panel); Rocha et al. (2011, right panel).

Considering the state of mind in social programs can also help the poor deal with stress and long-term planning. A pilot program conducted in the city of Bogota attempted to address the fact that stress can influence valuation of the future. In the pilot, beneficiaries of a conditional cash transfer program who received bi-monthly payments were randomly split into two groups: the first group received the full amount each payment day, while the second only received two thirds, with the last third put aside by the program team into a savings account. The total amount of savings was then given to beneficiaries as a lump sum in December, immediately prior to the due date for children's school enrollment fees. This simple modification was found to be effective: while both payment schemes had similar impacts on school attendance, the "save for when you need it" approach paid off in terms of achieving higher re-enrollment rates for the children of the second group (Barrera-Osorio et al. 2011). Simply by changing the timing of the payments, the savings were made available to parents at the time when they would most be needed.

Social programs can positively also influence the state of mind and aspirations by promoting interactions with role models. A social program in Nicaragua, for instance, provided to the majority of households in each community either vocational training or business grants to start a business, and explicitly encouraged group formation, thereby creating a unique space for social interactions among beneficiaries. As local leaders were also included among the beneficiaries, the authors were able to measure both the overall impact of the program as well as the extent to which social interactions between leaders and other beneficiaries led to additional impacts. Macours and Vakis (2014) show that beneficiaries that interacted more with

local leaders invested more in their children. Social interactions also amplified program impacts on the income generation side: income from non-agricultural activities among beneficiaries who received the business grant and who lived in proximity to a local leader grew by an additional 40 percent (see Figure 17).

Figure 17: The instrumental role of social interactions for aspirations and final outcomes



Source: Macours and Vakis (2014).

These illustrations show that it is possible to shift households' aspirations and behavior. Simply incorporating aspects of process simplification, norms or social interactions into existing interventions can deliver large returns. Natural leaders and role models living in close proximity can also serve as important vehicles for behavioral change, both by motivating and encouraging others and by providing examples that people aspire to follow. Finally, teachers, who already serve as important role models, can help children change their attitudes toward learning and the future. As seen in previous examples, it is not always necessary to develop brand new programs: small modifications to existing programs that carefully explore pathways of behavioral change are often a cost-effective way to improve the ability of programs to address chronic poverty.

Bundling behavioral and coordination solutions: the emergence of social intermediation services

Behavioral barriers, in their worst forms, have been shown to induce the chronic poor to exclude themselves from the very same social programs designed to assist them (Galasso 2014). The presence of numerous social programs that do not coordinate with one another, each with its own eligibility rules, clearly does not help in reaching them. There is therefore a need to go beyond the classical "passive" social assistance approach, where coverage is dictated by

budgetary considerations, poverty status, and the assumption that the poor will successfully and pro-actively seek out and enroll in social programs, and to move towards “active” approaches that seek out the extreme and chronic poor, assist them to efficiently use the existing social protection system, and help them in identifying their own development goals.

Efforts to offer a more systematic response to both behavioral and coordination constraints have been emerging in various Latin American countries under the form of “social intermediation services”, intended to support the poor to overcome access, information and other barriers, via a holistic, systemic, and household-based approach (Camacho et al, 2014). This approach deserves attention, as it represents a shift away from the traditional social assistance paradigm of providing the poor with a broad range of services and goods, towards a more personalized approach that aims at providing people with the building blocks needed for overcoming their specific challenges. As opposed to the classical social protection approach, where chronic poor families are required to apply for benefits, social intermediation services put families at the center by actively identifying and approaching the chronic poor, and guaranteeing them priority access to existing and newly created programs.

Camacho et al (2014) review two of these programs (*Chile Solidario*, the first such program in the region, and *Red Unidos* in Colombia) and assess factors that can enhance or hinder their effectiveness. The analysis of the two services reveals useful insights. Overall, the authors argue that social intermediation services can be powerful and cost-effective new tools to support poor and marginalized families, by facilitating the poor’s access to social programs, improving their social and emotional well-being, and, if the right conditions are provided, raising their employment perspectives. These services show that psychosocial constraints are not insurmountable barriers, and that, at least along the access dimension, it is possible to reach out to the chronic poor and ensure that they benefit from the assistance of the state.

Social intermediation services do not directly bring material benefits to the families; instead, they facilitate access to existing social programs. They must be therefore well integrated within the social assistance system, have inter-operable information systems to track the supply of social services and the population demand, and employ a staff of well-trained social workers to actively work with the target population to match them to social programs that address family-specific needs. A strong supply of existing social programs is also essential for the success of social intermediation services: granting access to services of poor quality, or services that are poorly tailored to the needs of the extreme and chronic poor, may lead to little or no impact.

As social workers are the backbone of family support, they also need to be well-trained and to satisfy minimum qualifications. Social workers not only need to be knowledgeable of the eligibility rules and procedures of all social assistance programs, but they also need to be familiar with the informational and psychosocial barriers faced by the chronic poor, in order to understand how to work with families to help them overcome these barriers. Visits to families must be conducted on a regular basis and must be tailored to individual needs; behavioral barriers can only be overcome if families feel that their constraints are understood and that social workers are willing and have the means to help them overcome these barriers.

Social intermediation services can also vary in sophistication. The ambition of an intervention such as *Chile Solidario* goes beyond the mere access to social programs and includes psychosocial support and programs to fill supply gaps. In a context of more limited resources and capacity, simpler programs that primarily focus on access can also lead to positive impacts.

Coordinating among social programs and addressing the state of mind of the chronic poor adds an additional layer of complexity to social assistance work. Nevertheless, it is imperative to think about new ways to reach the chronic poor, and social intermediation services are a promising avenue. Without such an active intervention, the chronic poor are likely to continue falling through the cracks of social assistance systems, perpetuating the vicious cycle of poverty.

- 1 Given the level of economic development of LAC, we use higher poverty lines compared to the rest of the world. A \$2.50 a day extreme poverty line (based on an average of national extreme poverty lines) is considered more appropriate for LAC than the World Bank \$1.25 a day global extreme poverty line. A \$4 a day poverty line is used to measure total poverty in the region and is approximately equal to the average of moderate poverty lines in the region. All incomes and poverty lines in this study are expressed in 2005 PPP (purchasing power parity) terms.
- 2 We follow Ferreira et al (2012) who define four economic classes based on the concept of economic security: (i) the poor for those with per capita income below \$4 a day; (ii) vulnerable for people – those with high risk of falling back into poverty and have incomes between \$4 to \$10 a day; (iii) the middle class, whose income ranges between \$10 and \$50 a day; and (iv) the rich who are those with incomes above \$50 (all in 2005 purchasing power parity).
- 3 Households are considered to have a minimum level of assets if they have at least three out of the following: communication (landline or mobile phone), transportation (bike, car or motorcycle), refrigerator, and television.

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