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Social Transfers: Incentives and Disincentives to Labour Insertion and Income Generation

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Over the last decade and a half, conditional cash transfer (CCT) programmes —together with other non-contributory social protection programmes such as social pensions — have become the main gateway into social protection systems for poor and vulnerable populations in Latin America and the Caribbean, which were long excluded from any social protection benefit. Today, CCTs cover 127 million people, or 21 per cent of the region's population. In several countries—including Brazil and Mexico—these programmes, which grant families a cash transfer on condition that they fulfil specific commitments aimed at improving their human capacities, have contributed significantly to reduce poverty and inequality.

However, criticism has been raised against CCTs because of their supposed negative impacts on the labour insertion of working-age adults from beneficiary families. There exists a belief that these programmes are creating dependency instead of fostering families' autonomous efforts to overcome poverty. This argument is frequently associated with a vision according to which people live in poverty because of their own lack of effort, rather than because of the structural problems that characterise our societies. CCT programmes, in particular, would constitute a disincentive to poor people to search for work, because families receiving cash transfers would already have a certain level of income guaranteed.

Cecchini (2013) shows that CCTs often have quite limited capacity to cover the income deficit of poor families. Around 2008, the regional average of the maximum per capita amount of transfers was US$16, about 20 per cent of the rural poverty line. It is thus quite difficult for poor people to stop looking for work simply because they receive public cash transfers. Families will have to continue trying to lift themselves out of poverty through their own efforts. Indeed, impact evaluations available for countries as diverse as Brazil, Chile, Honduras, Mexico, Nicaragua and Paraguay do not find empirical evidence of CCTs' disincentives to beneficiaries' labour insertion.

In turn, Levy (2010) has argued against a 'vicious circle' of non-contributory social programmes that generate subsidies to the informal sector, incentivising workers to look for low-productivity jobs (to avoid compulsory social security savings), lowering the productivity of labour and capital, and fostering the generation of low-quality employment.

However, the risk of giving social benefits to informal workers seems to have been overstated, as Latin America's informality rate has decreased while CCTs and social pensions have expanded, falling from 54.6 per cent of employed workers in 1990 to 49.1 per cent in 2009. Most CCTs are not directed to working-age adults, but rather to children; nor are they targeted according to the working conditions of beneficiaries. If incomes generated in the labour market do not have an impact on the transfers that can be received by families through social programmes, then there should not be any perverse incentives to informalisation. Chile's CCT —Ingreso Etico Familiar—actually attempts to provide correct incentives by providing an extra formalisation bonus to women who contribute to social security during their participation in the programme.

Furthermore, the theory of the 'vicious circle' is based on debatable assumptions: on the one hand, that social expenditure is not productive and offsets investment in employment-generating activities and, on the other, that self-employment is voluntary, meaning that most—if not all— of informal-sector workers choose jobs in the low-productivity sector.

However, social protection is an investment in human capacities, leading to important productivity gains. Also, in most cases, workers do not choose to work in the informal sector, but, rather, it is their only choice. Informality is the by-product of the heterogeneity of the productive structure, which creates and maintains the informal sector because of the weak capacity of the modern, higher-productivity sectors to absorb the labour force.

Contrary to the 'vicious circle' of greater informality and lower productivity, it can thus be argued that positive synergies exist among inclusive social protection, growth and decent work. Cash transfers financed by general taxation which are guaranteed and constant over time represent a basic social protection floor for poor households and can contribute to a 'virtuous circle' of autonomous income generation. People living in poverty who receive transfers have a better chance of participating in the labour market, as they have resources to search for work and to cover the costs of transport to and from work. Furthermore, they are able to look for better work, as they have better negotiating power in relation to very low salaries, as well as more resources to invest in productive activities, be they microentrepreneurial or agricultural.

In conclusion, while it is true that if poverty reduction programmes are not designed carefully — for instance, selecting families according to the labour status of their members — they may end up providing wrong incentives, the concerns of the supposed 'vicious circle' seem exaggerated, especially given the still very limited amounts transferred via most non-contributory social programmes in Latin America and the Caribbean.

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