



Targeted Transfers in Poor Countries: Revisiting Trade-Offs and Policy Options

Social safety nets are often seen as short-term palliatives or, worse, wastes of scarce money in developing economies. Critics point to leakages of benefits to non-targeted groups (i.e., the non-poor) or the policies' potential adverse effects on the incentives to work or save. Even supporters of social safety nets often view their benefits solely in terms of equity. These policies are rarely seen as an integral part of a strategy for fostering economic growth and poverty reduction. Indeed, many observers have argued that there are significant trade-offs between spending public money on such programs and long-term poverty reduction.

These views need to be re-assessed in the light of new theories and evidence. First, the evaluations of a number of transfer programs show that, while there may be examples of benefit-leakage, targeted social safety nets can achieve limited redistribution. Second, there are theoretical reasons to believe—and some statistical evidence to suggest—that social safety nets, properly designed and implemented, can sometimes contribute to 'pro-poor growth' (i.e., growth that reduces poverty) by helping the poor to be more productive workers or to take up productive opportunities for self-employment.

Equity to the Aid of Efficiency

When social safety nets make workers more efficient, they increase the potential output and growth rates of an economy.

- A malnourished worker is very unlikely to be an efficient worker. At one extreme, workers receiving less than the food-energy required to support bodily functions at rest simply cannot be productive. But even less severe nutritional deprivation can impede productivity. Malnutrition in children reduces their long-term capacity to learn and hence their ability to earn future incomes. Social safety net programs that prevent workers and their families from falling below this nutritional 'threshold' contribute to higher potential output.

- For those with little or no capital, the marginal product of additional capital can be quite high. Credit-market failures, however, mean that some people are not able to exploit their potential. Programs that reduce the incidence of poverty and programs that support productive saving amongst the poor may, again, raise the potential output of the economy.
- Poverty can have a geographic dimension: a poor household in a well-endowed area has a good chance to escape poverty eventually, whereas an identical household in a poor area is likely to see stagnation or decline. Policies that redress geographic inequalities may permit capital and labor in the poor region to be more productive and so stimulate pro-poor growth.
- If, as some believe and evidence suggests, higher poverty and inequality can lead to higher crime rates (which surely hurt aggregate efficiency in an economy) inequality-reducing safety nets can contribute to an economy's potential by reducing the costs associated with crime.

There is some statistical evidence to buttress these arguments. Studies of economic growth across many countries reveal that economies with higher initial inequality tend to experience lower rates of growth, when allowance is made for such factors as initial income, openness to trade and the rate of inflation. Indeed, one analysis found that a fifth of the developing economies it studied had such high inequality that it stifled pro-poor growth.

There are statistical difficulties with such macroeconomic evidence, however. Somewhat stronger support for the argument of equity-in-support-of-growth comes from some microeconomic analyses. Diverse examinations of initial inequalities in land-holdings, income, wealth and nutrition point to a negative impact of inequality on economic potential and output growth.

Inefficient Insurance?

The classic ‘moral hazard’ argument suggests that insurance can reduce long-term efficiency. Thus, unemployment insurance may discourage personal efforts to find work, and old-age pensions may discourage personal savings. There are reasons, however, to believe that uninsured risk may be a cause of chronic poverty.

- ‘Dynamic poverty traps’ might exist where lack of income, through resulting malnutrition or social exclusion, prevents a household from rising out of poverty. In the absence of (private or public) insurance, a negative income shock might push a family into such a trap. There is as yet little statistical evidence for the existence of such dynamic poverty traps, which can be very hard to detect in conventional data. However, some studies have found that poor families recover less quickly than other families from negative income shocks.
- Uninsured risk might also perpetuate poverty via production and portfolio choices. For example, poor, and poorly insured, households may prefer liquid wealth to more productive capital.

The evidence currently available on the long-term impacts of uninsured risk is mixed, though new research results will no doubt emerge. Of course, there are still welfare costs of uninsured risk confronting the poor, and the classic risk-aversion case for insurance exists even if it does not address chronic poverty.

Targeting and Efficient Redistributions

The common focus on static measures of transfers—e.g., what share of the benefit goes to the poor—may overlook the dynamic benefits of such interventions. This broader view also holds implications for the design of the targeting mechanisms of social safety nets.

Moreover, establishing that inequality and uninsured risk may be harmful to economic growth does not prove that any policy reducing inequality or uninsured risk will contribute to growth. Any such intervention that distorts external trade or the domestic economy would have ambiguous impacts on long-term poverty. The best role for policy may, in fact, not be to reduce current inequality but to attenuate its adverse impacts.

There are targeting mechanisms that may contribute more to long-term efficiency (and pro-poor growth).

- Targeting poor areas or minority ethnic groups—that would otherwise be locked out of economic opportunities—addresses an obvious market failure. It might have a greater impact on long-term poverty reduction than its static statistical measures would suggest.
- Conditional transfers—i.e., transfers that combine targeting with explicit attempts to enhance capital accumulation by the poor—by their nature are not intended simply to address current income shortfalls, but aim to facilitate longer-term poverty reduction. Mexico’s Progresa and Bangladesh’s Food For Education programs are examples with evidence of success in both reducing current poverty and promoting schooling and (hence) lower future poverty.
- Self-targeting transfers—e.g., workfare—can be designed in ways that also facilitate longer-term poverty reduction, such as by assuring that the work is done in poor neighborhoods, which are typically in great need for investment and maintenance of local public goods. Successful programs such as Argentina’s Trabajar Program have emphasized both current income gains and making the work productive.

Conclusions

Theory and evidence suggest that there may be scope for policies to alleviate current poverty and uninsured risk and, at the same, to enhance economic efficiency. There have been a number of successful transfer schemes. However, in drawing implications for future policies, targeted transfers may not dominate other options, such as fostering new institutions for credit provision, better enforcement of property rights, and supply-side interventions in schooling and healthcare.

Theory and evidence suggest that the trade-offs between traditional safety net goals and efficiency have probably been exaggerated. A new approach to social safety nets would recognize their potential to enhance growth and emphasize careful design and evaluation to ensure that that potential is realized.

The World Bank Social Safety Nets Primer series is intended to provide a practical resource for those engaged in the design and implementation of safety net programs around the world. Readers will find information on good practices for a variety of types of interventions, country contexts, themes and target groups, as well as current thinking on the role of social safety nets in the broader development agenda.



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