

Social Transfers and Growth in Poor Countries^{*}

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- Poverty reduction is the primary aim of social transfer programmes, but they also have the potential to support micro-level growth processes.
- Social transfers raise investment in human capital, particularly education and health, improving the underlying micro-level determinants of growth.
- The concerns raised in the theoretical literature that social transfers have a negative effect on labour supply and savings rates are largely unsupported by empirical studies.

A feature of the last decade has been the emergence of large scale social transfers programmes in many developing countries. Studies assessing the effectiveness of these programmes suggest social transfers have the potential to make a significant contribution to poverty and vulnerability reduction. The studies also show that social transfers are often associated with household investment in human capital and other productive assets. This raises the important question whether, and to what extent, social transfers contribute to broader growth objectives. This is the main focus of this practice note.

Large scale social transfer programmes are emerging in many developing countries

Over the last decade a significant number of large-scale social transfer programmes have emerged in a variety of developing countries, aimed at alleviating poverty. China's Minimum Living Standards programme and India's National Rural Employment Guarantee Scheme (when fully implemented) will each reach 24 million households. The Productive Safety Net Programme in Ethiopia reaches 7 million households, while *Bolsa Familia* in Brazil reaches 12 million. These and the many other schemes around the world have the potential to contribute to improving the lives of many poor people.

There is a growing number of studies assessing the effectiveness of social transfer programmes at reducing poverty. The general finding from these studies is that social transfers have the potential to make a significant difference to poverty and vulnerability in the developing world. They also find that, in addition to supplementing household income and consumption, social transfers facilitate household investment in their productive capacity. In some social transfer programmes, household investment in human development is an explicit objective of the programme. In other programmes, investment in other productive assets is a component. Many studies find, across a range of programmes and countries, that a good number of households in receipt of transfers show

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some improvement in their productive capacity. To date, insufficient attention has been paid to the potential impact of transfer programmes on growth and development. Social transfers can facilitate growth-mediating processes among poor household in a number of ways.

Social transfers can help move people out of poverty traps by addressing credit constraints...

Social transfers can enable people to overcome barriers to escaping poverty. The poor often face a limited set of economic opportunities and can find themselves trapped in a cycle of low income and low growth. For example, the poor are frequently highly credit constrained because they lack the assets to use as collateral to access loans. Social transfers, if they are regular and reliable, or effectively combined with other interventions, can help to alleviate this credit constraint. In Brazil, for instance, recipients of the social pension provided to informal workers are able to access loans from banks by showing the magnetic card used to collect the pension, proving that they have a source of regular income. Improving the availability of credit can enable households to make investments in human and productive capital, helping to move them onto cycles of rising income and improved opportunities.

... and improve their productive capacity

There is strong support from a range of studies that recipient households for both conditional and non-conditional transfers often invest in human capital, particularly through enrolling their children in school, helping to improve the underlying determinants of growth. For instance, the social pension in South Africa has been estimated to increase school enrolment of children living in three-generation households by about 3.1%, with a stronger effect among the poor (about 5%) and among girls, who are found to be around 7% more likely to attend school if living with a pensioner. Given that higher educational attainment and improved health and nutrition are strongly correlated with higher productivity and earnings, this can be expected to have a significant impact on the lifetime earnings of recipients. Furthermore, transfers reduce the incidence of child labour. Studies undertaken in Brazil have indicated that children of parents who entered the labour market early are more likely to do so themselves, and that this results on average in lower lifetime earnings of 13 to 17% and an increased probability of poverty of 7 to 8%. By reducing the incidence of child labour, social transfers help to prevent the transmission of poverty from one generation to the next. Many social transfers include conditions requiring recipients to engage in human or physical capital accumulation, through sending their children to school, making use of local health services or engaging in the construction of local infrastructure. Where this is the case, the impact on human capital improvement is usually greater.

Social transfers can help improve household resource allocation

Social transfers can encourage the use of household resources in a more productive fashion although the evidence on this is far from systematic. In many programmes, it is common for the transfer to be paid to the mother. This is done because it is generally found that children stand to gain more benefit if it is the mother that is the direct beneficiary. Paying mothers is also likely to have a positive impact on intra-household

resource allocation, since household decision-making is strongly influenced by the relative share of income contributed by each member. Improving the position of women in the household can impact not only on the share of income spent on human capital but also affects productive investment decisions. For instance, households in Burkina Faso have been found to under-invest in inputs of labour and fertilisers in women's plots of lands because the women are concerned that their plots and yields will be expropriated by their husbands. By improving women's position in intra-household bargaining, such outcomes become less of a threat, enabling more efficient investment decisions that serve to maximise household income.

Transfers can also protect the poor from hazards...

Social transfers can help protect households from crises, ensure a better use of resources and alleviate inter-temporal distortions on human and productive capital investment. Inadequate insurance protection leads the poor to an inefficient use of resources, such as opting for low-risk/low-return crops and production methods, and holding liquid but less productive assets. It also affects inter-temporal resource allocation, such as through inducing the withdrawal of children from school in response to adverse shocks. Regular and reliable social transfers can improve household security, firstly through supplementing household income and thereby ameliorating the impact of consumption shocks, and secondly through integrating insurance features protecting consumption, assets and investment. However, few social transfers include explicit insurance components, as they transfer fixed amounts at regular intervals without reference to shocks or crises. An important exception is India's National Rural Employment Guarantee Scheme, which provides an entitlement to up to 100 days of work for unemployed rural households, on demand. This is specifically designed to smooth consumption among beneficiaries. Other social transfer programmes could be designed to include insurance components, encouraging better allocation of resources among beneficiaries and helping to prevent the need for the fire sale of productive assets.

... and have the potential to support the local economy

There is insufficient evidence on whether social transfers have a significant positive effect on the local economy, largely because of the scarcity of studies in this area. However, studies of PROGRESA provide positive examples - observing an increase in consumption and productive assets among non-beneficiary households in programme areas. This was observed more strongly among non-beneficiary households with low asset levels at the start of the programme. More anecdotal evidence exists that social transfer programmes support trade, for example in South Africa and Lesotho traders flock to locations for pension payments and in Zambia and Bolivia some beneficiaries use part of the transfer to support agricultural activities.

... and asset accumulation

The example of India's National Rural Employment Guarantee Scheme illustrates the use of social transfers, when made conditional on work, for making a contribution to local infrastructure improvement. Other programmes have similar elements, such as the Ethiopia's Productive Safety Net Programme. In poor areas, growth may be inhibited by the lack of local infrastructure. In practice, assessment of such public works programmes

has shown the results to be mixed, with the value of the newly created infrastructure often found to be low. Nonetheless, designed correctly social transfers can have positive externalities that have a positive impact on the local economy.

More generally, well designed social transfers can contribute to the accumulation of human capital and other productive assets. Studies examining the use to which transfers are put by recipients indicate that they have effects which go beyond the supplementation of current consumption. As already mentioned, they can lead to investment in schooling and health care, while also facilitating the acquisition of livestock and other agricultural assets. For example, beneficiary households of Bolivia's BONOSOL programme in poor rural areas experienced an average increase in food consumption of almost 165% of the value of the transfer. This was achieved through the investment of part of the transfers in much needed agricultural inputs. Assets acquired through the transfer not only improve productivity but can subsequently provide the collateral necessary for accessing credit.

Frequently voiced concerns over negative effects of social transfers on growth determinants are not supported by available evidence

The literature raises concerns that social transfers may weaken growth due to the effects they have on labour supply and savings rates, but these concerns are not supported by the available empirical evidence. Standard economic theory suggests that an increase in income for beneficiaries could lead them to reduce their supply of labour, thus lowering in aggregate the labour available to the economy. The argument is that an increase in income would lead to higher demand for goods and services, including non-wage labour activities. The empirical evidence suggests labour supply responses to transfers in developing countries are more complex. On the one hand, social transfers lead to labour decreasing among school age children, particularly when the programme includes school attendance requirements, and labour participation rates among the elderly are found to decline substantially in response to social pension schemes. In some cases the reduction in child labour is an explicit objective programme. On the other hand, social transfers are often associated with an increase in the labour supply of adults. For example, the social pension in South Africa was found to enable other household members to migrate in search of work. 15-50 year old members of households receiving the pension were found to be 3.2 % more likely to be employed. Overall, the social pension is associated with a net increase in labour supply with fewer older people, but increased younger adults, in work. Taken as a whole, there is scant evidence that social transfers have overall a negative labour supply effect.

Similarly, there has been concern raised over the effect of social transfers on saving. The fear is that expectations concerning entitlement to transfers could have an effect on aggregate saving, through transfers diminishing incentives for saving in existing social insurance schemes. In Brazil, for example, there is concern that social pensions could reduce social insurance contributions. Empirically, however, there is very little evidence that this occurs. In low-income countries, where social protection provision is marginal, this is unlikely to be a significant problem, though it is an issue to be borne in mind when designing social transfer programmes. Furthermore, there is strong evidence that across a range of programmes recipients choose to save a small fraction of the transfer, even when the transfer is of only a small level. This is motivated by various things, such as the need to purchase more expensive goods, a desire to accumulate assets (partially to increase access to credit), and as insurance against future shocks.

Programme design is important in maximising growth effects from social transfers

Context is important: In designing social transfers it is critical to take account of existing vulnerabilities, institutional factors, and delivery capacity.

Timing and level: Social transfers can facilitate increased investment by the poor through raising household income, and can overcome problems of access to credit for the poor. In order to do this, transfers must be **regular and reliable**, with beneficiaries having clear and credible information on the size, time and schedule of entitlements. Also, the time-period during which households are supported needs to be long enough to influence the consumption-investment decisions households make. The **level of transfer** is also important. The level should, in theory, depend on the objectives of the programme. If the aim is to eradicate poverty, the level of transfers needs to be sufficient to bridge the gap between poor households' income and the poverty line. Alternatively, if the aim is to ensure children attend school, the level needs to cover the direct and indirect costs to the household of sending children to school. As noted previously, even small transfers induce beneficiaries to save or invest a small fraction but a higher level of transfer is likely to increase the amount invested. However, it is important that the level is set below the market wage to minimise adverse incentives on labour supply. In practice the level of transfers is strongly determined by national policy processes and financial conditions, and is frequently based on an insufficient analytical basis.

Duration: The time period over which beneficiaries will receive the transfer is also important. It needs to be long enough to influence the consumption-investment decision of households and not too long to generate dependency (although on this point there is no evidence for developing countries that well designed social transfers do generate dependency). Expectations of households exiting the programme successfully will need to take account of household heterogeneity and concurrent economic conditions.

Complementary interventions: Social transfers will increase the demand for local services, principally educational and health facilities, particularly when the transfer is made conditional on the use of such provisions. In order to offset the possible deleterious effect this increased demand can have on such services, **social transfers need to be implemented alongside other programmes** that ensure that sufficient increased resources are made available to service providers to maintain, or better still improve, the quality of such facilities. Requiring children to attend an under-funded and crowded school is unlikely to have the greatest possible impact on their educational achievement. Complementary interventions aimed at improving labour market participation and productivity, and to facilitate and protect asset accumulation can strengthen the growth effects of social transfers.

Eligibility: It is important to ensure that **eligibility conditions do not incorporate incentives for asset depletion or inactivity**. Programmes that are dependent on relatively liquid asset holdings, such as livestock, could generate incentives for divestment of assets in order to qualify for the transfer. Similarly, conditions based on inactivity, such as requiring beneficiaries of social pensions not to be in work, will have adverse effects on labour supply. This also applies to adult household members in the case of family allowances. For growth to be fostered by the programme, it is important that the transfer does not limit the use of productive assets available to the household.

Choosing the Right Recipients: Channelling the transfer through particular household members may have an effect on the use of transfers. In particular, by making the mother the direct beneficiary, as many cash transfer programmes currently do, it is

expected that more of the money will be spent on children. Strengthening the influence of the mother in household resource allocation is more likely to improve household investment in human capital. The gender of the transfer beneficiary therefore makes a difference to the effectiveness with which it stimulates investment and facilitates more efficient resource allocation within the household.

Providing security: Social transfer schemes that build in **protection in response to shocks** will help to maintain productive assets in the event of adverse crises. Currently few social transfer schemes have asset protection components beyond the limited sense of providing a stable income through shocks. In designing future schemes consideration could be given to whether the level of transfer could be linked locally more explicitly to addressing the impact of shocks such as droughts and floods. Social transfers could thereby acquire more of an income maintenance feature and provide a greater degree of insurance to the poor, helping to avoid the forced sale of productive assets.

Important knowledge gaps remain...

There are important knowledge gaps in both micro and macro level analyses. At the micro level, while a few social transfer programmes have implemented strong evaluation procedures this is far from being the norm. More needs to be done to ensure that large scale interventions are adequately monitored and evaluated. Doing so will ensure that the data necessary to better understand potential growth effects. From that basis, it should be possible to extend knowledge of the local economy effects of transfers.

At the macro level, we are far away from being in a position to evaluate reliably the growth effects of social transfers. In the context of developed countries, most of this work has relied on cross-country regression techniques. However, the rewards to this research have been very relatively small. Two further avenues of research are emerging. Firstly there have been some attempts to use computable general equilibrium analytical techniques, which are particularly strong at investigating the consistency of transfer programmes with macro variables such as taxation. However, they fare less well at examining the impact and intermediate processes associated with social transfers. The second approach is to use ex-ante simulation of programme effects. This holds great promise for future research.

... which could be addressed in future programmes

Most work done to measure the growth effects of social transfers to date has been a by-product of other evaluation processes. The next step will be to identify explicitly the processes needed to generate the data required to test for these growth effects. This can be done most effectively with new social transfer programmes when designing the monitoring and evaluation procedures. Improvements in evaluation processes and data will provide a basis for addressing the identified knowledge gaps.

Overall, the message is positive

While it is important not to see social transfers as a panacea that will solve all problems related to poverty, when properly designed and delivered social transfers are capable of making a significant contribution to improving the current lives of the poor and hold the promise of reducing persistent poverty. They play a significant role in

ensuring that economic growth reaches the poor and help to extend economic opportunity to the most vulnerable. Although the principal aim of social transfer programmes is, and should remain, poverty alleviation, they can nonetheless be designed with a view to supporting growth. Many gaps remain in our knowledge of the mechanisms linking social transfers to growth, but the available evidence clearly suggests that well designed social transfer programmes can have a positive impact on the growth prospects of the poor.

Notes

- 1 From a longer paper by Armando Barrientos (2008) 'Social Transfers and Growth. A Review', BWPI, University of Manchester, UK, www.chronicpoverty.org.