



# The “Local Economy” Effect of Social Transfers: An Empirical Assessment of the Impact of the *Bolsa Família* Program on Local Productive Structure and Economic Growth

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## SUMMARY

Social transfers impact local economic growth through local demand multiplier and local productive structures. Using original data on productive structures, growth determinants and *Bolsa Família* conditional transfers (BFP) for the 184 municipalities of the Brazilian state of Ceará during 2003–10, we show that the positive impact of the transfers on local growth is in fact conditional on the direction of local economic structure transformation. Indeed, transfers did spur light manufacturing transformation activities only in the poorest and less-industrialized localities and did prompt informal activities in weakly productive services in all municipalities. Although we do not find support for the hypothesis of a redistribution trap, our estimations indicate that, on average, the growth impact of BFP transfers could have been twice as great during the period investigated in the absence of the adverse impact of social transfers on structural transformation. By promoting services and informal occupations, including in light manufacturing industries, the BFP could possibly cause a problem of job quality in the future. The medium-term impact of social transfers on poor regions' local productive structures should therefore be more fully acknowledged by policymakers, notably by associating policies promoting the development and modernization of local productive structures with transfers.

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## 1. Introduction

Over recent years, conditional cash transfers (CCTs) have become a successful strategic tool of anti-poverty and social inclusion policies in many developing countries. Beyond their well-documented positive effects on poverty alleviation for direct beneficiaries, CCTs also bring about ‘local economy’ effects for non-beneficiaries, (Barrientos, 2012; Taylor, Dyer, & Yúnez-Naude, 2005). Various recent studies (Alderman & Yemtsov, 2014; Barca, Brook, Holland, Otulana, & Pozarny, 2014; Dercon, 2011; Taylor, 2012; Taylor, Filipinski, Thome, & Davis, 2014) have documented the fact that the local economy effects of social transfers operate through the demand-side impact of additional revenue availability, boosting trade and credit in goods in poor local economies. Moreover, by enhancing opportunities for strategic complementarities between individual investments (Alderman & Yemtsov, 2014), social transfers also increase expected investment return for both beneficiaries and non-beneficiaries, thereby promoting

supply-side impacts through the change in local production and employment.<sup>1</sup>

However, the existence of positive demand- and supply-side effects of transfers is not systematic. In fact, it is conditioned by local characteristics such as liquidity constraints or weak

<sup>1</sup> Substantial improvements in asset holdings among beneficiaries of social transfer programs have been measured by empirical studies. In a recent evaluation of the Mexican *Oportunidades* program, Gertler, Martinez, and Rubio-Codina (2012) find that recipient households invested 26% of the money received, mainly in productive farm assets, such as farm animals and land for agricultural production, and in start-up investment in nonagricultural micro-enterprises producing handicrafts for sale. Ferrario (2014)'s estimations for the BFP are significantly different since they report that monetary transfers are essentially used (87% according to MDS figures) for such priority goods as food and education materials, thus representing investment in human capital and not in productive systems. For an analysis of the impact of the *Bolsa Família* Program (BFP) on labor, see Machado, G. G. Fontes, R. H. Sieczkowski Gonzalez, and F. (2011).

investment capacities (Barrientos, 2012).<sup>2</sup> Looking further ahead, the capacity of social transfers to durably support local growth will be conditional on the way in which local economic structures change because of additional income and demand. In the areas that are poorly endowed with transformation industries, increasing local demand generated by transfers may well orient local investment toward relatively informal and unproductive retail and service activities. Conversely, formal and genuinely productive transformation activities may become increasingly polarized into a limited number of regional or national ‘industrial’ centers. Because of the contrasted dynamics of local economic structures, the local growth effect of social transfers might be magnified in productive and exporting regions, while being depressed elsewhere. By distorting local economic structures in initially poorly industrialized localities, social transfers could also lead to the formation of local redistribution traps in which more transfers would further increase the local economy’s future dependence on transfers and undermine future prospects of local income generation. Were this effect to intensify, such spatial differentiation would leave areas that are the most dependent on transfers without any resources if transfers were to diminish in the future.

In Brazil, the *Bolsa Família* program (hereafter BFP),<sup>3</sup> which brings together existing, independent, targeted redistributive programs and covered fourteen million households in 2016,<sup>4</sup> was introduced in 2003. While the program has made a meaningful contribution to alleviating poverty among its beneficiaries during the past 15 years (Limoeiro, 2015; Lustosa & Fauré, 2013; Silveira Neto & Azzoni, 2011; Soares, Ribas, & Osório, 2010), social transfers are also suspected of second-order adverse effects promoting the formation of ‘consumption economies without production’ in many regions (Araújo & Lima, 2009; Maia Gomes, 2001; Santos-Tupy & Harumi Toyoshima, 2013). Although these adverse trends may not be universally observed across all Brazilian regions, the impact of the BFP on local productive structures would need to be more rigorously investigated, most of the assessments mentioned above being essentially based on intuitive evidence or simple descriptive statistics. More generally, although the demand-side impacts of social transfers have started to be investigated, empirical evidence relating to the supply-side impacts of social transfers remains scarce. Still, we believe that such adverse second-order impacts driven by the change of productive structures could be observed in similarly weakly industrialized and formalized local economies in other developing countries, notably in Latin America today, or in Africa tomorrow, when nationwide CCTs become generalized there.

<sup>2</sup> Clientelist practices of purchasing political support through targeted transfers also condition the magnitude of the local growth impact of transfers. Khemani (2015) shows for example that Indonesian local politicians purchasing support through targeted transfers trade off social benefits against the provision of broader public services on which poor people would rely, with potentially adverse effects on local economic growth. Similar features have been observed by De Janvry, Finan, and Sadoulet (2012), Cavalcante and Uderman (2009) and Gomes and Vergolino (2010) in the case of Brazil, where local governments actually do have room for maneuver in the delivering of some social benefits. Three years after the introduction of the program, Hall (2006) discussed the risks raised by the politicization of the BFP including clientelism, biased targeting, inadequate monitoring, and weak accountability and warned against the dependence of the poor on local government and the extension of political patronage it may lead to. As will be discussed in Section 3.2, the risk of politicization of the BFP by local governments has been minored by various reforms of the program implementation process.

<sup>3</sup> The BFP is a typical conditional cash transfer scheme aimed at reducing poverty and inequality through the provision of a minimum level of income to extremely poor families. The program also aims to break the inter-generational transmission of poverty by conditioning the transfers on compliance with sound human capital requirements such as school attendance, vaccines and pre-natal visits (Lindert, A., J. Hobbs, & B., 2007).

<sup>4</sup> One million beneficiaries are reported for 2016 in the state of Ceará on which our analysis is conducted.

By assessing the ‘local economy’ effects running through productive structures for the 184 municipalities of Ceará, a state in northeastern Brazil, over the period 2000–10, the present paper is the first to have empirically identified the supply-side impacts of social transfers and how they condition the overall effect of the BFP on local economic growth. By estimating the reduced form of a local growth model and by addressing reverse causality and spatial correlation issues, we first find evidence in support of the hypothesis of a positive growth multiplier effect of conditional cash transfers in Ceará. The average additional GDP growth generated by the BFP is estimated at 2 percentage points over the study period. Next, the estimation of a structural model of local growth, including the impact of social transfers on productive structures, shows that the overall impact of the BFP on growth over the period was reduced by a second-order tendency of the social transfers to promote services and informal activities rather than manufacturing. Our estimations indicate that the overall local growth effect of BFP transfers over the medium term (6–7 years) could have been twice as big in the absence of an adverse supply-side impact of social transfers on structural transformation. Lastly, the politically sensitive assumption of a redistribution trap was formally elaborated, before it was tested by checking whether the impacts of the BFP on productive structures were non-linear in relation to the distribution of the initial productive capacities in the different municipalities of the sample. Counter to the assumption of a redistribution trap, we find that the adverse impact on productive structure described above tends to be stronger for the most productive municipalities, where industrialization actually stagnated during the study period, while on the contrary it was stimulated in the municipalities that were initially the least industrialized.

The dataset used in this paper is original as it brings together, at municipality level, statistical data formerly available from different sources and for different levels of observation. In order to gauge the productive structures of municipalities and the way they channel the impact of social transfers on local economies, the authors have computed various original indicators using geo-localized microeconomic primary data on firms that they have aggregated at the municipality level and matched with other municipal-level data. In addition to providing information about structural features that certainly condition the local impact of social transfers, the dataset and empirical results in this paper document new aspects of structural change that have not been assessed by any other study at this level of aggregation.

To our knowledge, the indirect impact of social transfers on local growth, acting through the structural changes they cause, has not been empirically documented, either in Brazil or elsewhere. Although abundant, the literature on the effects of conditional cash transfers (CCTs) has essentially focused on microeconomic impacts at individual or household levels<sup>5</sup> and tended to disregard the growth effect of social transfers at the ‘village level’ (Barrientos, 2012). One exception is the local-economy-wide impact evaluation (LEWIE) designed to capture the full impact of government programs using village-level structural economic models based on social accounting matrixes to assess local economic multipliers of cash transfers in various national settings (Filipski & Taylor, 2012; Levy and Sherman, 2014; Rawlings and Rubio, 2004; Taylor, 2012; Taylor et al., 2005; Thome et al., 2016).<sup>6</sup> Since they are based on simulations from local general equilibrium

<sup>5</sup> For an overview of the microeconomic impacts of CCTs, see Fiszbein and Schady (2009).

<sup>6</sup> Local goods and labor market linkages may transmit the transfer’s impacts from the beneficiary household to others inside and outside the local economy, including households not eligible for the transfer. *Local general equilibrium* (LGE) effects therefore depend on the local availability of factors and on the inter-sectoral linkages, with no local supply response arising in some extreme cases.

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