The Efficiency Gains from Cash Transfers: Experimental Evidence from Kenya

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Abstract

Cash transfer advocates have argued that they can both function as temporary poverty relief and potentially an economic development strategy, but there is limited direct evidence supporting the latter view. This paper shows in four steps how large, unconditional cash transfers can allow households to alleviate the distortionary effects of frictions in rural markets, diversify into additional economic activities, and improve their economic welfare. First, panel analysis shows that poorer households make production decisions that are distorted by market frictions, while wealthier households can avoid these frictions and engage in more capital-intensive forms of production. Second, experimental analysis shows that cash transfers allow poorer households to increase their capital stock and use of labour, intermediate inputs, and technology, partly by diversifying their forms of production. Third, experimental analysis shows that cash transfers lead households to supply more labour, especially in their newly diversified and more capital-intensive economic activities, a pattern that is not consistent with the higher leisure that would occur with frictionless markets. Fourth, combined panel and experimental analysis shows that cash transfers also allow these poorer households to avoid the distortionary effects of market frictions. These results suggest that cash transfers can improve households' economic welfare both directly – through wealth effects – and indirectly – by enabling more efficient production decisions.

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