FISCAL POLICY AND INCLUSIVE GROWTH IN LATIN AMERICA: LESSONS FOR ASIA

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NO. 408

October 2014

ADB ECONOMICS WORKING PAPER SERIES

ASIAN DEVELOPMENT BANK

ADB

ADB Economics Working Paper Series

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No. 408 | 2014

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ASIAN DEVELOPMENT BANK

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October 2014
ISSN 2313-6537 (Print), 2313-6545 (e-ISSN)
Publication Stock No. WPS146900-3

Note: In this publication, "$" refers to US dollars.

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ABSTRACT

Broadly speaking, developing Asia and Latin America are at similar income and development levels. Relative to the advanced economies, economic growth and development are much more urgent priorities for both, yet Latin America has significantly more experience in using fiscal policy to tackle inequality and to promote inclusive growth. Therefore, its greater experience with inclusive fiscal policy can offer valuable lessons for developing Asia in its new-found quest to leverage public spending and taxation to spread the benefits of growth to the broader population. While the Latin American experience has general implications for Asia, of particular interest is its generally successful experience with conditional cash transfer (CCT) programs. Overall, the evidence suggests that CCT programs can be an effective tool for inclusive growth in Asia, too. However, CCTs are not a panacea for poverty and inequality, and the ingredients for their success in Asia may differ from those in Latin America.

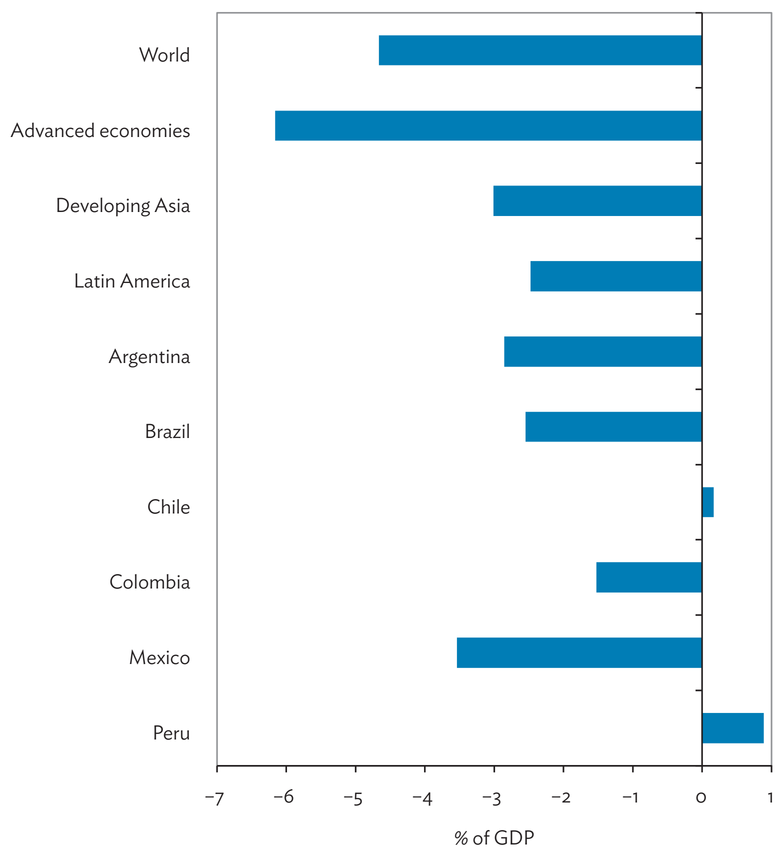
Keywords: fiscal policy in Latin America, conditional cash transfer, social protection

JEL Classification: I38, H50, H53

I. INTRODUCTION

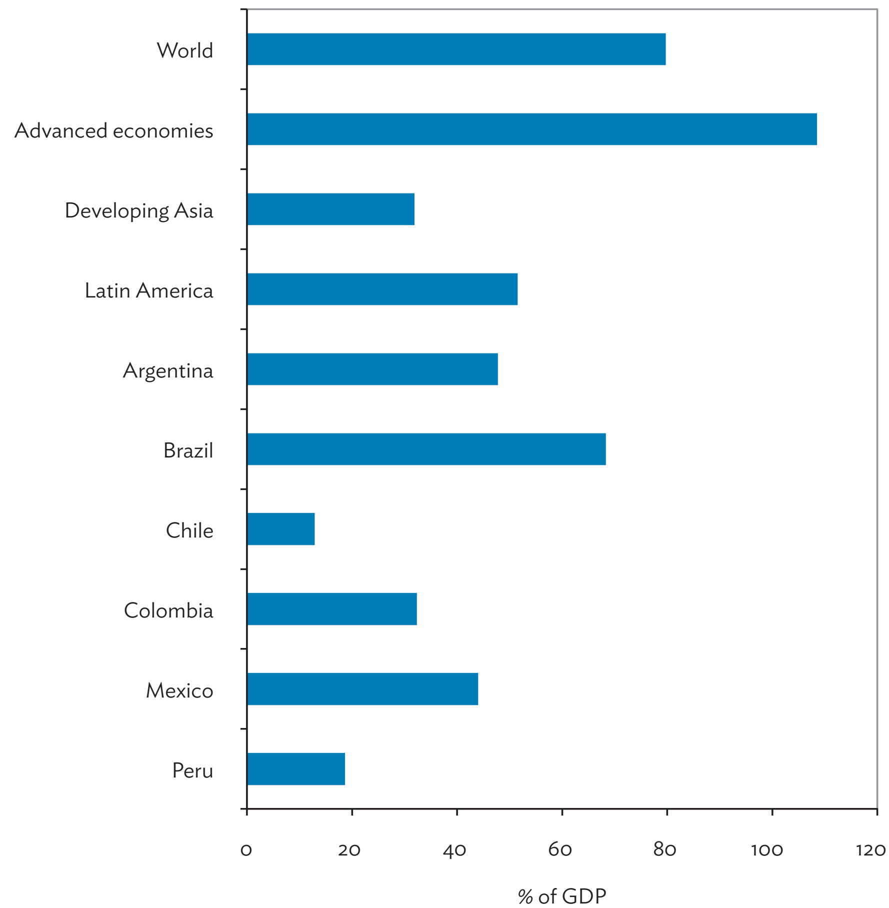
In the past, Latin America was wracked by macroeconomic instability rooted in unsustainable government budget deficits. The Latin American debt crisis of the 1980s epitomized the severe macroeconomic instability that curtailed growth in the region. However, since the early 1990s, fiscal and monetary policy has improved markedly in much of the region. The improvement sometimes took the form of a concerted and drastic policy effort. For example, in 1994, in the face of chronic inflation, Brazil implemented the *Plano Real* (Real Plan) that combined currency reform with monetary and fiscal tightening. The consequent improvement in fundamentals helped Latin America weather the global financial crisis during 2008–2009 well. Despite some major exceptions, there has been an unmistakable region-wide trend toward macroeconomic stability underpinned by fiscal responsibility. The improved fiscal performance is evident in key indicators, such as fiscal balance (Figure 1) and government debt (Figure 2).

Figure 1: Overall Fiscal Balance in Selected Regions and Latin American Countries, 2008–2013



GDP = gross domestic product.
Source: International Monetary Fund. Fiscal Monitor Database. http://www.imf.org/external/pubs/ft/fm/2013/01/fmindex.htm (accessed October 2013).

Figure 2: Gross Government Debt to Gross Domestic Product Ratio in Selected Regions and Latin American Countries, 2013

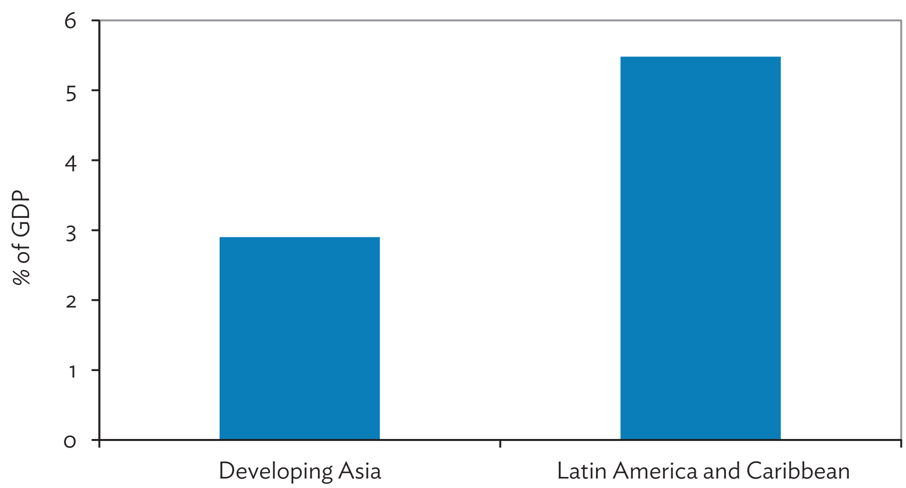


GDP = gross domestic product.
Source: International Monetary Fund. Fiscal Monitor Database. http://www.imf.org/external/pubs/ft/fm/2013/01/fmindex.htm (accessed October 2013).

Another key fiscal trend in Latin America has been the growth of social assistance and basic social services. The region has a long history of social spending that began around 1920 and consists of three main realms: social insurance, social assistance, and basic social services. Until 1980, social policy in Latin America was dominated by contributory social insurance schemes. Social assistance programs included family allowances, non-contributory pensions and health insurance, and emergency public employment. From 1972 to 1982, in 13 Latin American countries, social assistance on average accounted for 17.0% of total public social spending while social insurance accounted for 83.0%. However, severe economic crises combined with the evolution of democracy during the 1980s and the 1990s fueled public spending on social assistance and basic social services, which targeted poorer portions of the population, while the coverage of social insurance was reduced.

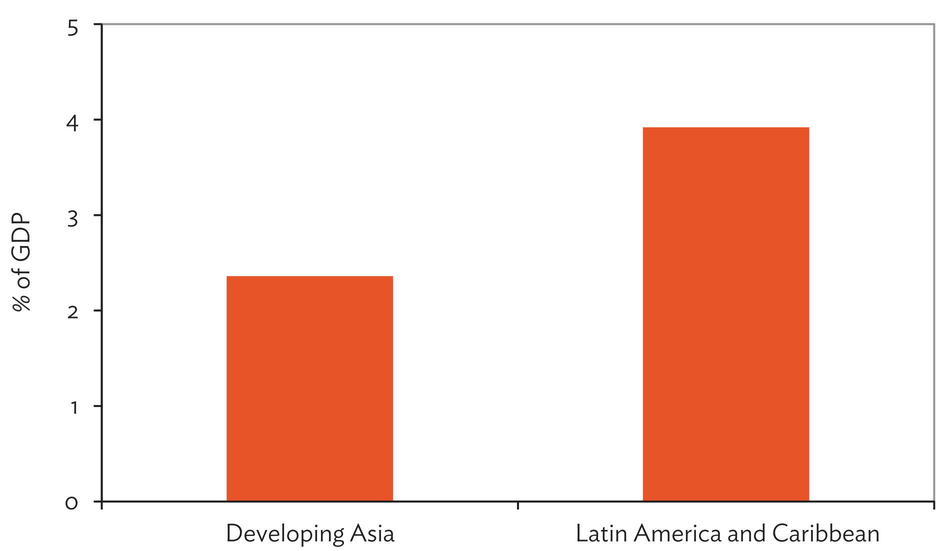
The central objective of this paper is to examine the relationship between fiscal policy and inclusive growth in Latin America with a view to drawing relevant policy lessons for developing Asia. Although the two regions are broadly comparable in terms of their income and development levels, as a result of the forces discussed in the preceding paragraph, Latin America has substantially more experience in leveraging fiscal policy to tackle inequality and poverty. This is evident in Latin America's high level of public spending on programs that can help promote more inclusive growth. For example, Latin American governments spend more on education, which directly improves the well-being of the poor and augments their productive capacity, than the governments of developing Asia (Figure 3). They also spend more on health, which also improves both the welfare and human capital of disadvantaged groups (Figure 4). The beneficial effects of public spending on education and health are likely to be disproportionately greater for the poor who lack access to private education and health. Further evidence that Asia trails Latin America comes from public spending on social protection (Figure 5).

Figure 3: Government Spending on Education, 2010



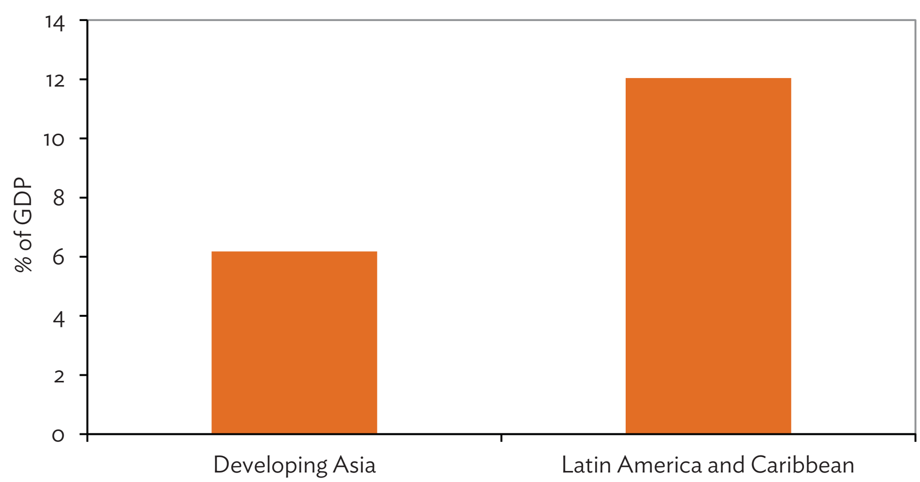
GDP = gross domestic product.
Source: ADB staff estimates.

Figure 4: Government Spending on Health Care, 2010



GDP = gross domestic product.
Source: ADB staff estimates.

Figure 5: Government Spending on Social Protection, 2010



GDP = gross domestic product.
Source: ADB staff estimates.

Latin America's greater public spending on education, health, and social protection is in line with the region's larger overall government size. From 1990 to 2000, the ratio of government expenditures to gross domestic product (GDP) was 18.6% for developing Asia and 29.9% for Latin America, and from 2000 to 2010, the corresponding figures were 21.0% and 30.6%. A bigger government requires a larger tax revenue base. Indeed, Latin America's tax revenue to GDP ratio exceeds the figure for developing Asia. The ratio was 18.1% for Latin America and 12.9% for developing Asia from 1990 to 2000. The corresponding figures from 2000 to 2010 were 21.8% and 17.8%.

While government transfers and subsidies do not directly contribute to human capital, they often provide vital protection to the most vulnerable segments of the population. However, in Asia as in other parts of the world, public transfers are often captured by the non-poor. For example, a large part of the benefits from general fuel subsidies flow to the middle and upper-middle classes. Such programs do not promote equity and are fiscally burdensome. In line with the smaller overall size of the government, the level of transfers is higher in Latin America than in Asia (ADB 2011). This is especially true for transfers to the elderly. Much more significantly, Latin America has become a global leader in the use of conditional cash transfers (CCTs). CCTs are usually targeted at low-income groups that can receive them only if they make human capital investments, such as in education or health care. Therefore, Latin America's CCT experience offers potentially valuable lessons for inclusive fiscal policy in Asia.

The rest of this paper is organized as follows. Section II briefly examines whether Latin America's fiscal policy has been pro-cyclical or counter-cyclical. This has significant implications for inclusive growth. Section III summarizes an in-depth study of the impact of social spending and taxes on inequality and poverty in Latin America. The study is based on six Latin American economies of varying sizes and income levels: Argentina, Bolivia, Brazil, Mexico, Peru, and Uruguay. Section IV takes an in-depth look at Latin America's extensive experience with CCT programs that are widely viewed as having been effective in reducing poverty and inequality in the region. As such, Latin America's CCT experience can point the way forward for Asia as well. Section V concludes with observations.

II. PRO-CYCLICALITY OF FISCAL POLICY IN LATIN AMERICA

There is a growing body of literature examining whether fiscal policy in Latin American countries has been pro-cyclical, i.e., moving with the business cycle, or counter-cyclical, i.e., moving against it. For example, when public spending rises when the economy is in a recession, fiscal policy is counter-cyclical. The growing interest in the subject is rooted in the fact that fiscal policy is a potentially important tool for mitigating the adverse impacts of major financial and economic shocks, such as the global financial crisis during 2008–2009. In particular, crises tend to have a proportionately bigger impact on the poor and disadvantaged who often lack the resources and capacity to protect themselves from the adverse effects of shocks. Therefore, assistance from the government can be a vital means for helping the poor during crises.

Latin American fiscal policy has been dominantly pro-cyclical, focused more on preserving long-term fiscal sustainability than on responding to big macroeconomic shocks, such as a financial crisis. On average, the stimulus packages implemented during the recent global financial crisis are believed to have been less than 1.0% of GDP, a full percentage point less than those in developed countries. Berganza (2012) surveyed seven Latin American countries' fiscal rules since the early 2000s and discussed general characteristics along with the advantages and disadvantages of different types. He used two important criteria for classifying them: long-term sustainability and diluting the pro-cyclicality of fiscal policy. While the former emphasizes reducing the deficit bias and controlling the growth of public debt, the latter emphasizes the short-term output stabilization role of fiscal policy. His findings showed that only Chile targets cyclically adjusted indicators, although the policies of Colombia and Mexico offer some stabilization properties. However, many of the other countries, including Argentina, Brazil, and Peru, simply applied numerical rules for overall public spending without any output stabilization.

This problem may not be restricted to only Latin America but may affect developing countries as a whole. Del Granado et al. (2013) studied the cyclical behavior of public spending, particularly on education and health, in 145 countries between 1987 and 2007 and found that spending on education and health was pro-cyclical in developing countries and acyclical in developed countries. In addition, education and health expenditures follow an asymmetric pattern in developing countries. They are pro-cyclical during periods of positive output gap and acyclical during periods of negative output gap. Furthermore, the degree of cyclicality is higher, the lower the level of economic development, suggesting that this problem is especially pronounced for developing countries. Calderón and Fajnzylber (2009) documented that the pro-cyclicality of Latin America has improved since the early 2000s in large part due to the decline in government debt as a share of GDP after 2003. The decline in public debt was in turn driven by improvements in debt management and rising fiscal revenues associated with higher global commodity prices.

Daude, Melguizo, and Neut (2011) found that this pro-cyclical bias in fiscal policy persisted in the region during the recent global financial crisis, even though many countries did implement discretionary stimuli. They note that most Latin American economies collect significantly fewer tax revenues than the Organisation for Economic Co-operation and Development (OECD) economies. A government with a debt level of 40.0% of GDP that collects tax revenues of only 16.0% of GDP can actually have a debt-to-revenue ratio of 250.0%. Thus, many countries in the region cannot take fiscal sustainability for granted. They also noted, however, that there are important differences throughout the region. Brazil, Chile, Colombia, and Peru seem to be effectively rebuilding their fiscal space while Argentina and Costa Rica implemented traditional pro-cyclical fiscal policies. Zoido and Santiso (2010) also stressed this heterogeneity and the continued poor fiscal performance of some countries.

Calderón and Fajnzylber (2009) argued that pro-cyclicality has adversely affected the region's long-term growth in three ways. First, it amplifies economic fluctuations. According to estimates by Lopez-Monti (2009), the welfare cost of an amplified business cycle is not negligible. Second, governments tend to cut back on public investments during downturns. Last, pro-cyclical fiscal policy has made it difficult to expand social safety nets during economic downturns. The last adverse effect has major implications for inclusive growth as it could be especially harmful for poor and disadvantaged groups. These groups are more vulnerable during economic downturns due to their limited access to credit and limited capacity for consumption smoothing. Although, as noted earlier, the fiscal position of Latin American countries has greatly improved in the last 2 decades, the pro-cyclical bias of fiscal policy may be more difficult to alter in the short run. In this context, policymakers are beginning to pay more attention to pro-poor government expenditures, particularly to CCT programs that have become a feature of the region's fiscal policy.

III. THE IMPACT OF SOCIAL SPENDING AND TAXES ON INEQUALITY AND POVERTY

In a recent in-depth study, Lustig et al. (2013) applied standard benefit–tax incidence analysis to estimate the effect of direct taxes, indirect taxes, and subsidies, and social spending (cash and in-kind transfers) on inequality and poverty in six countries: Argentina (transfers only), Bolivia, Brazil, Mexico, Peru, and Uruguay. All country studies applied a common methodology to micro data obtained from household surveys (year of survey is in parenthesis). The studies for Bolivia (2009), Brazil (2009), Peru (2009), and Uruguay (2009) focused on average incidence for a particular (recent) year. The studies for Argentina (2003, 2006, 2009) and Mexico (2008, 2010) looked at how incidence has changed over a particular period. This study is one of the most detailed, comprehensive, and comparable benefit–tax incidence analyses available for Latin American countries to date.

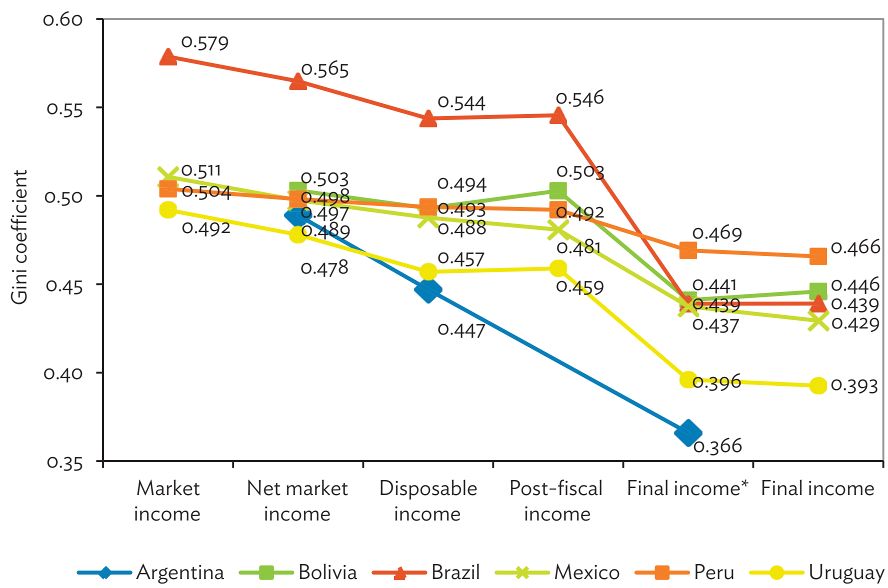
We used five income concepts in our incidence analyses: market, net market, disposable, post-fiscal, and final income. Market income is total current earned income from all labor and non-labor sources before direct taxes—auto consumption (except in the case of Argentina and Bolivia), imputed rent for owner-occupied housing, private transfers (remittances and other private transfers such as alimony), and old-age and other pensions from the contributory social security system. (We also performed a sensitivity analysis where contributory pensions were classified under government transfers.) Net market income equals market income minus direct personal income taxes on all income sources (included in market income) that are subject to taxation and all contributions to social security, except for the portion going to pensions. Disposable income is equal to the sum of net market income plus direct government transfers (mainly cash transfers but can include food transfers). Post-fiscal income is defined as disposable income plus indirect subsidies minus indirect taxes (e.g., value-added tax, sales tax). Final income is defined as post-fiscal income plus government in-kind transfers in the form of free or subsidized services in education, health, and housing minus co-payments or user fees. We also defined final income as disposable income plus government in-kind transfers in the form of free or subsidized services in education, health, and housing minus co-payments or user fees.

Consistent with other conventional tax incidence analyses, here we assumed that the economic burden of direct personal income taxes is borne by the recipient of income. The burden of payroll and social security taxes was assumed to fall entirely on workers. Consumption taxes were assumed to be shifted forward to consumers. Evasion of direct income and payroll taxes was taken into account in the analysis by assuming that individuals who do not participate in the contributory social security system do not pay income or payroll taxes (Brazil's survey includes a question on tax payments so tax evasion was assumed to be as reported in the survey). In the case of indirect (consumption) taxes, assumptions to take evasion into account varied. The approach to estimate the incidence of public spending on education and health followed here was the so-called "benefit or expenditure incidence" or "government cost" approach. In essence, we used per beneficiary input costs obtained from administrative data as the measure of average benefits.

The following are some of the key findings that emerged from the empirical analysis.

- **Inequality and poverty reduction.** Taxes and cash transfers reduced inequality and poverty by nontrivial amounts in Argentina and Uruguay, less so in Mexico, and little in Peru. In the case of Bolivia, inequality remained essentially the same, but post-fiscal extreme and moderate poverty increased with respect to market income. In Brazil, inequality fell significantly, but poverty rose (Figures 6 and 7).
- **Direct personal income taxes.** Revenue from personal income taxes included in the incidence analysis varied from around 5.0% of GDP in Uruguay to 0.0% in Argentina and Bolivia. In all countries in which direct taxes were analyzed, they were progressive; however, their redistributive power varied. The Gini coefficient declined by 2.8%, 2.6%, and 2.4%, respectively in Uruguay, Mexico, and Brazil while in Peru, it declined by only 1.1%. For the relatively small amount of direct taxes collected by Peru, their redistributive effect was relatively large.

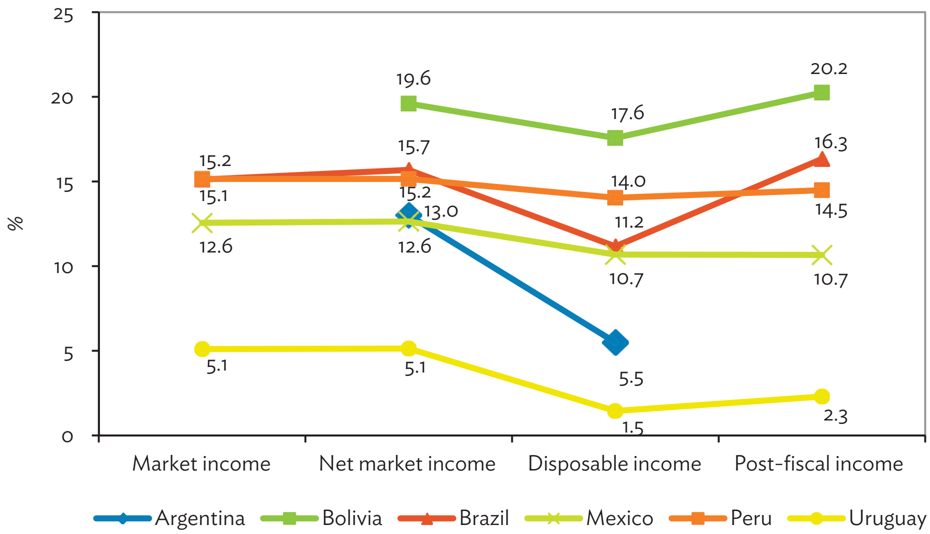
Figure 6: Gini Coefficient for Each Income Concept for Argentina, Bolivia, Brazil, Mexico, Peru, and Uruguay



Notes:
1. Final income* is defined as disposable income plus in-kind transfers minus co-payments and user fees. For the definition of other income concepts, see Lustig and Higgins (2013).
2. The analysis for Argentina does not include the tax side so the disposable income Gini is gross of direct personal income taxes. The results are thus not strictly comparable.

Sources: Bucheli et al. (2014); Higgins and Pereira (2014); Jaramillo (2014); Lustig and Higgins (2013); Lustig and Pessino (2014); Lustig, Pessino, and Scott (2014); Paz Arauco et al. (2014); and Scott (2014).

Figure 7: Extreme Poverty Headcount Ratio for Each Income Concept for Argentina, Bolivia, Brazil, Mexico, Peru, and Uruguay



Notes:
1. For definition of income concepts, see Lustig and Higgins (2013).
2. The analysis for Argentina does not include the tax side so the disposable income headcount is gross of direct personal income taxes. The results are thus not strictly comparable.

Sources: Bucheli et al. (2014); Higgins and Pereira (2014); Jaramillo (2014); Lustig and Higgins (2013); Lustig and Pessino (2014); Lustig, Pessino, and Scott (2014); Paz Arauco et al. (2014); and Scott (2014).

- Direct cash transfers. Direct taxes and cash transfers reduced inequality (as measured by the Gini coefficient and with respect to market income inequality) by as much as 8.6% in Argentina (even without including direct taxes) and 7.1% in Uruguay, to as little as 2.0% in Bolivia and Peru. Direct taxes and cash transfers reduced extreme poverty by more than 55.0% in Argentina and Uruguay but by only 7.0% in Peru, which spent too little on cash transfers to achieve much poverty reduction. Bolivia spent 5 times more than Peru (as a share of GDP) on cash transfers, but because funds were weakly targeted or not targeted at all to the poor, the amount of redistribution and poverty reduction has been limited. For Bolivia, the impact of these programs in terms of redistribution has been no better than Peru's, and in terms of poverty reduction, was only slightly higher.
- Indirect taxes. In Bolivia and Brazil,[1] indirect taxes wiped out the effect of direct transfers on extreme poverty which was actually slightly higher including taxes and direct transfers in income as compared to income before taxes and cash transfers. In contrast, extreme poverty rates in Mexico and Peru were virtually unchanged after indirect taxes because due to exemptions on essential goods and to informality, the poor pay little in the form of indirect taxes (Figure 7).
- In-kind transfers. Public spending on education and health was significantly more redistributive than cash transfers in all of the countries. When one adds the effect of transfers in-kind (access to free or quasi-free services in education and health), inequality declined by

[1] In Brazil, however, the poverty-increasing impact of indirect taxes may be overestimated due to the assumption of no differences in evasion rates along the income distribution.

14.0 percentage points in Brazil, 12.3 percentage points in Argentina,[2] 9.9 percentage points in Uruguay, 8.1 percentage points in Mexico, 5.7 percentage points in Bolivia, and only 3.8 percentage points in Peru as measured by the difference between the final income Gini coefficient and the market income Gini coefficient (Figure 6). Peru was the least redistributive for two main reasons: the amount of social spending was relatively small and the total redistributive effectiveness of social spending was the second lowest (after Bolivia). In Bolivia, the limited redistributive power stems from the fact that per capita spending is practically the same for everyone. In a country with such a high incidence of poverty, we would like to observe more "pro-poor" education and health spending. The low progressivity of education spending is explained by (i) the comparatively low progressivity of primary education (due to low coverage rates among the poor) and (ii) an exceptionally high allocation of educational spending to tertiary education.

- Unpleasant facts. The largely positive redistributive picture in Argentina, Brazil, and Uruguay hides some unpleasant facts. In Brazil and Uruguay, spending on tertiary education is clearly "pro-rich;" in both countries, a large proportion of tertiary education spending subsidizes the rich—those with incomes above $50 per day in purchasing power parity terms—who receive a budget share significantly larger than their population share. In Argentina, government spending on progressive cash transfers is substantially less than the budget share allocated to indirect (and regressive) subsidies to agricultural producers, airlines, manufacturing, and transportation and energy. Furthermore, Argentina's social spending may not be fiscally sustainable as the sharp rise in public spending during the 2000s has been increasingly financed by distortionary taxes and unorthodox revenue-raising mechanisms.

In sum, redistribution and poverty reduction through fiscal policy is nontrivial especially in Argentina, Brazil, and Uruguay. As an important contributing factor, cash transfers were quite progressive in absolute terms, except in Bolivia where programs are not targeted to the poor. However, their poverty-reducing impact, as expected, was smaller in countries that spent less (as a share of GDP) on direct cash transfers targeted to the poor (Mexico and Peru). Including the monetized value of in-kind services in income, in all six countries, public spending on education and health reduced inequality considerably more than cash transfers. Direct taxes are progressive, but the redistributive impact is small because direct taxes as a share of GDP are generally low. Indirect taxes offset the poverty-reducing effects of cash transfers in Bolivia and Brazil. In Mexico and Peru, the poverty-increasing effect of indirect taxes is tempered because basic goods are exempted and there is a high level of informality (e.g., consumers are able to avoid indirect taxes).

Of the three most redistributive countries, Brazil would significantly improve its redistributive effectiveness if cash transfers were more targeted and if tertiary education for the rich were not so heavily subsidized. The latter is also true for Uruguay. Brazil would also improve its poverty-reducing impact if consumption taxes were lower. In the case of Argentina, the fiscal sustainability of its redistributive model is seriously in question. Of the three least redistributive countries, Mexico and Peru reduced inequality and poverty relatively little because they spent less on cash and in-kind transfers than Argentina and Brazil. Bolivia's social spending was higher than Mexico's and Uruguay's (a high redistribution country), but because Bolivia's cash transfer programs are not specifically targeted to the poor, redistribution was small in scale.

2 It should be noted, however, that Argentina is not strictly comparable as the analysis firstly does not include the impact of taxes and secondly, does not include public spending on the contributory health system.

IV. LATIN AMERICAN EXPERIENCE WITH CONDITIONAL CASH TRANSFER PROGRAMS

As previously stated, Latin American countries have developed policies since 1920 for social insurance, social assistance, and basic social services. Until 1980, social policy in Latin America was dominated by contributory social insurance schemes with government efforts centered on widening coverage among urban formal-sector workers. Social assistance programs during this period included family allowances, noncontributory pensions, health insurance, and emergency public employment that had a progressive benefit incidence but were quantitatively inadequate to ease the hardship of the poor. Their ineffectiveness was exacerbated by poor design and implementation. For example, from 1972 to 1982, in 13 Latin American countries, social assistance accounted for 17.0% of total public social spending while social insurance consumed 83.0% (McGuire 2011).

During the 1980s and 1990s, however, the combination of economic crises and new-found political democracy fueled public spending on social assistance and basic social services, both of which targeted the poorer portion of the population and reduced the coverage of social insurance. Due to a poor setup in some initial trials in the 1980s, the redesigned social spending program remained unsuccessful in reaching the poorest parts of the population. Despite this, the use of CCTs has become a unique and successful feature of Latin American expenditure policy for social inclusion since the 1990s. Countries in Latin America have adopted CCT programs at a rapid rate; nowadays virtually every country in the region has such a program. The two largest programs are in Brazil and Mexico and have covered millions of poor people.[3] (See the following box.)

Bolsa Família

In 2003, the government of Luis Inacio Lula da Silva launched a comprehensive program to stimulate growth and social progress. On the social side, the centerpiece was a sweeping reform of Brazil's social safety net, the *Bolsa Família* Program which integrated four cash transfer programs into a single program. The transfers are made preferentially to women in each family. The program supports the formation of human capital at the family level by conditioning transfers on behaviors such as children's school attendance, use of health cards, and other social services. Since its launch, the *Bolsa Família* Program has grown exponentially, and by the end of 2006, about 50 million people were served, at least two-thirds of whom were very poor. The *Bolsa Familia* has been widely admired among developing countries because it is perceived to have reduced poverty significantly without harming economic growth. Furthermore, the fiscal cost of the program has been relatively small.

Sources: Lindert, Skoufias, and Shapiro (2006); Glewwe and Kassouf (2010).

There is a huge body of literature discussing issues in CCT programs. The most comprehensive study of them was conducted by Fiszbein et al. (2009) and included 90 pages of detailed descriptions of CCT programs around the world. We summarize only the most important issues in this paper.

A. Conditional versus Unconditional Cash Transfers

First, there is a question of whether conditionality is necessary for cash transfer programs. Three types of programs are found in many developing countries: unconditional cash transfers (UCT), CCT, and workfare programs (i.e., cash transfers conditional on work). The workfare programs have a somewhat different purpose since they provide temporary employment opportunities. The CCT programs are

[3] CCT programs are also found in Asia, such as in Bangladesh, Cambodia, India, Indonesia, Nepal, the Philippines, and others, but the scale is much less than in Latin America.

different from UCT programs, because unlike UCT programs, CCTs impose conditions on recipients that must be fulfilled in order to gain benefits from the program. While CCT recipients do not have autonomy to spend the money they receive, CCTs are believed to be more effective in promoting human capital investment even though the main goal varies greatly across countries. While most CCT programs target poor families to foster human capital investment—especially in education and health care—CCT programs in Bangladesh and Cambodia have been used to reduce gender disparities in education and in Sub-Saharan African countries to alleviate HIV epidemics.

For social protection, both UCT and CCT programs are potentially more efficient and more effective than in-kind transfers. This is clear from the broad objective of the cash transfer programs which is to generate a sustained decrease in poverty among some of the most disadvantaged groups. The underlying premise is that a major cause of the intergenerational transmission of poverty is the inability of poor households to invest in the human capital of their children. Supply-side interventions that provide in-kind transfers through the availability and quality of education and health-care services are often ineffective in resolving this problem since the resource constraints facing poor households preclude them from incurring the private costs associated with utilizing these services. Unlike in-kind transfers, however, cash transfer programs that do not require large storage or transportation costs address this problem by targeting the poorest communities which, if done effectively, transforms them into human capital subsidies for poor households.

On the other hand, a well-known shortcoming of UCTs is that recipients may use the money for things like cigarettes, alcohol, or gambling as has been shown in many studies in the literature (e.g., Srisuchart 2008). The downside of the CCT is that conditionality involves substantial administrative costs for monitoring, so the key question is whether the welfare gains from CCT programs are bigger than those of UCT programs after taking into account the administrative costs.

There are several empirical studies on this issue using various methodologies. In general, research has found that CCT programs proved to be much more successful in reaching the poor than any other form of social assistance. (See, for example, Lindert, Skoufias, and Shapiro 2006; Tesliuc et al. 2006; Hernanz, Malherbet, and Pellizzari 2004. Also see Parker, Rubalcava, and Teruel 2008; and Fiszbein et al. 2009 for a literature review). Furthermore, most studies on Latin American countries show that benefits from conditionality can outweigh the cost of monitoring. The most successful CCT program, Brazil's *Bolsa Família* that reaches almost 50 million people, costs only 0.4% of GDP, about half of which is actual transfers (Glewwe and Kassouf 2010).

We should not, however, ignore the political dimension, especially since conditionality makes cash transfers more politically acceptable to non-beneficiaries. Middle- and upper-class voters may believe that UCTs are subject to abuse unless they are tied to an improvement in specific indicators or behaviors (Febriany and Suryahadi 2012). In Indonesia, the introduction of the UCT program in 2005 generated a much higher level of public attention and scrutiny than other social protection programs had, and in some areas, it led to community conflicts, widespread protests, and even riots. Indonesia's UCT program was heavily criticized on the grounds that it would be ineffective in the long term because it would create dependency and disincentives to work.

It is also very important to understand that it is not simply a matter of UCT versus CCT in itself. Program design, implementation, targeting, timing, and level of benefit matter as well (Fiszbein et al. 2009; and Bazzi, Sumarto, and Suryahadi 2012). For example, the programs in Bangladesh and Cambodia have several common elements. They are both poor countries with limited administrative capacity, so both programs set forth only education conditions for cash benefits and are limited in scope to secondary education for girls. Nevertheless, because of careful geographic and proxy means targeting, Cambodia was able to concentrate benefits among the poor. In Bangladesh, the program operates nationally and is targeted only by gender. In practice, the incidence of the program has been regressive largely because the base enrollment is higher among the less poor. This suggests that the program may be particularly effective in rural areas where child labor is more prevalent, i.e., CCTs will be more effective in areas with high opportunity costs for children's time. This is indeed a justification for Mexico's CCT program that is targeted in rural areas. In addition, the program allocates more to girls.

B. Impact Evaluation

CCTs have been praised as a way of reducing poverty and encouraging parents to invest in the education and health of their children. Many researchers and governments have investigated if empirical evidence supports this assumption. Unlike most other government programs, CCTs have been subject to rigorous evaluations of their effectiveness, using experimental or quasi-experimental methods. The assessments have addressed various aspects, such as their impact on poverty reduction, employment, schooling, and health.

Several single-country studies show that CCT programs have achieved significant success in reaching the poor and bringing about short-term improvements in consumption, education, and health (Schultz 2004; Gertler 2004; Behrman, Parker, and Todd 2005; Rawlings and Rubio 2005; Schady and Araujo 2008; Baird, McIntosh, and Özler 2011; de Brauw and Hoddinott 2011; and Barrera-Osorio and Raju 2011). Some reviews of the literature on CCT evaluations conclude that on the whole, these programs have had positive effects on schooling (enrollment, attendance, dropout rates); health (vaccinations, medical checkups); and child nutrition outcomes (Fiszbein et al. 2009, Saavedra and Garcia 2013). These reviews also indicate that there is substantial variation in effect between countries and among different population groups even within the same country.

One natural question is whether the results depend on the design quality of the studies. Lagarde, Haines, and Palmer (2007) reviewed the literature and selected studies that met specific design criteria (randomized controlled trial, interrupted time series analysis, and controlled before and after study) and included a measure of at least one of the following outcomes: health-care utilization, health expenditure, or health outcomes. In all, 28 papers met the criteria and were reviewed for possible assessment. They then selected 10 of the 28 for more in-depth analysis and assessment. Overall, the evidence from these analytically rigorous, high-quality studies suggested that CCT programs were indeed effective in increasing the use of preventive services and sometimes in improving health status.

Ranganathan and Lagarde (2012) provide an updated overview of CCT programs in low- and middle-income countries and present the evidence on their contribution to improvements in health and the encouragement of health-conducive behavior. Again, several bibliographic databases and websites were used to identify relevant studies that met the criteria; experimental or quasi-experimental study designs were deemed suitable. They identified 13 CCT programs, mostly in Latin American countries, whose effects had been evaluated. Their updated results confirmed that CCT programs have indeed been effective in increasing the use of preventive services, improving immunization coverage and certain health outcomes, and in encouraging health-conducive behavior.

Despite these positive effects, many questions remain unanswered, including the potential of CCT programs to function well under different conditions, to address the broader range of challenges among poor and vulnerable populations, and to prevent the intergenerational transmission of poverty. De Janvry and Sadoulet (2006) provide some insights on this issue. Using randomized experimental data from the *Progresa* (*Oportunidades*) program in Mexico, they showed that large efficiency gains can be achieved by taking into account how much the probability of a child's school enrollment is affected by a conditional transfer. Rules for targeting and calibration can be made easy to implement by selecting indicators that are simple, observable, and verifiable, and that cannot be manipulated by beneficiaries. The Mexican case shows that these efficiency gains can be achieved without increasing inequality among poor households.

A recent survey study by Saavedra and Garcia (2013) using several dozens of case studies evaluated the impact of CCTs on educational outcomes along with their cost-effectiveness and found a great deal of heterogeneity in both. They found that CCT programs in developing countries are more effective at increasing school enrollment and attendance, with relatively low levels of baseline school enrollment, and therefore are particularly effective at increasing secondary enrollment and attendance. In addition, their results indicate that program impact and cost-effectiveness are significantly larger when programs attempt to provide assistance and improve educational supply through grants, infrastructure, or other resources for schools instead of providing family transfers only. They further found that these programs have a greater impact on education when they have lower payment frequency and more stringent schooling conditions. All these results are generally consistent with previous studies and suggest that specific conditions and requirements really matter in the effectiveness of CCT programs.

C. Other Considerations

It is important to understand that human capital accumulation cannot be addressed solely by CCT programs. This is especially true in countries or regions where the supply of such services is insufficient or of low quality. In other words, constraints to the supply of education or health care impinge upon the effectiveness of CCTs. Cash transfers may be the right policy instrument to alleviate poverty in the short run, but their contribution to longer-term poverty reduction depends on supply-side factors as well.

In addition, although CCT programs have promoted greater consumption of education and health services among the poor, the evidence on improvements in education and health is mixed. Therefore, although there is clear evidence that CCTs increase the likelihood of access, the evidence of their impact on improving learning outcomes and nutritional standards is weaker. There are several reasons for this. One possibility is that there are important constraints at the household level that are not addressed by CCT programs. Other inputs into the production of education and health might play a substantial role as well. Another possibility is that the low quality of available services prevents increased use from leading to substantially improved final outcomes. Thus, CCT programs should be combined with other programs to improve the quality of the supply of education and health services as well as the access to these programs. This also suggests the need for more research that investigates final outcomes rather than access alone.

Some policymakers worry about the potential side effects of CCT programs, such as disincentives to work, crowding out private transfers, effects on fertility and family composition, and effects on local wages and prices. The evidence reviewed in Fiszbein et al. (2009), however, suggests that these effects have generally been modest. They conclude that offsetting behavioral responses are unlikely to be large and that the marginal propensity to consume out of transfer income is high. Moreover, because transfers generally are well targeted to the poor, the effects on consumption have translated into sizable poverty reduction.

The evidence further suggests that CCT programs generally do not have large disincentive effects on the labor supply of adults. Although the results should be interpreted with caution in large part due to their short time horizon, they generally find that CCT programs do not discourage work. In addition, unlike most social assistance programs in the developed world, there is little evidence that CCT programs crowd out private transfers, and they do not appear to have had large effects on fertility either. Finally, the evidence shows that CCT programs have had no significant negative effects on wages, prices, or the receipt of other welfare payments.

In sum, the main conclusion is that CCT programs have generally worked well in Latin America. Most programs, especially those making sizable transfers, have had substantial impacts on consumption and on poverty. While effects such as work disincentives were a source of concern, they do not appear to have occurred on a scale large enough to offset the benefit of the transfers. Moreover, CCT programs generate many positive externalities. For example, monitoring and evaluating them helps to strengthen institutions and policies. This is potentially a very important issue in countries where monitoring and evaluation systems are not very well developed.

V. POLICY LESSONS FOR DEVELOPING ASIA FROM THE LATIN AMERICAN EXPERIENCE

In this paper, we looked at the Latin American experience using fiscal policy to tackle inequality and promote inclusive growth with a view to drawing relevant policy lesson for developing Asia. The fact that Latin America is more or less at similar income and development levels as Asia makes the exercise all the more opportune and timely as developing Asia is beginning to explore leveraging fiscal policy—public spending and taxation policies—to tackle the region's growing inequality. Further, Latin America has had a sizable head start on Asia in inclusive fiscal policy.

At a macro level, the overriding lesson for developing Asia is that fiscal policy can have a significant effect on inequality and poverty even in developing countries. In this context, the Latin American experience may be more relevant for Asia than the advanced-country experience since Asia and Latin America face a much more urgent need to preserve growth even as they use fiscal policy to promote equity. That is, both regions understandably accord a higher priority to growth relative to equity compared with advanced countries that are much richer. We should, however, remember that developing Asian economies have grown much faster than Latin America's, and as a result, poverty reduction has been much greater (ADB 2012). Therefore, of utmost importance to Asia are equity-promoting fiscal policies that do not jeopardize economic growth and in particular, fiscal sustainability. Fiscal activism in the cause of equity must not impinge on growth and fiscal space.

In this context, the Latin American experience indicates that one particular instrument of inclusive fiscal policy, namely CCT programs, offers a promising way forward for Asian economies. CCT programs have proven to be an effective means of assisting the poorest and most vulnerable members of society in Latin American countries. They promote equity because they are targeted at the poor, and growth because they build up human capital via investments in education and health care. A key additional attraction of CCTs is that, if designed and implemented well, they need not impose large fiscal burdens that harm fiscal sustainability.

CCTs are not without potential problems. One area of concern for Asian policymakers is the impact of CCT programs in very different settings and outcomes that have not yet been studied. Although there is some encouraging evidence on the impact of CCTs in low-income countries, including Bangladesh, Cambodia, and Pakistan, most of it is still confined to middle-income countries of Latin America. In addition, Asian evidence is limited and also more mixed compared with Latin American evidence. For example, in Bangladesh, many people fail to participate in CCTs in large part due to the very low benefit level.[4] Moreover, as mentioned earlier, CCTs were more successful in Cambodia than in Bangladesh because the program was better targeted.

There is little guarantee that programs that worked well in Latin America will work well in Asia. A complex administrative structure to monitor a large-scale program does not exist in many developing Asian countries. On the other hand, the role of the community could be greater in Asia than in Latin America, so a simple pilot program that emphasizes the role of the community in implementing the programs could work in Asia.

Son (2008) warns that CCT programs are not a panacea to reduce poverty, and policymakers should be aware of their limitations. First of all, countries that provide CCTs must have the social services in place to meet the demand created by the program. This reiterates the point we made earlier about supply-side constraints to the effectiveness of CCTs. Most of all, CCT programs need to be carefully monitored and rigorously evaluated. They also need high-level political support because they are typically implemented by multiple government agencies that need to work closely with each other.

Furthermore, CCT programs are just one option among many social protection programs; they cannot be the right instrument for all poor households. Most of all, they have limited relevance for the elderly poor or households whose children are outside the age range covered by the CCT. Redistribution to those groups can be better handled with different kinds of programs. In particular, for the elderly poor, social insurance programs, such as pensions, are the preferred instruments to provide assistance since justification for further human capital development is weak. This is particularly important in Asia where many populations are aging rapidly.

In addition, since the focus of CCTs is long-term human capital investment, it is questionable if these are the best instruments to deal with transient and acute poverty. Programs like workfare seem to address macroeconomic shocks better than CCT programs. Finally, fiscal policy is just one part of the policy package for inclusive growth. Land reform, sound governance, and other policy instruments can give the poor greater economic security and enhance children's education and health, which in turn can make them more productive. A number of Asian governments have followed this route to greater prosperity, but many of them still have a long way to go.

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[4] Transfers as a share of pre-transfer consumption among all beneficiaries were 0.6% in Bangladesh's Female Secondary School Assistance Project in 2000 while they were 6.1% in Brazil's *Bolsa Família* in 2006 and 21.8% in Mexico's *Progresa* (*Oportunidades*) in 2004 (Fiszbein et al. 2009).

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Fiscal Policy and Inclusive Growth in Latin America

Lessons for Asia

Latin America's experience with inclusive fiscal policy can offer valuable lessons for developing Asia in its new-found quest to leverage public spending and taxation to spread the benefits of growth to the broader population. Of particular interest is its generally successful experience with conditional cash transfer (CCT) programs. Overall, the evidence suggests that CCT programs can be an effective tool for inclusive growth in Asia, too. However, CCTs are not a panacea for poverty and inequality, and the ingredients for their success in Asia may differ from those in Latin America.

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