Chapter 4

Antidote to Poverty: Economic Freedom, Not Government Dependency

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In 1979, Nobel Laureate Milton Friedman stated, "no economic system in history has been as successful at lifting people out of poverty as that of capitalism and free trade, based on principles of economic freedom." He also remarked, "there is no alternative way so far discovered of improving the lots of ordinary people that can hold a candle to the productive activities that are unleashed by a free enterprise system."[1]

Economic freedom has done more for the poor throughout the world than any taxpayer-funded social program or welfare check ever could. This system based on individual freedom, private property, limited government, and limited regulation has improved the lives of millions of people worldwide. Every year, the results of The Heritage Foundation's *Index of Economic Freedom* reinforce the conclusion that the world's freest economies have less human poverty and higher living standards.

Notwithstanding the overwhelming evidence of success over the past two centuries, however, critics continue to insist that economic freedom has been a failure. A frequent charge is that governments that prioritize policies such as low tax rates, impartial rule of law, strong private property rights, and unfettered access to markets generally fail to provide citizens with adequate social benefits such as health care and education—key components of the multidimensional measures of poverty. The results of the *Index of Economic Freedom* tell a quite different story. In fact, greater economic freedom correlates with better outcomes in education and health.[2]

Attempts to improve people's quality of life have been particularly important in emerging and less developed economies because of their relatively higher poverty rates. In fact, while the poverty headcount rate in most developed countries is close to zero according to the international measure of $2 a day (in PPP),[3] in the rest of the world, poverty affects the lives of billions.[4] It is logical and understandable that governments in these economies and the international aid community worry about this problem and occasionally make new plans and programs to eradicate poverty. The Millennium Development Goals, promising to cut poverty in half by 2015, are one example.[5]

The idea of cash transfers to the poor, a form of social assistance programs that emerged in the mid-1990s, has recently captured increased attention from policymakers and scholars due to the increasing number of countries that have been adopting such programs.[6] Today, these types of programs are the most common social assistance interventions in many emerging and less-developed economies, especially in Latin America, and more recently in Africa and Asia.

Cash transfers are increasingly popular both within the donor community and among policymakers in developing countries that are seeking more innovative ways to improve welfare. The idea behind cash transfer programs is that distributing cash to the poor seems more efficient than public-sector spending.

There are different variations of cash transfers, but they can be grouped into two types: conditional or unconditional. Although unconditional cash transfers, such as pensions to the elderly, are still in force and represent a significant amount of money in public budgets, the introduction of conditionality on cash transfers has become more popular among governments because of the political benefits that can accrue to the ruling party or the central government. Adding requirements that the poor "do something" might be necessary in helping to make cash transfers politically acceptable even while having little to do with the eventual success or failure of the program in meeting its goals.[7]

Moreover, studies of cash transfers in developing countries have concluded that the determining factor for beneficiaries in executing the pre-specified actions was the increase in income, not the conditionality, which had no discernable impact. Thus, the conditions attached to such programs and the additional cost of enforcing them may be less valuable than the cash itself.[8]

Conditional cash transfer (CCT) programs aim to break the intergenerational transmission of poverty by conditioning payments on compliance with co-responsibilities intended to develop children's human capital. By introducing these programs, proponents expect that conditions would allow the accumulation of sufficient human capital to drive the next generation out of poverty so that social assistance would no longer be needed in the future.[9]

All of the above seem noble intentions, but there is little evidence that such programs have resulted in improvements in the quality of life of poor families. Public services in most of the developing world still lack quality, mainly because governments generally insist on maintaining a monopoly on the service in question and are reluctant to accept private competition. Additionally, these types of programs have not helped the poor to get permanent jobs because their labor skills and productivity remain unchanged. Moreover, year after year, the coverage of these programs increases along with the amount of money needed to keep them running, and there is strong evidence that due to poor monitoring and control mechanisms, these programs are creating clientelistic behavior on the part of politicians.

Sadly, many of the countries that have introduced cash transfer programs have not made any improvements in advancing economic freedom. Structural policy changes that foster rule of law, limited government, regulatory efficiency, and open markets—key elements of economic freedom—are needed to break the intergenerational transmission of poverty. Delays in the implementation of such policies are typically the main reason why some countries fail to eradicate poverty or provide higher living standards for their inhabitants.

CONDITIONAL CASH TRANSFER PROGRAMS

One of the main arguments by the proponents of cash transfer programs is advanced by Ariel Fiszbein and Norbert Schady:

> 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 foundations for economic growth, policy 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.[10]

Under this premise, CCT programs have received significant and increasing attention. Many countries in the developing world have created programs that make regular payments to poor households on the condition that those households undertake pre-specified actions such as periodic health and nutrition checkups, growth monitoring, and vaccinations for children younger than five years of age. Education conditions usually include school enrollment and attendance on 80 percent–85 percent of school days, but in many cases, there are no measures of performance.

By 2011, at least 18 countries in Latin America had implemented such programs. Elsewhere, there are large-scale programs in Bangladesh, Indonesia, and Turkey and pilot programs in Cambodia, Malawi, Morocco, Pakistan, and South Africa, among others. Just in Latin America, the number of beneficiaries grew from 38 million in 2001 to 135 million in 2010.[11]

The largest programs in terms of absolute coverage are located in Mexico and Brazil. In Mexico, the program is called *Oportunidades*. It started in 1997 with 300,000 beneficiary households and now covers almost 6 million households. In Brazil, *Bolsa Familia* started in the municipalities of Brasilia and Campinas and now serves 11 million families (58 million people) countrywide. The smallest program in terms of coverage is located in Chile, serving 215,000 households. In terms of relative coverage, programs range from approximately 40 percent of the population (Ecuador) to about 20 percent (Brazil and Mexico) to 1 percent (Cambodia). Santiago Levy and Norbert Schady show that for 16 countries in Latin America, average coverage is one out of every four households.[12]

In terms of budget, the costs range from about 0.50 percent of gross domestic product (GDP) in such countries as Brazil, Ecuador, and Mexico to 0.08 percent of GDP (Chile). The generosity of benefits ranges from 20 percent of mean household consumption in Mexico to 4 percent in Honduras and even less for programs in Bangladesh, Cambodia, and Pakistan.

IMPACT OF CONDITIONAL CASH TRANSFER PROGRAMS

The impact of CCT programs individually is difficult to evaluate. Programs vary widely, both in the quality of their evaluation methods and in the extent of control and monitoring schemes. Governments that have adopted strict operational rules show more positive plausible results than those that have implemented more flexible designs or looser rules.

The ultimate goal of CCT programs is to alleviate and break the intergenerational transmission of poverty by inducing parents to use public health and education services for their children. In almost 15 years, these programs, both in Latin America and in the rest of world, have yielded mixed results. Following are case studies of *Oportunidades* in Mexico and *Bono Juancito Pinto* (BJP) in Bolivia.

Oportunidades[13]

Mexico's *Oportunidades* program has its roots in a predecessor program, *Progresa*, initiated under President Ernesto Zedillo and the Partido Revolucionario Institucional (PRI) in 1997. *Progresa*, the first large-scale CCT, focused on promoting education, health, and nutrition among the poor in rural Mexico. The program was submitted to evaluation after its first year, and studies demonstrated that it positively affected school attendance and the frequency of health clinic visits among its beneficiaries, in addition to reducing the number of families living in extreme poverty by nearly 3 percent during its first five years of operation.

Thus, despite initial skepticism, President Vicente Fox and the Partido Acción Nacional (PAN) decided to maintain the program upon coming to power in 2000. In 2002, Fox put his own stamp on the program, changing its name to *Oportunidades*, emphasizing the importance of co-responsibility between the government and the poor, and extending the program's reach both to involve a greater proportion of the rural poor and to include the urban and semi-urban poor. The monthly cash transfer under *Oportunidades* is $20 per family per month.

Since its beginning, *Oportunidades* has been subject to randomized evaluations, and results show that school enrollment and preventive health care utilization have increased. The program helped to increase enrollment in secondary school by 6 percentage points for boys and 9 percentage points for girls. For girls, who often drop out before secondary school, the number of those making the transition to secondary school increased by 15 percentage points. Children in the program also entered school at an earlier age and repeated fewer grades. *Oportunidades* had relatively little impact, however, on school attendance rates, on achievement on standardized tests, or in bringing dropouts back to school.

Health visits increased by 18 percent in *Oportunidades* localities, and illnesses among *Oportunidades* children up to five years old were reduced by 12 percent. Stunting was reduced in *Oportunidades* children by 10 points. Although the exact mechanism that triggers improvement is not known with certainty, it may result from one or several program characteristics, such as the provision of higher incomes that permit increased expenditure on food, growth monitoring and information about nutrition and child care, or nutritional supplements.

Bono Juancito Pinto

Bolivia's *Bono Juancito Pinto* program was implemented in 2006 by President Evo Morales to encourage parents to send their children to school. If a child attends school at least 80 percent of the time, parents receive approximately $30 at the end of the academic year. This program is funded mainly by natural resource revenues from the state-owned oil and mining companies.

At the beginning, the bonus was supposed to be given only to students in public school between first and fifth grade. However, the government has relaxed the requirements each year, and since 2013, students in public school from first to tenth grade have received the bonus. The total amount spent in the program has increased from $27 million in 2006 to $60 million in 2013, which represents 0.25 percent of Bolivia's nominal GDP. Student coverage has increased from 1 million to nearly 2 million. These numbers merit some skepticism. A comparison of numbers from the Minister of Economy, in charge of giving the bonus, and the Minister of Education shows that the number of students receiving the bonus every year is greater than the number of students enrolled in school each year.[14]

To date, no official evaluation document has been issued by the Bolivian government. However, a few attempts have been made recently to evaluate the program's impact according to its objective. Using micro simulation techniques, Ernesto Yañez Aguilar finds that the BJP has had a positive impact on reducing school absenteeism in primary schools, has helped to reduce the extreme poverty rate, and has improved income distribution, especially in the rural sector.[15] Flavia Marco Navarro shows that the program has had a positive impact on school attendance and a slight impact on the dropout rate, while the effect on enrollment is less clear.[16]

On the other hand, Sergio Daga and Roberto Orihuela find that the net enrollment rate for beneficiaries of the bonus (students from first to eighth grade) has not increased; actually, it decreased from 94 percent in 2006 to 82 percent in 2011.[17] The drop is especially surprising given that the net enrollment rate for students that do not benefit from the bonus increased from 60 percent in 2005 to 70 percent in 2011. Additionally, the study shows that dropout rates among beneficiaries have decreased, so any possible impact of the bonus is unclear.

Most shocking is that the failure rate among beneficiaries of the bonus increased sharply from less than 1 percent in 2005 to 6.1 percent in 2011, while the failure rate among those who do not benefit from the bonus decreased from 7.4 percent in 2006 to 5.7 percent in 2011.

CONCERNS ABOUT CONDITIONAL CASH TRANSFER PROGRAMS

According to Santiago Levy and Norbert Schady, careful randomized evaluations of some CCT programs in Latin America have shown that, on average, they have increased school enrollment and attendance and the utilization of preventive health services.[18] However, despite these apparently positive results, there are at least four main concerns.

Poor Quality of Public Services

While cash transfer programs have increased school enrollment, the evidence on whether the additional schooling results in better learning outcomes for children who were brought into school by these programs is mixed. Tania Barham, Karen Macours, and John Maluccio find that in Nicaragua, boys (but not girls) whose families received transfers from the *Red de Protección Social* program when they were between nine and 11 years of age have test scores that are approximately 0.2 standard deviations higher 10 years later.[19]

On the other hand, Jere Behrman, Susan Parker, and Petra Todd find that children in Mexico who received *Progresa* transfers do not have higher test scores than comparable children who did not receive them.[20] Although the reasons for this finding are unclear, the poor quality of education and the fact that many of the children who were brought into school are drawn from the lower end of the distribution of ability are probably part of the explanation.

More generally, while conditional cash transfers have increased the utilization of health and educational services, impacts on final human capital outcomes have been more limited. As a result, the effect that conditional cash transfers have on reducing the intergenerational transmission of poverty—a key objective of these programs—may be limited.[21]

Reduced Incentives to Work

In some cases, the transfers may be so large that they can have a negative effect on incentives to work.[22] In Ecuador and Mexico, transfers have increased substantially in magnitude. In Mexico's *Progresa* (since renamed *Oportunidades*), transfers are now equivalent to over 40 percent of household pre-transfer income in the lowest quintile of the distribution. Transfer income also represents a sizeable share of total income in Ecuador, where the program is also very large in scope, covering almost 40 percent of the population. If leisure is a normal good, we might expect that the income effect of transfers of this magnitude would reduce labor supply.

Moreover, many of the cash transfer programs periodically "recertify" beneficiaries to ensure that they are still poor enough to qualify for continued eligibility. This obviously introduces an incentive for households to continue to be (or at least appear to be) poor. Adriana Camacho and Emily Conover show that once the exact formula used to calculate the proxy means test that determined eligibility for Colombia's *Familas en Acción* program was made public, there was substantial heaping of households just below the cutoff value.[23]

In Chile (and in some other countries), having a household member with a physical or mental disability increases the value of the subsidy. Rodrigo Herrera, Osvaldo Larrañaga, and Amanda Telias show that among the poorest households, almost 80 percent report having a household member with a disability on the *Ficha de Protección Social*, the survey that is used to determine assistance levels. In comparison, on the national CASEN household survey, which does not determine eligibility for transfers, only 20 percent of the poorest households report having a member with a disability.[24]

Formal vs. Informal Employment

Conditional cash transfers can also favor informal over formal employment. The Uruguayan PANES program explicitly disqualified recipients if their formal sector earnings increased above a predetermined value. Verónica Amarante, Marco Manacorda, Andrea Vigorito, and Mariana Zerpa show that PANES substantially reduced formal employment among men and that these effects persisted at least two years after the program ended.[25]

Political Clientelism

The political clientelism that CCT programs may create is a derivative effect that has yet to be fully investigated. Emerging and less developed economies have suffered from political clientelism, especially regarding social assistance programs, for a long time. As World Bank CCT scholar Laura Rawlings points out, traditionally, "there has been criticism of paternalism, clientelism and corruption in social assistance programs, many of which are perceived as vehicles for political patronage."[26] CCT programs seem to follow the same pattern.

Since CCT programs are generally administered by the central government, they invariably affect the relationship between program beneficiaries and the executive in the central government. Given this connection, certain features of CCT programs indicate that the executive is focused more on using the program for short-term political gains (earning political capital) than on attaining its long-term goals (building human capital to break the cycle of intergenerational poverty). The most salient features in this respect include the process of targeting beneficiaries, the degree of the central government's involvement in program operations, the method of oversight, and the investment in the supply side of the program.

For example, the largest CCT program, *Bolsa Familia* in Brazil, has been very successful in targeting the poorest members of Brazilian society, but it has also done so in a way that inculcates significant allegiance to the central government among program beneficiaries. The combination of strong central government involvement in program operations, weak oversight of compliance with program conditions, and a lack of supply-side investment indicates that *Bolsa Familia* is more focused on short-term political goals than it is on long-term structural reform.

ECONOMIC FREEDOM AND POVERTY ALLEVIATION

The Honorable Obiageli Ezekwesili, a Nigerian citizen and then Vice President of the World Bank for Africa, highlighted the importance of economic freedom in fighting poverty in a lecture at The Heritage Foundation in October 2011.[27] She stressed, based on a research paper published by Jean-Pierre Chauffour,[28] that economic freedom and civil and political liberties are at the root of the reasons why some countries achieve and sustain better economic outcomes while others do not. The expansion of the conditions of freedom—whether economic, civil or political—over time positively influences long-run economic growth and therefore promotes higher income levels and lower poverty rates.

She also mentioned that the *Index of Economic Freedom* underlines the positive role that economic freedom plays in enabling prosperity, raising living standards, curbing poverty, and improving economic growth and social well-being. She quoted Nelson Mandela: "Money won't create success; the freedom to make it will."

Ms. Ezekwesili said that prioritizing economic freedom over social entitlements could be an effective way to reform the welfare state in many developing countries, especially if they want to make their economies more sustainable in the long run. In other words, deregulation, lower taxes, and less interference in the market would make these countries much more prosperous, not less, and ultimately eliminate the need for the state to engage in huge social spending that creates only more dependence and marginalization.

As noted, one of the strongest results of The Heritage Foundation's *Index of Economic Freedom* is that countries that prioritize economic freedom tend to be richer, tend to grow faster, and tend to reduce poverty faster, and their people tend to live longer and to be more educated. They tend to be less corrupt, to respect human rights more, to promote gender equity, and to have more of their people employed.

Looking at the level of economic freedom in the countries that have implemented conditional cash transfer programs in recent years, it should not be surprising to see that the vast majority of them are considered either mostly unfree or just moderately free economies based on their average score in the *Index of Economic Freedom* in the past

Countries in the World with CCT Programs, by Region and Economic Freedom

Region	Country	Score in the *Index of Economic Freedom,* 2009–2014	*Index* Category
Sub-Saharan Africa	Burkina Faso	59.8	Mostly Unfree
	Kenya	57.3	Mostly Unfree
	Nigeria	55.7	Mostly Unfree
East Asia and Pacific	The Philippines	57.4	Mostly Unfree
	Cambodia	57.4	Mostly Unfree
	Indonesia	56.1	Mostly Unfree
Europe and Central Asia	Turkey	63.3	Moderately Free
Latin America and Caribbean	Chile	78.2	Mostly Free
	El Salvador	68.3	Moderately Free
	Peru	67.5	Moderately Free
	Colombia	67.4	Moderately Free
	Mexico	66.8	Moderately Free
	Jamaica	65.8	Moderately Free
	Panama	64.2	Moderately Free
	Paraguay	61.6	Moderately Free
	Guatemala	60.7	Moderately Free
	Dominican Republic	60.1	Moderately Free
	Honduras	58.3	Mostly Unfree
	Nicaragua	58.3	Mostly Unfree
	Brazil	56.8	Mostly Unfree
	Bolivia	49.9	Repressed
	Argentina	49.1	Repressed
	Ecuador	48.7	Repressed
Middle East and North Africa	Yemen	55.4	Mostly Unfree
South Asia	Pakistan	55.4	Mostly Unfree
	India	54.7	Mostly Unfree
	Bangladesh	51.9	Mostly Unfree

Sources: Terry Miller, Anthony B. Kim, and Kim R. Holmes, *2014 Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2014), http://www.heritage.org/index; and Ariel Fiszbein and Norbert Schady, "Conditional Cash Transfers: Reducing Present and Future Poverty," World Bank *Policy Research Report* No. 47603, February 9, 2009, http://documents.worldbank.org/curated/en/2009/01/10298306/conditional-cash-transfers-reducing-present-future-poverty (accessed November 6, 2013).

Table 1 heritage.org

six years. (See Table 1.) Ecuador is an especially vivid case. This country is considered a repressed economy, and its CCT program has the highest relative coverage in terms of its total population, reaching more than 40 percent. (See Table 2.)

The countries that have implemented CCT programs have common features: They lack property rights, suffer from corruption, have rigid labor market laws, and restrict capital mobility. Investors' perception is that governments in these countries do not provide adequate protection for their investments.

Under these circumstances, the ability of individuals in these countries to create and

Number of CCT Program Beneficiaries in Selected Latin American and Caribbean Countries in 2010

Country	Beneficiaries (millions of people)	Population (millions of people)	Beneficiaries as Share of Total Population
Argentina	11.8	40.4	29%
Bolivia	2.1	10.1	20%
Brazil	52.4	194.9	27%
Chile	1.2	17.1	7%
Colombia	17.8	46.3	38%
Costa Rica	0.19	4.6	4%
Dominican Republic	3.0	9.9	30%
Ecuador	6.2	14.5	42%
El Salvador	0.5	6.2	8%
Guatemala	3.3	14.4	23%
Honduras	1.1	7.6	14%
Mexico	27.3	113.4	24%
Panama	0.4	3.5	10%
Paraguay	0.5	6.5	9%
Peru	2.6	29.1	9%
Uruguay	0.8	3.4	23%

Source: Marco Stampini and Leopoldo Tornarolli, "The Growth of Conditional Cash Transfers in Latin America and the Caribbean: Did They Go Too Far?" Institute for the Study of Labor *Policy Paper* No. 49, November 2012, http://ftp.iza.org/pp49.pdf (accessed November 6, 2013).

Table 2 heritage.org

accumulate wealth, engage in entrepreneurial activities, and make long-term investment plans is constrained. Alleviating poverty in a sustainable way will be impossible in these countries until their governments remove the real obstacles that restrict economic freedom.

CONCLUSION

The latest attempt to fight poverty is the idea of conditional cash transfers to the poor, a form of social assistance program that has become very popular in Latin America and more recently in Asia and Africa. Typically, such programs transfer money to the poor conditioned on the utilization of health and education public services. The main goal, according to proponents, is to break the intergenerational transmission of poverty by the accumulation of sufficient human capital so that social assistance would no longer be needed in the future.

In countries where this was possible, careful randomized evaluations of some CCT programs have shown that, on average, they have increased school enrollment and attendance and the utilization of preventive health services. In others, where CCT programs were implemented under more flexible designs or looser rules, the positive impacts are less clear.

There are at least four main concerns that are likely to undercut the effectiveness of these programs.

- Public services in most of the developing world still lack quality;
- In some cases, transfers may be so large that they can have a negative effect on incentives to work;
- There is evidence in some countries that cash transfers could favor informal over formal employment; and
- CCT programs affect the relationship between program beneficiaries and the government,

with certain features of CCT programs designed apparently more to achieve short-term political gains than to attain their long-term stated development goals.

Every year, the results of The Heritage Foundation's *Index of Economic Freedom* reinforce the conclusion that the world's freest economies have less human poverty and higher living standards. The countries that have made significant achievements in poverty reduction in a sustainable way have done it by implementing policies that prioritize rule of law, limited government interventions, regulatory efficiency, and open markets.

With a few exceptions, countries that have implemented conditional cash transfer programs lack property rights, suffer from corruption, have rigid labor market laws, restrict capital mobility, and offer few protections for investment. They would achieve better results if they focused more on removing barriers to economic freedom and less on actions that encourage more dependence on the state.

Endnotes

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28 Jean-Pierre Chauffour, "On the Relevance of Freedom and Entitlement in Development: New Empirical Evidence (1975–2007)," World Bank *Policy Research Working Paper* No. 5660, May 2011, http://econ.worldbank.org/external/default/main?pagePK=64165259&piPK=64165421&theSitePK=469372&menuPK=64166093&entityID=000158349_20110516090121 (accessed October 4, 2013).