

# Why has Poverty Increased in Chile?

**In Chile, 75% of the poverty decrease is due to economic growth. In this perspective, the economic policies which favor employment and productivity are essential tools to uproot poverty. Likewise, the poverty increase between 2006 and 2009 is mainly explained by the economic deceleration.**

The last report of the CASEN Survey revealed an unexpected poverty increase in Chile, in spite of the former government's effort to emphasize the social aspect, expressed in a substantial growth of public spending. A possible explanation is given by Larrañaga y Herrera (2008)<sup>1</sup> who concluded, in a study for a precedent period, that economic growth accounted for 72% of the poverty decrease (1990-2006).

Libertad y Desarrollo has just finished a new study which points out that the growth effect (in this case, the economic deceleration) is the main explanation for the unexpected poverty increase during 2006-2009. The study also shows that social policy has lost focalization during the last 20 years, which means a worrisome increase in the social spending with low effectiveness. A reflection thereof is the recent poverty increase during a period of strong social spending increase.

Table 1 shows how poverty indicators have evolved in the last 20 years; poverty, extreme poverty and poverty gap indicators are illustrated. This last measure indicates the extent of poverty. It is calculated as the difference between the per capita income and the poverty line. In relation to the evolution of these indicators, we observe that they all changed for the worse in 2009.

### **The Trouble is Growth**

In order to answer the question of why poverty increased, it is interesting to calculate in what proportion economic deceleration contributed to the poverty increase. The methodology introduced by

Datt-Ravallion (1991)<sup>ii</sup> allows decomposing the variation of the poverty estimators in two parts: one related to economic growth and the other one to income redistribution.

Table 1

EVOLUTION OF POVERTY INDICATORS				
	1990	2000	2006	2009
<b>Pobres Totales (% de la población) (1)</b>	38.6	20.2	13.7	15.1
<b>Indigentes (% de la población)</b>	13.0	5.6	3.2	3.7
<b>Brecha Pobreza (%) (2)</b>	12.4	4.3	1.8	2.3

(1) Corresponde al total de Pobres no Indigentes más Indigentes.  
 (2) Cuociente entre la distancia entre el ingreso per capita de cada individuo pobre a la línea de la pobreza, con el número total de individuos calificados como pobres.

Source: Self-preparation based on the CASEN Survey.

When applying this methodology to Chile, we observe that during the last 20 years, economic growth accounts for most of the poverty decrease. As can be observed in Table 2, between 1990 and 2009 poverty decreased 23.47%; 17.61% of this figure is explained by economic growth, which represents 75%.

It is also worth noting that most of this decrease occurred during the first 10 years, between 1990 and 2000. In this period, poverty decreased 18.37%, of which 17.99% is explained by the growth effect, corresponding to 97.9%. Then, in the following 10-year period, between 2000 and 2009, poverty decreased 5.10%. The redistribution effect accounts for 5.09% of this decrease. Likewise, we observe that between 2006 and 2009, poverty increase is mainly due to economic deceleration. Moreover, it is shown that deceleration contributed with 2.02% to the poverty increase.

Table 2

DECOMPOSITION OF POVERTY MEASURES, DATT-RAVALLION					
Períodos	1990-2000	2000-2006	2000-2009	2006-2009	1990-2009
<b>Reducción de la Pobreza</b>	<b>-18,37%</b>	<b>-6,51%</b>	<b>-5,10%</b>	<b>1,41%</b>	<b>-23,47%</b>
Efecto Crecimiento	-17,99%	-1,71%	0,03%	2,02%	-17,61%
Efecto Desigualdad	0,35%	-4,21%	-5,09%	-0,57%	-3,17%
Residuo	-0,73%	-0,58%	-0,03%	-0,04%	-2,69%
<b>Variación Brecha de la Pobreza</b>	<b>-8,02%</b>	<b>-2,50%</b>	<b>-2,00%</b>	<b>0,50%</b>	<b>-10,01%</b>
Efecto Crecimiento	-8,09%	-0,73%	-0,50%	1,07%	-7,95%
Efecto Desigualdad	0,66%	-1,94%	-2,09%	-0,49%	-2,46%
Residuo	-0,58%	0,17%	0,60%	-0,07%	0,40%

Source: Self-preparation based on the CASEN Survey.

Table 2 uses the same Datt-Ravallion decomposition for the poverty gap indicator. It is important to notice that the growth effect also explains the poverty gap indicator decrease during those 20 years. The poverty gap indicator decreases 10.01% between 1990 and 2009, where growth accounts for 7.95%, that is, 79.4% of the fall, while between 2006 and 2009, the poverty gap increases 0.50%, where growth accounts for 1.07%.

### **The Trouble is Focalization**

The other explanation as to why poverty increased is that this strong spending increase did not reach the poorest. Between 1990 and 2009, the resources allocated to social spending increased substantially. Nevertheless, this increase did not go along with the subsidies' focalization. In fact, according to the Statistical Report of Public Finance of the Budget Office (DIPRES), social spending had quadruplicated in this period, while poverty had decreased only 23.5 percentage points.

In order to analyze if the focalization of the government's transfers got worse or not, monetary and non-monetary subsidies must be considered. Monetary subsidies are money transfers allocated to people who comply with specific features, while non-monetary subsidies are transfers in species, services or other type of goods.

For the non-monetary subsidies, health and education benefits were assessed. They were distributed by deciles, according to the information of the CASEN Survey regarding the people who declared to be beneficiaries.

Chart 1 shows the distribution of the monetary and non-monetary resources allocated by the government among the different deciles in an accumulated form, from the poorest households to those of higher incomes. These amounts are accumulating, that is, the first decile accumulates the average subsidy of the households pertaining to the poorest 10%, and so on, until decile 10 accumulates the average value of all the respective subsidies. Intuitively, in a perfectly focalized world, we should expect that all resources reach decile 1 and the charts would have the form of an inverted "L".

In the following charts, all subsidies show a clear focalization loss in the benefits' allocation.

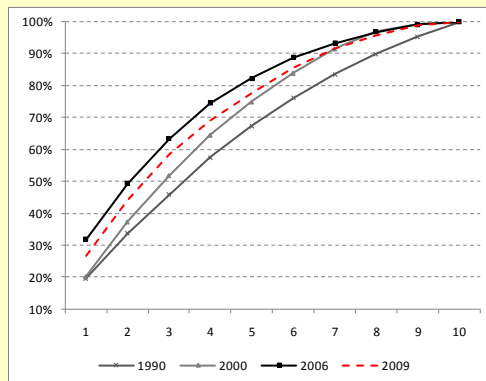
In the case of Monetary Subsidies (a), focalization was improving until 2006; in 2009, however, it got worse. The first warning signal is

that in 2006, decile 1 was capturing 31.9% of the resources, and in 2009, only 26.6%.

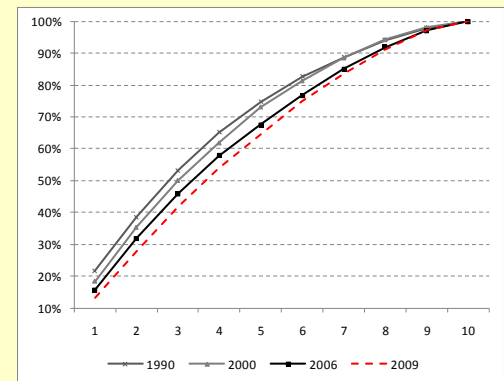
Chart 1

## EVOLUTION OF THE SUBSIDIES' FOCALIZATION BY RELATIVE VALUE (IN CHILEAN PESOS NOVEMBER 2009)

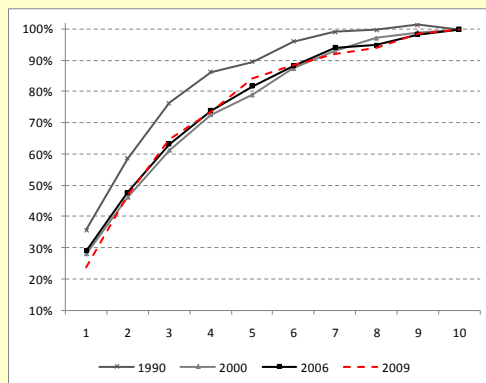
a) Monetary Subsidies



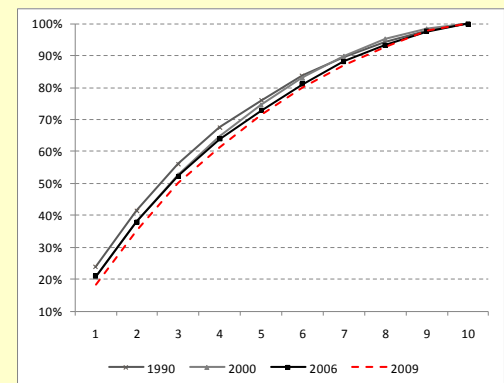
b) Education Subsidies



c) Health Subsidies



d) Total Subsidies



Source: Self-preparation.

In the case of Education Subsidies (b) the evolution is even worse. We observe that focalization had gotten worse since 1990. Each year, less subsidy resources were given to the 10% corresponding to the poorest households. In 1990, 22% of the resources were allocated to the poorest 10% of households. Then, in 2000, 18% of these resources were allocated to the first decile. In 2006, it decreased to 16%, and in 2009, to only 13%.

With regard to Health (c), we observe that focalization got worse since 1990, and we may conclude that the first decile in 2009 presents a worst focalization. In fact, in 1990, 36% of the resources were allocated to the poorest 10% of households and, in 2009, only 24%.

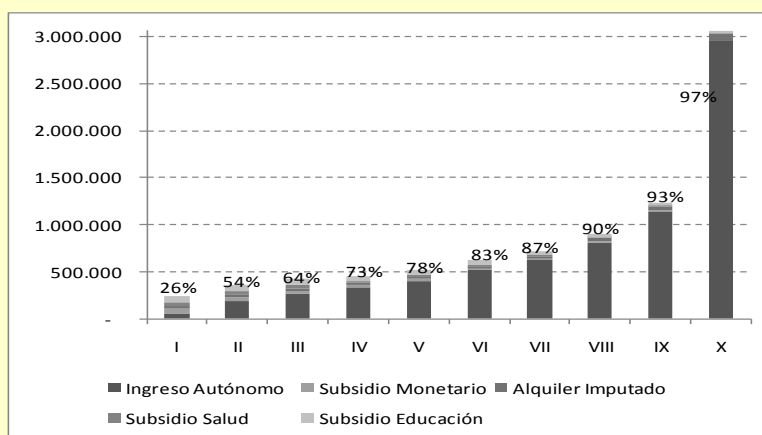
Finally, it shows that when all subsidies (d) are aggregated, there is a substantial loss in the social policy focalization during these 20 years. In 1990, 24% of the subsidies were allocated to the first decile, while in 2000 and 2006 it was 21%. In 2009 it was only 18%.

It is important to highlight that the share of these subsidies, increases in the household's total income. This is a worrisome trend, since there is greater dependence on the State's benefits and less incentives to come out of poverty.

On the other hand, Chart 2 shows the incidence percentage of the autonomous income on the total income by income decile. In other words, it shows the importance of the subsidies described earlier on the total income. It indicates that, for the first decile, 26% of the total income corresponds to autonomous income. For the higher income 10% of households, the autonomous income accounts for 97%. For the first decile, 74% of their income depends on the government's transfers, so it is very hard not to generate a dependence on the government's transfers and come out of poverty.

Chart 2

### TOTAL INCOME COMPOSITION, 2009 (IN CHILEAN PESOS NOVEMBER 2009)



Source: Self-preparation

### Conclusions

In the last 20 years, growth has been the most important factor for reducing poverty. The study of Libertad y Desarrollo reveals that, even if social spending increases, as it happened in the period 2006-2009, poverty uprooting is only possible when economy grows. This research shows that 75% of the poverty decrease in Chile is due to economic growth. In this perspective, the economic policies which favor employment and productivity are essential tools to uproot poverty. Likewise, the poverty increase between 2006 and 2009 is mainly explained by the economic deceleration; therefore, we confirm the thesis demonstrated in the study of Larrañaga and Herrera, in the sense that the best social policy is the one which fosters economic growth.

This study clearly shows that it is necessary to improve the focalization of the government's subsidies. It indicates that, despite the significant increase in the amount of subsidies, focalization has suffered a serious deterioration.

Likewise, it shows the great dependence of the 10% of poorest households on the government's transfers. The latter reveals a new challenge: incentives must be improved so that people are able to overcome poverty.

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<sup>i</sup> Larrañaga and Herrera (2008). "Los recientes cambios en la desigualdad y la pobreza en Chile". Estudios Públicos, 109. CEP, Chile.

<sup>ii</sup> Ravallion, M. and Datt, G. (1991). "Growth and Redistribution Components of Changes in Poverty Measures: A Decomposition with Applications to Brazil and India in the 80's". World Bank. Living Standard Measurement Study, Working Paper 83. Washington DC.