The Economic Rationale for Conditional Cash Transfers

CC Ts ARE CASH TRANSFERS THAT ARE (1) TARGETED TO THE POOR and (2) made conditional on certain behaviors of recipient households. More specifically, these cash transfers are conditioned on minimum levels of use of health and education services, generally by (or for the benefit of) the children in the household. Typical requirements include enrollment and actual attendance at schools (for example, minimum attendance rates of 85 percent are required in Brazil’s Bolsa Família and a similar restriction applies in Mexico’s Oportunidades). Programs that have a health component also may require that children make regular visits to a health center and receive immunizations, and that pregnant women and lactating mothers keep a predetermined number of appointments at local clinics or attend informational sessions (pláticas) on hygiene and nutrition.

This chapter provides a conceptual understanding of how CCTs work. Governments have scarce resources and CCTs—whether they increase service use or not—compete for funds with other worthwhile projects, such as buying school equipment or upgrading rural roads. Why is giving people money to keep their children in (possibly very bad) schools a good use of public funds? Wouldn’t it be better to buy more books and supplies or to improve teacher training so as to raise the quality of the education provided in those schools?

Even if there are good arguments for spending part of the government’s budget on direct cash transfers to households, does it really make sense to attach conditions to the cash? After all, if attending those schools (or walking 5 miles to the local clinic to have the baby weighed) contributed more to expected future well-being than an alternative
use of the child’s time, wouldn’t households already be sending their children there? A condition is a constraint on behavior. What good can come of adding a constraint to the household’s optimization problem? Why not just make the transfer unconditionally?

Economists might think of at least two kinds of disadvantage associated with attaching conditions to cash transfers. First, some of the neediest households might find the conditions too costly to comply with (because the clinics are too far away or because their need for child help in harvesting a living from the land is too pressing), and may thus be deterred from taking up the benefit. Conditions thereby might exclude some of the people the program aims to reach. Second, those households that do opt for the benefit may incur a costly distortion to their own behavior for the sake of a little extra cash in the short run. Perhaps they know how bad the local school (or clinic) is. Perhaps it is wasteful for the children to spend time there, rather than learning how to tend the fields or how to weave a basket with their parents. By pushing poor households to do something that they would otherwise not be doing, CCTs might be imposing costly distractions on people who are trying to do the best thing for their families under conditions of severe scarcity.

Proponents of CCT programs should have good answers to questions and arguments such as those posed above. There are, in fact, a number of good reasons for attaching conditions to targeted cash transfers. This chapter reviews the case for conditioning, and briefly discusses some of the empirical evidence on how likely it is that circumstances that justify conditions are found in practice.

Cash Transfers: Arguments in Support and Against

The first question one might ask when considering whether a CCT makes sense is this: are cash transfers in general a good instrument in a particular country? That question is by no means rhetorical. Even if everyone accepts poverty reduction as a central policy objective, it does not follow immediately that the government should spend its scarce resources by transferring cash directly to poor people.

Broadly, one hears two arguments against such transfers: First, poverty is best reduced by economic growth, particularly in the poorest countries. In those same countries, fiscal efforts and administrative
capacity both tend to be low, and governments should focus on providing basic infrastructure (which could include roads and ports as well as schools and clinics). In this view, cash transfers to a vast poor majority are seen as having a lower future payoff than investment in public capital, and as being harder to target and deliver. The second argument against cash transfers is that they provide the wrong incentives to recipients. For example, they may discourage labor supply or investment in a person’s own human capital for future gainful employment. If the government provides the basic necessities of life, the thinking goes, why would people in low-productivity settings bother with very hard work that pays so little?

When combined, those arguments are not to be dismissed immediately. Direct investment in public infrastructure is likely to be a serious alternative use of public funds in very poor countries, and handouts of public cash can discourage self-reliance. But there also are many arguments for direct redistribution. First, in most developing countries, public expenditure on infrastructure and public services—of the kind just advocated—often fails to reach the very poor. In Nicaragua, only 10 percent of households in the bottom quintile of the expenditure distribution had access to electricity in 1998, compared with more than 90 percent of households in the top quintile (de Ferranti et al. 2004, p. 209). The sizable electricity subsidies that were in place in Mexico in 2000 also had a regressive incidence, as documented by Scott (2002). In fact, the proponents of the pioneering Oportunidades CCT program explicitly couched the initiative as an alternative to the electricity and tortilla subsidies, in a way that would be both more equitable (by reaching the poor) and more efficient (by eliminating the price distortions generated by the subsidies). In this context, if cash transfers can be shown to be targeted to the poor more effectively than other forms of public expenditure, they may contribute to poverty reduction in ways that direct public investment does not.

Second, markets seldom work perfectly in practice, and sometimes they fail in ways that prevent poor people from being as productive as they might otherwise be. If the root causes of some of these failures are too costly to correct, simple redistribution of current resources may be able to reduce the efficiency costs. The classic example is that of credit-constrained families (in an economy with imperfect capital markets) that cannot make profitable investments in their children’s education or in some other business project. A direct transfer of cash to these
families might enable them to undertake an efficient project that would otherwise not have taken place. Once again, the transfer would be both equitable (by making a poor person better off) and efficient (by better allocating capital within the economy).

Similarly, insurance markets often are beyond the reach of many poor families. When incomes are volatile, reflecting a risky economic environment, cash transfers can smooth (some of) the fluctuations, raising household welfare. Fields et al. (2007) review evidence of substantial short-term income volatility in a number of countries in Latin America. If these fluctuations are sufficiently severe, they may affect demand for schooling or health investments, potentially with long-term consequences.2 Once again, if fixing the insurance markets themselves is too costly or complicated, volatility can provide an additional argument for targeted cash transfer programs.

Finally, the fact that many of the inequalities one observes in the developing world are inherited from one’s parents may make them ethically objectionable. Differences associated with circumstances over which individuals have no control (such as race, gender, or family background) often are regarded as “inequality of opportunity,” which the state has a moral obligation to redress (see Roemer [1998] and Bourguignon, Ferreira, and Walton [2007]). Cash transfers might be suitable instruments for compensating families who suffer from inherited disadvantage.

In the face of arguments both for and against, it cannot be stated categorically that every country in the world should have a cash transfer program in place to help reduce poverty. But the case often can be made that some efficient redistribution of the kind just described can be achieved, as discussed in box 2.1. Chapter 5 of the World Development Report 2006 (World Bank 2005) discusses other examples from across the developing world, both of market failures and of the resulting underinvestment.

CCT programs still may be justified in the absence of redistributive goals, as a means to improve incentives for households to invest in human capital. In the remainder of this report, however, it is assumed that policy makers have weighed the arguments for and against cash-based redistribution, and have reached a considered decision that there is some room for cash transfers in their policy arsenal against poverty.

This chapter next turns to the question of whether it makes sense to attach conditions to these cash transfers. The “theoretical default”
Box 2.1 Efficient Redistribution in the Presence of Market Failure

There are many situations in which a market failure opens up the possibility of efficient redistribution. Under certain types of credit market imperfection, and if there are economies of scale, the poor may be unable to take advantage of profitable opportunities because they do not have access to the required scale. They thus may be trapped in a low-productivity sector of the economy, even as more productive opportunities go unexploited, because of an inability to commit to repayment in credit markets. Some amount of redistribution in cash from the rich to the poor may raise the ability of the latter to take advantage of these more profitable investments, thereby reducing both inequality and inefficiency.

This possibility was first modeled by Loury (1981), who introduced credit constraints into a model of intergenerational mobility. Galor and Zeira (1993) further noted the link between aggregate efficiency and reduced inequality under nonconvex production sets. Banerjee and Newman (1993) exploited long-term implications of the same basic type of mechanism by noting the effect of initial levels of inequality on patterns of occupational choice and subsequent inequality trajectories. All those papers demonstrate the theoretical plausibility that some redistribution may increase efficiency.

Empirical examples of aggregate underinvestment arising from the inability of the poor to access credit and insurance markets on equal terms now abound. In one striking case from Africa, Goldstein and Udry (1999) document the failure of many farmers to switch from a low-return maize and cassava intercrop to a much more profitable pineapple culture in southern Ghana. Despite an expected return of 1,200 percent, only 190 out of 1,070 plots in the study sample made the switch. When asked why, the modal answer was “I don’t have the money.” In Sri Lanka, de Mel, McKenzie, and Woodruff (2008) use a randomized experimental design to estimate the return on capital for microenterprises that generally are thought to be credit constrained. They find average monthly real rates of return of 5.7 percent—much higher than the market interest rate. The existence of investment projects (in preexisting firms) that are profitable at the prevailing market rate, but that do not take place (before the intervention) is prima facie evidence that the credit market is imperfect.

Until the underlying causes of failures in credit and insurance markets can be corrected, this kind of evidence suggests that targeted cash transfers can be useful not only in reducing inequality and current poverty, but also in reducing inefficiencies in the economywide allocation of resources.

Position—with informed rational agents, benevolent governments, and functioning markets—should be to favor unconditional cash transfers. Standard revealed preference arguments establish that choice sets are larger for an unconditional cash transfer than if the same transfer is given in kind with a no-resale condition. Similar arguments also show that a consumer is at least as well-off under a cash transfer as when the same budget is used to subsidize a particular good. A transfer that is conditional on the purchase of a specific good (or the use of a particular service) is, of course, analogous to such a subsidy (even if the posttransfer price is negative).
There are three main conceptual arguments for conditioning a cash transfer. First, agents do not always behave exactly as one would expect fully informed, rational agents to behave. Private information about the nature of certain investments, or about their expected returns, may be imperfect and persistent. There is also a body of evidence from recent research in behavioral economics that suggests that people often suffer from self-control problems and excessive procrastination, in the sense that their day-to-day behavior is inconsistent with their own long-term attitude toward the future (for example, see O’Donoghue and Rabin [1999]). There also may be conflicts of interest within the household, either between the parents (who “pay” for education or health services today) and their children (who benefit tomorrow), or between the father and the mother. These conflicts of interest may result in “incomplete altruism”: parental decisions that are not fully consistent with what the child would have chosen herself, if fully rational.

What imperfect information, myopia, and incomplete altruism have in common, for our purposes, is that they may cause a family’s privately chosen level of investment in human capital to be too low, compared with its own “true” private optimal. If they are pervasive, then these distortions in private decision making provide some contemporary support to the time-honored notion that governments may “know better” what is privately good for poor people than do the poor themselves, at least in some realms. The following section of this chapter therefore reviews these arguments under the general heading “Microfoundations of Paternalism.”

The second main conceptual argument for conditioning a cash transfer is that governments typically do not behave like textbook benevolent dictators. Policy decisions generally result from decision-making processes that involve voting, lobbying, bureaucratic and interagency bargaining, and a variety of other forms of what one broadly might call political economy. Under some circumstances, conditioning cash transfers on “good behavior” may increase public support for them, making the program either feasible or better-endowed. The third section below briefly reviews this political economy argument.

A third set of justifications for making cash transfers conditional is that, even if the levels of human capital investment by the poor were privately optimal, they might not be socially optimal because of the presence of market failures, particularly, externalities. These justifications are considered in the fourth section, “Social Efficiency Arguments.”
The Microfoundations of Paternalism

The idea that poor people need the push (or nudge) of government “incentives” to behave in ways that are “good for them” is a very old notion. It seems to imply that if left to their own devices, these agents somehow are not capable of choosing what is in their best interests. Although it is not a very fashionable notion among most mainstream economists today, paternalism (under different guises) has long been used to promote conditional forms of redistribution.

Consider, for instance, the idea that there are some specific goods that society sees as essential, as in Richard Musgrave’s (1959) description of merit goods or merit wants. These might be goods that enter the social welfare function directly, implying that “society” derives utility from everyone being educated or from everyone having access to decent housing or health care—in addition to the benefits accruing to each individual from his or her own consumption of those goods. Another way to think about merit goods is that a “social planner” places greater welfare weight on consumption levels of certain specific goods than the individual himself would place on them (for example, see Besley [1988]). However it is modeled formally, this old idea of merit goods could be used as an argument in support of today’s CCT programs: if society somehow places a value on every child being schooled or having access to health services that is greater than the value that individuals themselves place, then a CCT will provide an incentive toward that additional consumption of the merit good, as desired.4,5

Paternalism well may be justified if the individuals in question hold persistently erroneous beliefs; if they are not unitary agents, but households within which there may be conflicts of interest; or if they behave myopically. Recent developments in economic theory and recent empirical evidence both suggest that all three of those phenomena may be at work.6

The basic economics of these sources of private decision-making failure can be illustrated using a simple dynamic model of educational choice, outlined more formally in Ferreira (2008). The essence of the model is that individual welfare depends on consumption in two periods—childhood and adulthood. The link between the two periods is that children can contribute to household resources during childhood by working (some of the time) in the first period. But any time spent working comes at the expense of time spent studying (or otherwise
investing in the child’s human capital), and thus at the expense of earnings and consumption during adulthood. This trade-off between present and future welfare is at the heart of educational decisions made for or by children in developing countries, where child earnings (or contributions to family enterprises) often are not negligible.7

This simple framework sheds light on the consequences of each of the three kinds of distortion listed above for educational choice and for child welfare (under different assumptions about how the credit market works). In each case, the model tells us what we might expect from two kinds of policy response: unconditional cash transfers (UCTs) and conditional cash transfers.8 When credit markets are missing, many of those insights can be illustrated by figure 2.1, where the household’s choice of child time spent in school is plotted against the market wage rate for child labor.

The schooling investment function yields the household’s demand for schooling, given the prevailing child wage rate ($w_m$) and a set of additional parameters, such as expected returns to schooling, the discount rate, the quality of the education expected from the school, and other incomes available to the family. When plotted against the wage rate, it slopes downward: the higher the opportunity cost of attending

Figure 2.1  Choice of Investment in Children with Missing Credit Markets

Source: Authors’ illustration.

*Note: $w_m$ = child wage rate.
school, the lower the desired investment in education. Changes in the remaining arguments shift the function up or down in this space. For instance, a decline in the expected returns to (or quality of) education, a rise in the discount rate, or a reduction in the levels of other income sources available to the household would shift the investment function in figure 2.1 from a position such as that denoted “original” to one such as that denoted “shifted.” This simple framework can be used to investigate the effects of the distortions mentioned above.

Misinformation or Persistently Misguided Beliefs

Suppose that, for some reason, potential beneficiaries are poorly informed about the future returns to education. Of course, if this is a simple information asymmetry with no mechanism causing the incorrect belief to persist, then the optimal policy intervention is to address the information problem—say through a publicity campaign. But processing information may be costly: Being convinced about the health benefits of greater schooling, for instance, may require time and effort to process the evidence. In addition, certain beliefs may be self-reinforcing so that when agents act on the basis of the beliefs, the outcomes confirm them, even if alternative beliefs would have led to superior outcomes. It is possible that large groups of people may then believe that returns to education are lower than they really are. A possible example is that of poorer families believing that effort (perhaps in education) is less important than connections in generating upward mobility, whereas those who are better-off believe the opposite. These beliefs can lead to different actions and thus to different outcomes that appear to confirm the initial beliefs—even though the poor also would have benefited if they had put in greater effort.

It also is possible that people hold incorrect beliefs about how human capital itself accumulates (rather than about returns). They may believe that formal schooling requires very high levels of natural talent that are not to be found in their families. They may ignore the existence of links between formal schooling and parenting skills or health and hygiene outcomes. These inaccurate beliefs may result from the insufficient availability of information or from difficulties in processing the information that is available. If parents are poorly educated, it may limit their ability to process the information on education complementarities or on rates of return.
In fact, there is some evidence that incorrect beliefs about education returns can persist in real populations. A practical way to test for such information problems is to compare expected returns to schooling (for example, by asking students or parents what they think) with the observed Mincerian returns from a household survey (“realized returns”). For example, Attanasio and Kaufmann (2008) compare expected and realized returns among 15–25-year-olds in Mexico and find that expected returns from additional schooling were lower than the realized returns, especially among children of fathers who have low education levels.

Similarly, Jensen (2006) finds that, in the Dominican Republic, eighth-grade students estimated the rate of return to secondary school to be only one quarter to one third of the rate derived from an income survey. When students were told of the real rate, those who underestimated it in the first place increased their secondary school graduation rate by 6 percentage points. Both studies provide evidence consistent with information failures resulting in inefficiently low investments in education. But the evidence is not conclusive, and testing for information failures in other types of investments in human capital is less straightforward.

Also, investments in education may have positive impacts on health, and vice versa—another good reason why individuals may have a hard time adequately estimating returns. For instance, Jalan and Ravallion (2003a) show that piped water only improved health status when mothers were educated. Along similar lines, de Walque (2007) shows that an HIV/AIDS campaign in Uganda was most effective among educated households. Miguel and Kremer (2004) provide an example of how health investments (deworming) improve education outcomes.

As previously indicated, if the problem is only missing information, providing the information directly would seem to be the first-best intervention (rather than having a CCT). For example, Dupas (2007) shows how informing girls that HIV prevalence was higher among adult males and their partners than among teenage boys led girls to avoid the cross-generational partnerships that are riskier in terms of HIV infection rates.

However, there are at least two situations under which simply providing information may not do much. First, incorrect beliefs may be self-reinforcing, in which case merely providing the information will
not help. Second, passively providing information may not be enough because, at least initially, people may not think they need the information and so may not respond to it. A transfer conditioned on attending relevant information sessions or activities thus may be a better option. One example is parenting interventions. There is a great deal of evidence that poor outcomes in early childhood can be a result of poor home environments, including inadequate parenting practices (some of this evidence for the United States is discussed in box 2.2). However, most people believe that they are not bad parents and, therefore, are unlikely to respond either to an information campaign or to home-visiting programs in which social workers teach them how to be better parents. Oportunidades and some other CCTs attempt to expose parents to new information and practices by conditioning transfers on participation in

**Box 2.2 Investing Early in the Life Cycle**

NOBEL-WINNING ECONOMIST JAMES HECKMAN and many others have argued recently for the importance of investments in early childhood (Heckman and Masterov 2007; Heckman 2008). This research makes a number of important points: (1) poor outcomes in early childhood have long-lasting implications for functioning in adulthood, including low earnings, increases in the likelihood of criminal activity, and poor parenting practices; (2) poor outcomes in early childhood are often a result of adverse home environments, including the absence of a stable family structure and nurturing relationships for children; (3) interventions in early childhood increase the productivity of interventions later in the life cycle (“learning begets learning”); (4) deficits in early childhood are much more costly to remedy later; and (5) investments in different dimensions of child well-being, such as those that lead to improvements in cognitive skills, behavioral outcomes, and child health, are interlinked in important ways. Improving outcomes in one dimension makes it more likely that children will be able to make up deficits in other dimensions.

Whereas the research by Heckman and his coauthors has focused on the United States, some of the conceptual underpinnings are relevant for the design of CCTs in developing countries. Unlike most other programs, CCTs seek to improve outcomes in various dimensions of child well-being, including education, health, and, through the pláticas, parenting practices (although pláticas are required in some but not all CCTs). Arguably, CCTs therefore implicitly attempt to exploit the synergies that Heckman and others have identified. In addition, CCTs seek to build the human capital of children throughout the life cycle, including at the earliest ages. Finally, CCTs transfer cash, and this can help alleviate the resource constraints that partly explain the adverse home environments and inadequate investments by parents in their children. That being said, CCT programs would benefit from more experimentation to see what combination of cash, conditions, social marketing, and information provision is most effective at ensuring that children do not fall behind at early ages—one of the main messages of this report.
pláticas; cumulative exposure of this sort may help do the trick, and the conditioned cash helps ensure that parents attend and participate in the talks (Schady 2006).

What might be the consequences of persistent misinformation? An underestimation of returns to schooling, for instance, could lead to an inefficiently low level of investment in education (or health), even under perfect credit markets. With lower expected returns, the demand for education depicted in figure 2.1 shifts downward and schooling investment falls from a high level in point A, to a low level in a point such as B. Since actual returns to schooling are higher than the household’s expectation, point B is a (privately) inefficiently low level of schooling. Some form of intervention may be warranted—but what kind?

Because credit allows for a separation between investment and consumption decisions, a UCT would have no effect on investment under perfect credit markets. A UCT merely raises the overall level of permanent income. And when capital markets are perfect, investment in one’s children, just like any other investment decision, is independent of one’s income levels and depends only on expected returns and the interest rate. A CCT, on the other hand, can help shift the investment level toward the optimal by reducing the opportunity cost of studying. It alters the expected returns to investment by affecting the price associated with the investment good, in addition to raising income levels. A CCT would move the agent along the shifted investment function, from point B upward and to the left.

On the other hand, if credit markets are imperfect, the effect of misguided beliefs is likely to be even greater, particularly for the poor. When credit is not available, those who are poor today may find it optimal to use child labor as a (very costly) consumption-smoothing mechanism: children may be sent out to increase the availability of consumption goods today, even at the expense of higher remuneration in the future. In this case, even a UCT would have some effect on present levels of investment in health and education. These effects correspond to the income effect of the transfer and reduce the effects of missing credit markets on educational investment. Nevertheless, a CCT generally will have a larger positive effect on investment than will an unconditional transfer of the same amount. This outcome simply follows from the fact that a CCT adds a substitution effect to the income effect of the UCT. If an underestimation of expected returns
to education had shifted the household from point A to point B in figure 2.1, then a small UCT could shift it back upward to point C. A CCT of the same amount will move the household’s choice to point D, entailing a higher level of investment in schooling. By remunerating school attendance, the CCT effectively lowers the opportunity cost of studying, relative to working.

Note that for the household’s welfare (rather than simply its investment in schooling) at point D to be higher than at point C, it is critical that the household be operating under incorrect beliefs. That is why, as previously discussed, another imperfection (in addition to the credit market failure) is required to justify the condition. Credit constraints are relaxed by cash, not by conditions. If there were no additional imperfection and the only problem were a credit constraint, a UCT should be preferred. A CCT that provided the same income transfer would only inefficiently distort behavior (toward excessive schooling) through the condition.

The existence of the substitution effect discussed above has another important implication for program design: it is possible to set a CCT level too high, thus encouraging children to a rate of service use that is greater than optimal. This situation (which corresponds to points northwest of point E in figure 2.1) is evocative of anecdotes about children wasting valuable time in classrooms where they learn nothing instead of helping their parents in the field, or of children taken to unsanitary health facilities that act as disease contamination foci because parents have been bribed to take the risk. The upshot seems to be this: because CCTs impose a condition, they are more powerful instruments for inducing behavioral change than are UCTs. They are “higher-risk/higher-return” policy instruments. When private behavior is suboptimal, they correct it at a lower cost. When private behavior was fine to begin with, their misuse is likely to be costlier.

**Principal–Agent Problems within the Household, or “Incomplete Parental Altruism”**

Even if parents have a correct expectation of future returns to education, they may discount the future more heavily than is optimal from the point of view of the child. Basic models of schooling choice usually are written under the simplifying assumption of a unitary household. When that
assumption is relaxed and the objectives of different household members are allowed to differ (say, by having different discount rates), then the ensuing conflict of interest within the household may provide another justification for CCTs: parents make the education decision for their children, but discount the future at a higher rate and, therefore, demand less schooling than the child’s optimal. If policy makers take the view that the child is the principal in the matter of her own education, and that parents act as her agents, then a principal–agent problem is characterized.

A slightly different but equally plausible version of this problem is a conflict of interest between the parents themselves, as opposed or in addition to one between parents and children. One possibility is that mothers’ objectives are more closely aligned with those of all her children. This closer alignment is mentioned often as a justification for handing the transfer to the mother (when there is one), as is common practice in most CCT programs, rather than to the father.

It turns out that differences in the discount rate do not affect the investment decision under perfect credit markets. Changing the discount rate will affect consumption choices—how much is consumed now versus how much is consumed in the future. Any adjustment will take place through borrowing or lending, with no effect on schooling or any other investment. As noted previously, investment and consumption decisions are separate. But if credit markets are missing, then a higher parental discount rate affects the education decision in a way that is exactly analogous to a lower expected rate of return to education. The results described when discussing the effects of misguided beliefs do hold, with both a UCT and a CCT resulting in higher investments and welfare (for the child), but the conditional transfer does so at lower cost because of the induced substitution effect.

What is the empirical evidence on intrahousehold principal–agency problems? It is hard to test conclusively for the presence of “incomplete altruism”.

Perhaps the most compelling evidence in that regard is the presence of gender differences in child human capital. The clearest case is in countries where girls’ education lags significantly behind that of boys, even when the Mincerian rate of return to women’s education is at least as high as that of men. This kind of differential is prima facie evidence of inefficient underinvestment in girls’ schooling and is most apparent in South Asia. Such differentials may be rational from the viewpoint of parents who are thinking of their own welfare (because girls are more costly in terms of dowries or boys are more likely to take
care of their parents than are girls who move to their husbands’ homes upon marrying), but they are most likely socially inefficient.

Somewhat more indirect evidence from countries outside South Asia has suggested that differential bargaining power between men and women affects the level of human capital investment in children. Indeed, there is a lengthy body of empirical literature showing that when mothers have greater control over resources, more resources are allocated to food and children’s health and education (Thomas 1990; Hoddinott and Haddad 1995; Lundberg, Pollak, and Wales 1997; Quisumbing and Maluccio 2000; Attanasio and Lechene 2002; Rubalcava, Teruel, and Thomas 2004; Doss 2006; and Schady and Rosero 2008). That evidence provides a strong justification for making payments to mothers, as CCT programs do. At the same time, in circumstances in which women’s power within the household is limited, attaching strings to the transfers by mandating specific human capital investments could strengthen the mother’s bargaining position and reinforce her ability to shift household spending and time allocation decisions.17

Although the extent to which incomplete altruism can provide a blanket justification for the use of conditions is unclear, there is now a substantial body of evidence suggesting that parents (especially fathers) value their own utility more than that of their children. Girls, in particular, often are at a disadvantage. The implication is that schooling and health levels chosen on a child’s behalf are likely to be too low relative to the child’s optimal level, and that conditions attached to cash transfers can help drive the actual household choices toward that optimal.

A Political Economy Argument

The second class of arguments that may provide a justification for conditioning a cash transfer has to do with the political economy of funding redistribution. Transfers, whether conditional or unconditional, need to be financed, and budget allocation decisions are never really the choice of a benign social planner. Rather, they are the outcome of a (generally complex) political economy process. Most standard theories of the political determination of redistribution do not distinguish CCTs from UCTs. Voters are assumed to care only about their final welfare level, so they look at how much they receive in transfers and at how much they pay in taxes. If voters are not recipients of a targeted transfer, then,
conditional on their tax bills, they should be indifferent to whether there are specific conditions attached to the transfers.

One implication of that kind of analysis is that transfer schemes narrowly targeted to the poor would tend to have limited support because a small share of the population benefit, whereas the costs are dispersed across all taxpayers. Gelbach and Pritchett (2002) have a model in which an increase in the degree of targeting actually can result in a reduction of both the equilibrium level of the transfer and the welfare of the poor. The implied vulnerability of targeted redistribution schemes to political change enjoys a measure of empirical support (see Subbarao et al. [1997] for examples from Colombia and Sri Lanka).

It is conceivable, however, that voters (or other decision makers) are not entirely self-regarding. It is possible, for instance, that taxpayers are more prepared to pay for transfers to those who are seen to be helping themselves than to other equally poor people who are seen to be lazy or careless. Some voters who object to unconditional “handouts” may be less averse to “rewards” to “deserving” poor people who are investing in the education or health of their children. (Box 2.3 contains a brief summary of evidence from the recent behavioral literature on fairness, which suggests that many people are routinely prepared to incur real financial losses to reward others whom they think are deserving or to punish those they feel have behaved unfairly.) If this view is commonly held, the introduction of conditions may result in an increase in the overall budget available for redistribution in the political equilibrium.

If none of the private inefficiencies discussed in the second section of this chapter existed, then attaching a condition to a cash transfer would be, of itself, suboptimal to beneficiaries (because it adds an additional constraint). But that cost may be offset by an increase in the overall size of the transfers that are funded, in which case the conditions will be justified for political economy reasons. The condition is justified by making redistribution more acceptable to taxpayers and voters—and possibly to many beneficiaries. Another way of seeing this is that, unlike a UCT, a CCT can be seen not as plain social assistance, but rather as part of a social contract whereby society (through the state) supports those poor households that are ready to make the effort to “improve their lives”—the deserving poor.

The notion that CCT programs constitute a new form of social contract between the state and beneficiaries has been manifested in the use of the term co-responsibilities (instead of conditions) in a majority of
Box 2.3 Fairness, Merit, and the “Deserving Poor”

People often behave in ways that are inconsistent with pure self-regarding preferences. In particular, there is now a substantial body of experimental evidence suggesting that large numbers of people are altruistic rewarders or altruistic punishers in the sense that they are prepared to incur personal losses to reward behavior they regard as socially fair or to punish behavior they regard as unfair (see Fehr and Schmidt [1999] for the basic theory; Fehr and Gächter [2000] for a review of the early evidence).

Some of the main results come from experiments in which subjects were asked to play what is known as an ultimatum game under experimental conditions. In the game, a first-mover proposes a split (of an exogenously given sum) between himself and the second player. If the second player accepts the proposal, the split is implemented. If he rejects it, both players earn zero. If people behaved as standard economic theories used to predict (that is, if preferences were purely self-regarding), then the outcome of this game—the so-called Nash equilibrium—would be “as little as possible for you, all the rest for me.” Empirically, however, such an outcome is seldom observed. The modal offer is in the 30–60 percent range, depending on the cultural context. And a sizable fraction of offers below that range is rejected outright even when the sums in play are nontrivial: people appear to be prepared to “pay” for the opportunity to punish a player whom they see as having behaved unfairly.

More interesting from the point of view of CCT programs, Hoffman et al. (1994) find that players in anonymous ultimatum games tend to be more tolerant of other players in positions of power when those positions are allocated on the basis of “merit” (that is, to those who score higher in a general knowledge quiz) than when they are allocated randomly. The accumulated evidence from the large body of literature on fairness suggests that people take considerations of “justice” into account when making decisions. The evidence from this particular study suggests that people’s perceptions of what is a fair distribution may be affected by the perceived “merits” of the recipient.

Would a similar line of reasoning imply that taxpayers (or public officials) might be more willing to fund transfers to people who invest in the future of their children than to others who do not? Although some tentative suggestions in support of this conjecture are reported in the main text, more research is needed to address the question rigorously.

Poor families need help, but this should not suppress or undermine their role as protagonists in transforming their living conditions. Shared responsibility and respect are not only prerequisites for effectively combating poverty but are essential elements of a democratic society. Shared responsibility and respect inevitably imply a reciprocal effort by the poor families to link the benefits they receive to concrete actions on their part. Thus independently of technical considerations, in 1996...
it was considered vital that PROGRESA benefits go directly to poor families and be conditioned on direct action by them to improve their own nutrition, health and education, and that such support complement but not substitute for their day-to-day efforts (Levy and Rodríguez 2004, p. 48).

A recent analysis of the treatment of the Bolsa Família program in the Brazilian media (Lindert and Vincensini 2008) provides additional support to the idea that conditions make transfer programs more politically palatable. There is little question that Bolsa Família is a popular program in Brazil. An Ipsos opinion poll taken in September 2007 found that the program tops the list of items mentioned in response to a question on what President Luiz Lula da Silva had done well in office. The authors of the study find that most media criticism of the program centered on the possibility that it would “generate dependency” and find that this criticism usually was coupled with reports that the conditions were not being monitored and enforced properly. Conversely, most of those people arguing the program was not assistencialista listed the existence of conditions as one of the top two reasons. Lindert and Vincensini (2008) conclude that the acceptance of conditions across the political spectrum—where the Left sees the conditions as merely restating citizen’s rights, and the Right tends to see them as enforceable contracts—played an important role in generating broad-based support for the program in Brazil.

This perception of the condition as a mutually agreeable contract leads to an interesting apparent paradox: CCTs often are seen as less, not more, paternalistic than UCTs. Indeed, several authors have argued that CCT programs provide the basis for a less paternalistic (and possibly less clientelistic) form of social assistance (Cohen and Franco 2006; de la Brière and Rawlings 2006). Reconciling this view with the “paternalistic” arguments described in the second section of this chapter requires distinguishing between two very different justifications for conditioning. The first justification, which was discussed in the second section above, relies on imperfections in private decision making by the poor households themselves. They might be poorly informed, parents may not fully internalize the best interests of their children, and so on. Conditions then help, by inducing agents to do what is best for their children, individually.

The second view, which is being proposed here, is that when conditions are seen as co-responsibilities, they treat the recipient more as a
“grown-up,” capable of agency to resolve his or her own problems. The state is a partner in the process, not a nanny. This latter interpretation is particularly plausible when the counterfactual to a CCT is not an automatic, transparent, unconditional cash grant seen as a citizen’s entitlement (which is close to the textbook concept of a UCT), but instead a myriad of ad hoc and mostly in-kind transfers, intermediated through various service providers, nongovernmental organizations, and local governments. Under those circumstances, conditioning the transfers on “good behavior” may be perceived as less paternalistic than the alternative of conditioning transfers on voting for a certain party or belonging to a given social organization.

Moreover, the fact that the conditions are focused on building the human capital of children (rather than simply supporting parents) adds to their political acceptability as an instrument to promote opportunities. After all, it is hard to “blame” children for being poor. In that sense, using public resources to support the human capital development of poor children makes CCT a “poverty reduction” rather than a “social assistance” program. Making payments to mothers also resonates with well-accepted beliefs (mostly supported by evidence, as shown above) that mothers tend to put funds to better use than men do.

This view of CCTs as an enabling instrument, which creates political viability for targeted redistribution that effectively reaches the poor, resonates in many of the Latin American countries that introduced CCT programs over the last decade. Social protection systems in the region have been characterized by “truncated welfare states” (de Ferranti et al. 2004) that channel significant public resources to subsidize social insurance schemes for the formal labor force and provide little, if any, redistribution (particularly in the form of cash) to the lower segments of the income distribution. As in other spheres (for example, service delivery [Fiszbein 2005]), political capture of state institutions and policies by elites meant an historical pattern of low social assistance. From that perspective, the introduction of CCT programs since the late 1990s can be seen as a break with history.

Take the case of Brazil, a country with extremely high inequality that long has subsidized social insurance programs (with limited reach to the poor). Public subsidies for (generally regressive) pension schemes alone represent more than 5 percent of GDP (Lindert, Skoufias, and Shapiro 2006). It was only in the late 1990s, with the introduction of a series of CCT-like programs such as the PETI, Bolsa Alimentação, and Bolsa
Escola, that cash-based social assistance programs became a significant federal public spending item, reaching approximately 0.5 percent of GDP in 2000. And it is through the expanded and enhanced Bolsa Família program in more recent years that federal spending on social assistance reached the 1 percent of GDP mark (Lindert, Skoufias, and Shapiro 2006). The story is very similar for the case of Mexico: Oportunidades represented a major shift from broad price subsidies that benefited the poor only marginally to a cash-based redistribution to more than 5 million poor households. And, as discussed in chapter 1, Mexico’s success appears to have influenced other countries in the region to follow a similar path.

The conclusion is that even in situations where a narrow technical assessment might suggest that a UCT is more appropriate than a CCT (say, because there is no evidence of imperfect information or incomplete altruism in poor families), CCTs might be justified because they lead to a “superior” political economy equilibrium. The political process may make significant cash transfers to the poor close to impossible unless those transfers are tied somehow to clear evidence of commitment and “positive behaviors” on the part of beneficiaries. Once again, the Latin American experience suggests that in the absence of dramatic political shifts, the increasing trend toward cash-based redistribution schemes has been associated with the use of some form of conditioned grants.

Social Efficiency Arguments

Attaching conditions to cash grants might make sense for political economy reasons or because distortions in individual behavior cause decision making in the household to be privately inefficient. We now turn to a third set of reasons for conditioning, namely, human capital externalities.

If investments in human capital generate positive externalities that parents do not take into account when making decisions, then the aggregate (market equilibrium) level of human capital in society will be inefficiently low. This is a standard argument for subsidizing provision of education or health care. Empirically, health investments have important external benefits. Although those benefits are well established in some cases (for example, immunization), the supporting evidence
is rather new in other cases (such as deworming [Miguel and Kremer 2004] or insecticide-treated nets [Gimnig et al. 2003]).

In the case of education, externalities might arise if there are increasing returns to skilled labor in production, at the aggregate level. There is empirical support for the idea that more education can have spillover effects to other workers in the same plant (Moretti 2004b), in the same village (Foster and Rosenzweig 1995), or in the same city (Moretti 2004a). Possible spillovers also may be present if crime, violence, and related social ills decline with average schooling levels. There is solid evidence for the United States that education lowers crime—with perhaps the best evidence coming from the Perry Preschool program evaluation, which shows that children randomly assigned to the intervention have much lower incarceration rates as adults (Currie 2001; Schweinhart 2004).

How large these externalities are and whether (conditioned) cash transfers are the most effective instrument to correct for them, however, remains to be determined. In most countries, education and health services already are heavily subsidized. In many cases, they are publicly provided free of charge. To argue for an additional subsidy that compensates households for some of the indirect or opportunity costs of using these services, on the basis of the externality alone, would require showing that those externalities are quite large. If that were found to be true, then a CCT can be justified on that basis alone: it is effectively an additional component to a Pigouvian subsidy, which often already is implicit in the service fees.

Conclusion

Although market-driven economic growth is likely to be the main driver of poverty reduction in most countries, markets cannot do it alone. Public policy plays a central role in providing the institutional foundations within which markets operate, in providing public goods, and in correcting market failures. In addition to laying the groundwork for economic growth, policy also can supplement the effects of growth on poverty reduction, and one of the instruments that governments can use to that end is direct redistribution of resources to poor households. Although direct cash transfers have opportunity costs (in terms of forgone alternative public investments) and may have some perverse incen-
tive effects on recipients, there is a growing body of evidence to suggest that some such transfers may be both equitable and efficient.

The cash transfer programs that have been growing most rapidly across the developing world over the last decade or so are CCTs, by which cash is paid to poor households on condition that they invest (in certain prespecified ways) in the human capital of their children. Because attaching a constraint on the behavior of those you are trying to help is an unorthodox idea for economists, this chapter has reviewed the conceptual arguments for making cash transfers conditionally.

Essentially, there are two broad sets of arguments for attaching conditions to cash transfers. The first argument applies if private investment in children’s human capital is thought to be too low. The second argument applies if political economy reasons mean that there is little support for redistribution, unless it is seen to be conditioned on “good behavior” by the “deserving poor.”

CCTs are not a panacea. If there is little evidence to suggest that private levels of investment in human capital are too low (in any of the senses previously discussed), and if the political economy can accommodate the desired levels of redistribution without appealing to co-responsibilities, then UCTs (or some completely different kind of public expenditure) may be preferable.

There also may be good arguments against conditioning if the same result can be achieved at a lower cost through the social policy equivalent of “moral suasion.” Recent research has found evidence of “flypaper” or “labeling” effects, whereby the household expenditure shares of certain goods are higher out of transfers that are notionally earmarked for (but not conditional on) those goods, than out of other incomes. Flypaper effects constitute a fairly fundamental violation of rationality in that they suggest households do not treat all their income sources as fully fungible. Like other departures from full rationality, flypaper effects certainly are plausible and, if ubiquitous, could have serious implications for the design of social protection, tipping the balance in favor of UCTs (which then would appear to have some of the benefits of conditions, without the costs). But much more research is needed before the evidence on these effects reaches critical mass.