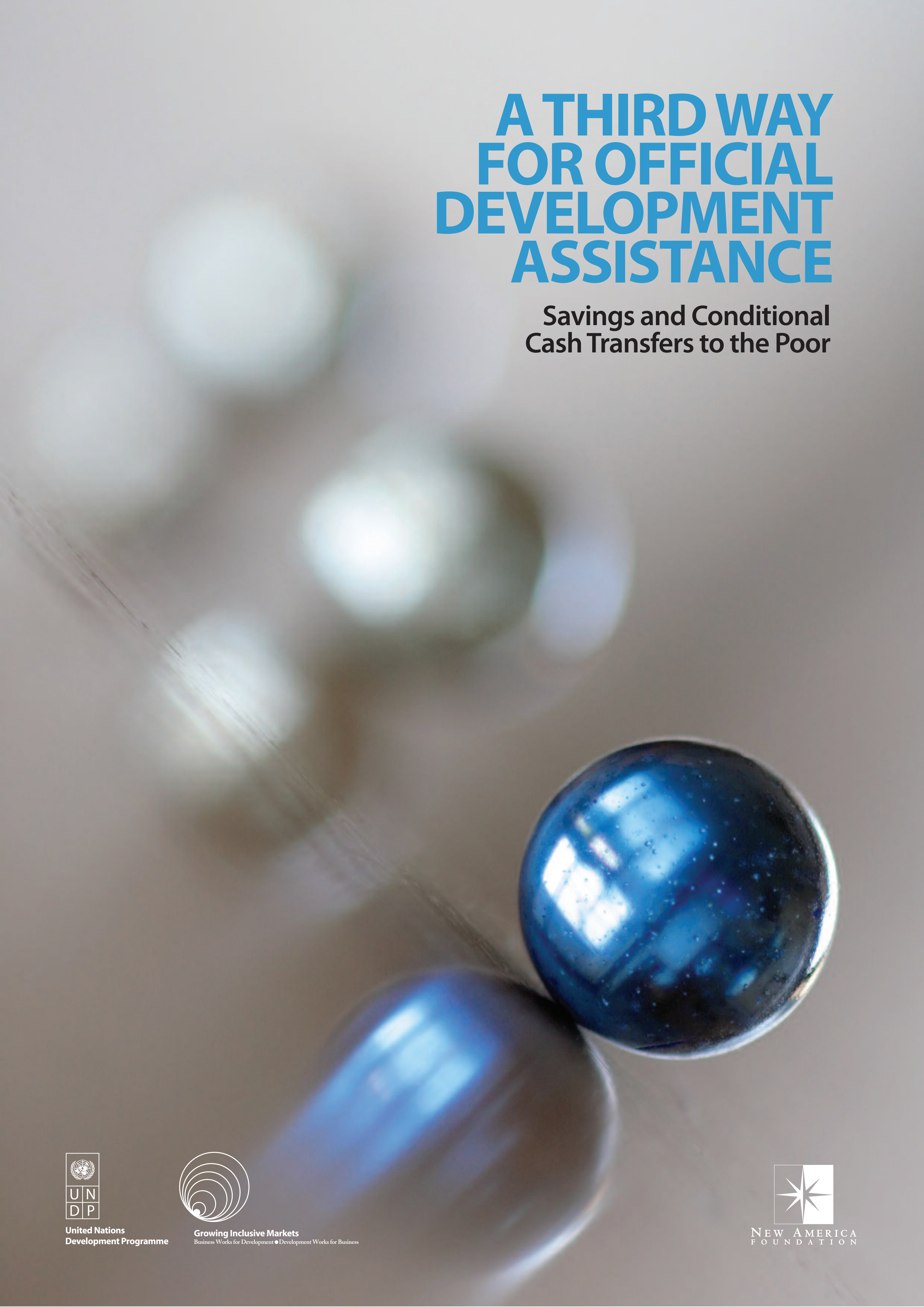
A THIRD WAY FOR OFFICIAL DEVELOPMENT ASSISTANCE

Savings and Conditional Cash Transfers to the Poor



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A THIRD WAY FOR OFFICIAL DEVELOPMENT ASSISTANCE

Savings and Conditional Cash Transfers to the Poor

CONTENTS

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I. INTRODUCTION[1]

Official Development Assistance (ODA, or hereafter referred to as 'aid') reform has been hotly debated in global development circles for decades. Aid has been plagued by inefficiencies, ineffectiveness, and corruption, inviting tough criticism and calls for all manners of restructuring. The 2005 Paris Declaration on Aid Effectiveness formalized actions for donor countries to take to improve the effectiveness of aid, emphasizing national ownership of development priorities, harmonization and alignment of donor activities, predictable and untied aid, program-based approaches, improved procurement and financial management systems, results-oriented frameworks, and mutual accountability. But there is still a wide recognition of persistent problems in donor coordination (leading to huge administrative costs for recipient governments) and fragmentation, aid-tying, an inability to direct aid to where it is needed (such as to the poorest), and an overemphasis on 'rich-country' technical assistance.

Changes in why and how foreign aid was delivered in the 1990s, as well as, in particular, after 9/11, have only further fueled the debate over ODA measurement metrics and how to better leverage aid flows toward more meaningful outputs. As Jean-Michel Severino, former director of France's international development agency (Agence Française de Développement), argued, along with Olivier Ray at AFD, it "is hard to find other examples of public policies whose performance is assessed so little on the basis of results and so much on the basis of expenses." Secretary of State Hillary Clinton agreed last year, stating that a "new [development] mindset means a new commitment to results," and that the U.S. "must not simply add up the dollars we spend or the number of programs we run, but measure" lasting change. Rajiv Shah, the administrator of the U.S. Agency for International Development, recently echoed that sentiment. "This agency is no longer satisfied with writing big checks to big contractors and calling it development," he said.

The two primary methods of ODA delivery—transfers from donor governments to recipient governments, and from donor governments to international development agencies—have complex modalities and frameworks which hamper transparency and accountability, and are poorly incentivized to measure efforts and deliver results.

Meanwhile, cash transfers to the poor have been met with increasing success, and have the benefit of being accompanied by evaluation data to measure their results. Emergency cash transfer programs, conditional cash transfers, and cash grants mark an important departure from previous donor strategies that typically funneled aid that was tied through expansive bureaucracies. The economic argument for the success of cash transfer programs lies in giving the poor choice in exercising demand, and allowing local demand to stimulate and reform a local supply of essential goods and services.

Conditional cash transfer programs (CCTs) deliver cash to recipients on the condition that the recipient fulfills some pre-determined behavior (e.g. a certain level of school attendance or number of health visits for children of the recipients). Explicitly monitoring these goals, along with dependable cash delivery mechanisms, have resulted in significant improvements in social protection programs. In addition, absorbing the poor into national educational and health frameworks has fortified a sense of citizenship by the poor, leading to a stronger national social contract.

[1] This paper reflects the views of its authors and not necessarily of their respective institutions.

I. INTRODUCTION

Not all of these cash transfer programs are as efficient or effective as they could be, however. For one, the actual distribution of the transfers, ranging from armored cars with ATMs, to post-offices, to state lottery offices, can incur high operational costs. In addition to the costs of inefficiency, cash approaches may incur risks of insecurity and corruption as well as government absorptive capacity constraints, and leave the poor still facing, as John Farrington, Paul Harvey and Rachel Slater put it, "markets, bureaucracies and political systems which disadvantage them."

Secondly, experts and practitioners question the degree to which unrestricted transfers are the most effective means for long-term poverty alleviation, rather than a short-term mitigation of a consumption shortfall. Without explicit incentives to change behavior (particularly in areas like health and education that generate positive externalities for society), the ability of cash transfers to accelerate poverty reduction, particularly across generations, is limited.

Conditional cash transfer programs (CCTs) deliver cash to recipients on the condition that recipients fulfill some pre-determined behavior (e.g. a certain level of school attendance or number of health visits for children of the recipients). Explicitly monitoring these goals, along with dependable cash delivery mechanisms, have resulted in significant improvements in social protection programs. In addition, absorbing the poor into national educational and health frameworks has fortified a sense of citizenship by the poor, leading to a stronger national social contract.

And still, the full potential of cash transfers, conditional or otherwise, has yet to be realized. Critically, an approach that attempts to link cash transfer programs with financial inclusion (and importantly, saving possibilities for the poor) on a large scale remains untried and untested.

To date, in most countries, only around one quarter of all cash transfer programs are delivered through financially inclusive or bank account-linked mechanisms, a figure that represents an enormous opportunity to provide recipients with the ability to save, invest productively, and mitigate emergencies.

While universal access to financial services is not a magic bullet for poverty reduction, it may be a necessary condition that has traditionally been overlooked by the global development community. Moreover, though consumption and income remain important indicators of current poverty, saving and building wealth is the only way to ensure that the next generation escapes poverty. Financially inclusive cash transfer programs have the potential to be both more efficient and more effective.

The initial data on savings-linked CCT programs, many in their infancy or pilot stages, reveal their great potential. By 'savings-linked,' we mean the provision of a basic transactional account that acts also as a deposit facility. Mexico's Oportunidades program, by the most recent estimates, has produced over 1 million savings-enabled accounts for program participants. Personal Capitalization Account Pilots (PCAs) in Peru show great promise, providing matching grants for participant saving deposits. One PCA pilot showed that 10,000 women had saved 2 million in less than three years of saving. Brazil's Bolsa Família is also transitioning to delivering transfers through an account held at Caixa Economica, with over 2 million accounts already enrolled.

Technological advances have also altered the playing field, heralding the promise of universal financial access. The success of mobile banking in developing countries has now led to the creation of mobile savings accounts in Kenya (through a partnership between Equity Bank and M-PESA). These accounts allow low-income subscribers to pay bills, take out loans, and even make deposits in interest-bearing accounts, all without ever visiting a bank. Mobile banking has opened up a set of new opportunities in offering financial services to unbanked people who own cell phones—a population estimated to reach 1.7 billion by 2012. Such technologies promise to further improve the efficiency and lower the cost of electronic transfers.

Taken together, these circumstances present an opportune moment to suggest a potential third way for ODA.

This paper explores the conceptual and practical case for a simple yet radical idea: improve ODA's efficiency and effectiveness by directing ODA funds toward account-linked cash transfer programs. In effect, this would enable the creation of bank accounts for aid recipients around the world and then leverage those accounts to a) deliver aid or make other transfers and b) create additional opportunities to enhance human capital and asset building. This would address the renewed emphasis on more meaningful, measurable outputs of aid and fulfill a critical need of the poor, with tools that provide a safe and secure place to save, manage resources, and build wealth over the long-term.

The next section addresses why a third way for ODA is necessary, followed by a practical exploration of how it can work. We also highlight the potential benefits of this new idea, and explore the political and technical challenges that need to be addressed in order to make it a reality.

EVIDENCE FROM CCTs

The first generation of conditional cash transfer programs in Colombia, Brazil, Honduras, Nicaragua, and Mexico prioritized the early use of robust evaluations to inform program design and evaluation. Early findings include:

Education and School Attendance: In education, CCTs have demonstrated a positive effect on enrollment rates for both boys and girls. For example, a study of Brazil's Bolsa Família program showed a clear positive impact on school attendance. The probability of absence was 3.6 percentage points lower for children in the program. Also, their probability of dropping out was 1.6 percent lower than that of children in non-treated households.

Health: In Mexico, an evaluation showed a significant increase in nutrition monitoring and immunization rates. In Colombia's CCT, the proportion of children under age 6 enrolled in growth monitoring rose 37 percent. In Nicaragua, after several months of program operation, more than 90 percent of children in program areas participated in nutrition monitoring, as compared with 67 percent in control areas. Bolsa Família recipients also saw a reduction in stunted growth for children aged 6 - 11 months.

Consumption: CCTs have also resulted in higher consumption levels. In Mexico, after a year of program operation, the value of food consumption for the median beneficiary household was 11 percent higher in program households than in non-program households (with higher expenditures on fruits, vegetables and animal products accounting for much of the increase). In Nicaragua, the net program impact translated into a 19 percent increase in per capita consumption.

Labor: In the evaluation for Bolsa Família, it was found that the labor market participation rate of adult participants was 2.6 percent higher than for non-participant adults. The participation rate of beneficiary women was 4.3 percent higher than non-beneficiary women.

II. WHY DO WE NEED A THIRD WAY FOR ODA?

Current Ways of ODA Aren't Achieving Enough Results

Despite the valuable efforts of official development assistance, the ten years and multiple billions of dollars invested toward the Millennium Development Goals (MDGs) has seen insufficient progress. There has been progress toward halving the number of people in developing countries living on less than $1.25 a day, but many regions, particularly Sub-Saharan Africa, are lagging far behind in many indicators. In parts of East Asia, hunger actually increased between 2002 and 2007. The list of Asian nations alone that are likely to miss the MDG income-poverty target include India, the Philippines, Bangladesh, Georgia, and Uzbekistan.

Taxpayers in donor countries express frustration with and skepticism of ODA due to perceptions about its ineffectiveness, its lack of impact, and its lack of coverage. Especially in these straitened economic times of slashed budgets, governments have a renewed pressure to 'do more with less.' For both donors and recipients, reforming even a small amount of aid could be catalytic.

The delivery of foreign aid may well soon find itself at a crossroads, especially with significant budget pressures in today's economic reality.

While conventional calls for foreign assistance reform focus mainly on increasing the amount of aid or improving measurable metrics, they often do little to suggest concrete next steps. Understanding more precisely the current shortcomings in ODA measurements and delivery—and what the alternatives are—is a first step in charting an effective course forward. One issue remains the complex, and at times counter-intuitive, bureaucracy of disbursement. As William Easterly put it in 2002, "despite numerous attempts at reform, bureaucratic characteristics of foreign aid stayed remarkably persistent throughout its fifty year history." The fault does not necessarily lie with aid bureaucrats, as Easterly points out, but rather with an incentive structure that provides scant feedback and accountability. As Jean-Michel Severino noted, ODA "measures expenditures not remotely relevant to what really matters; it fails to capture the resources that are dedicated to specific ends; and it does not align costs with outcomes."

Many critics have also suggested that aid has been used to achieve geopolitical aims rather than foster development in the past (evidence shows, for example, that aid has been traditionally allocated with little weight placed on management and governance capacity). Although this has improved somewhat, with aid being given to countries that have a better record, the existing aid architecture still frequently suffers from misaligned incentives where rewards are generated on the basis of processes and protocols, rather than on the basis of results for the poor.

ODA Needs New, Fresh Thinking

ODA flows currently work, essentially, in two ways. Along with complex modalities of disbursement, donor governments give aid (through bilateral or multilateral frameworks) either directly to recipient governments or to international development agencies/nongovernmental organizations for in-country assistance.

Both methods result in leakages and inefficiencies that hamper aid delivery to those at the bottom of the pyramid. The percentage of ODA that actually makes its way to the individual, poor household level has been estimated to be as low as 10 percent. Other estimates put the figure closer to 40 percent[2], although exact data are impossible to discern given the number of stakeholders.

The delivery of foreign aid may well soon find itself at a crossroads, especially with significant budget pressures in today's economic reality. With the demand for new, high-impact programs as robust as ever, the time is ripe for new strategies that could retro-feed existing ODA programs and revitalize ODA moving forward. So what exactly are the best new reform strategies?

[2] This estimate is based on the Center for Global Development's (CGD) Commitment to Development Index (CDI), 2007, paper. It reflects Western Official Development Assistance only and through a formula designed by the CGD for the annual CDI. This figure is a measure of aid effectiveness more than it is aid distribution.

Cash Transfers: In recent years, unconditional cash transfer programs have gathered undeniable momentum. Yet such cash transfer programs, particularly those that are not well targeted, monitored, or delivered, can also be guilty of inefficiency, ineffectiveness, and insufficient metrics, as with many government-to-government and government-to-NGO transfers. Successful programs have been proven to increase short-term economic impact and help reduce corruption, but the global development field continues to debate their long-term effects.

Microfinance: Financial services to the poor have made great progress over the last decade. The success of microfinance programs, in their myriad forms, has revealed the very real demand of the poor to be financially included and to have access to formal savings products as well as credit. The poor can and do apply these funds wisely, often investing in productive capacity with repayment rates for microcredit over 90 percent, above banking norms. But microcredit alone (the dominant service offered by microfinance programs) has not been able to generate a clear and consistent positive effect on poverty reduction,[3] and the need to provide savings to allow the poor to build wealth has only been growing. See Appendix 1 for an overview of the literature on the demand for savings by the poor.

Both of these trends point to a convergent solution: to incentivize savings and financial inclusion through conditional cash transfer programs. These programs would provide recipients with the incentives, convenience, and stability of a recurring cash flow, which is needed in order to accumulate assets, generate income, and escape poverty permanently.

Such programs would leverage existing cash transfer programs by providing incentives for behavioral change—for instance, to create a savings habit—as well as provide a more cost-efficient platform for microfinance programs, many of which are currently grant-dependent and not profitable. In addition, we anticipate that there will be positive effects through feedback loops on educational and health outcomes as well (thus increasing the development impact). In other words, account-linked CCTs may have the potential to improve the efficiency and impact of existing transfer programs, and provide a dynamic financial platform that can help the poor use their resources to escape poverty more effectively.

Financially Inclusive and Asset Building CCTs Hold Promise

The Program Rationale

Linking CCTs to financial inclusion initiatives could enable better outcomes for the poor and allow donors or governments to better leverage social protection programs. The effects could be widespread, providing participants with greater social empowerment, positive psychological impacts, increased investment in human capital, future-oriented outlooks, the ability to weather shocks, and the promotion of the Millennium Development Goals.

Conditional cash transfers, unlike traditional food or in-kind welfare programs, allow, as David Porteous and John Ratichek have written, "recipients to choose the consumption/investment mix which suits their circumstances best" while also embedding "further incentives for recipients to modify behavior towards socially desired patterns." The usage of cash can also be justified on the basis of lower delivery costs, greater accountability, and reducing corruption. In conflict zones, for instance, food is a target for asset stripping. One study found that in Ethiopia, a switch from food to cash was "associated with a decline in corruption, theft and wastage." The switch also increased consumption of local goods and services.

The best evidence of the impact of CCTs on poverty and inequality has come from the evaluations of conditional cash transfers in Brazil and Mexico. According to these evaluations, the CCTs "cost only about half a percent of national income" and yet "they have been responsible for a fifth of the reduction in inequality in these countries over the past ten years, as measured by the Gini coefficient." In Mexico, PROGRESA was correlated with reducing poverty by 8.2 percent, the poverty gap by 23.6 percent, and the severity of poverty by 34.5 percent. In Brazil, the Gini index fell by 4.7 percent from 1995 to 2004. Bolsa Família was responsible for 21 percent of this fall. Since the transfers represented a mere 0.5 percent of total Brazilian household income, it is impressive that Bolsa Família was the second most important factor—after labor earnings—in driving down inequality.[4]

[3]See Odell, Kathleen, "Measuring the Impact of Microfinance," Grameen Foundation, Publication Series, May 2010 for a discussion of the findings from different microfinance impact studies.
[4]See papers by Sergei Soares et al and Fábio Veras Soares et al for further details.

At a micro level, three needs drive the financial activities of the poor. These include: the financial basics like managing cash flows to transform irregular income into a dependable resource that can meet daily needs; coping with risks like emergencies that can derail families with little in reserve; and raising lump sums that would allow families to seize opportunities and pay for big-ticket expenses.

In addition, evidence from Mexico's Oportunidades program suggests that CCTs can increase savings and investment, promote banking, and create more responsible spending habits. These ancillary effects are in addition to the documented health and educational outcomes discussed earlier.

World Bank research in Africa has shown that CCTs can significantly reduce HIV/AIDS and other sexually transmitted infections. In Malawi, one study enrolled roughly 3,800 girls and young women in a program that delivered cash payments for school attendance above 75 percent. After a year and half, girls enrolled in the program had 60 percent lower HIV infection rates than those in the control group. Herpes infections were 75 percent lower, and girls had less sex and with safer—younger—partners. The likelihood that the girls would turn to older men for sex, gifts, and cash declined as the size of the payments from the program rose, suggesting the central role of extreme poverty in sexual choices. The research provides even more evidence that CCTs can affect participants significantly in other important aspects of their lives.

As Armando Barrientos, social protection expert and researcher at the Brooks World Poverty Institute, puts it, "well designed and implemented social transfer programs can have positive effects on the ability of poor households to invest in their productive capacity, and can therefore support growth strategies." Barrientos has identified three ways in which transfers can contribute to investment, asset building, and growth at a household level: reducing liquidity constraints; lifting credit constraints; and improving household security and certainty. These three attributes enable the poor to mitigate external shocks, thus affecting assets and facilitating household resource allocation and dynamics. Going further, Barrientos, David Hulme, and Joseph Hanlon recently argued that "instead of maintaining a huge aid industry to find ways to 'help the poor,' it is better to give money to poor people directly so that they can find effective ways to escape from poverty."

The Consultative Group to Assist the Poor (CGAP) reported in 2009 that over 140 million people are receiving cash transfers from their governments. Yet only one quarter receive these benefits into a financially inclusive bank account. The majority thus receive their recurring payments through an extensive administrative structure.

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At a macro level, the latest economic models suggest that a lack of access to finance can be, according to the World Bank, the "critical mechanism for generating persistent income inequality or poverty traps, as well as lower growth." As illustrated by the figure on the following page, countries with the highest percentage of households below poverty lines have the lowest deposit account penetration.

Source: Financial Access database (http://fas.imf.org)

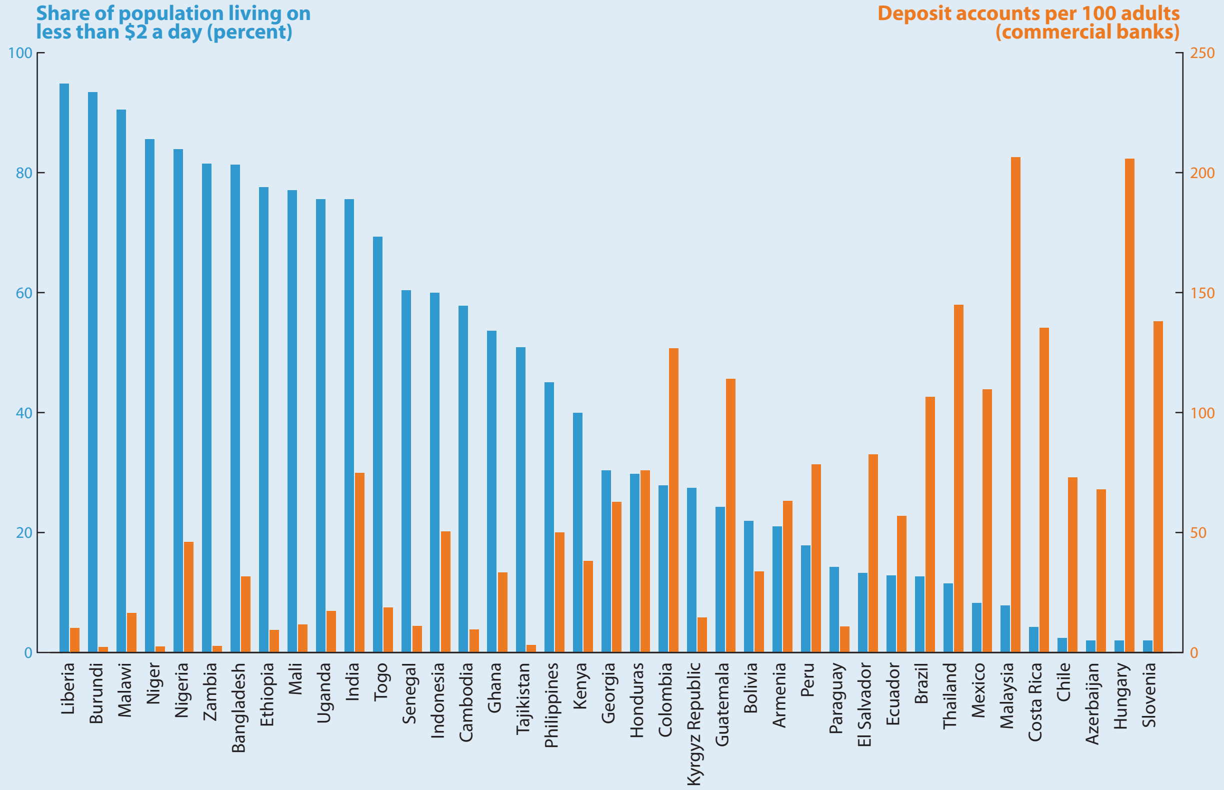
A few outliers, like Mongolia for example, which has a high banking penetration likely due to government payments through accounts for children and families, point also to the fact that it is possible to provide bank accounts to populations largely in poverty.

One sample of 52 industrial and developing countries over the period 1980 to 2000 looked at the relationship between financial development (proxied by the total value of private credit relative to GDP), poverty alleviation, and changes in the distribution of income. Its authors, Beck, Demirgüç-Kunt, and Levine showed that financial development:

- "boosts the growth rate of the poorest quintile's income, suggesting that financial development reduces income inequality, suggesting that financial development reduces income inequality;
- induces a drop in the Gini coefficient measure of income inequality even when controlling for real per capita GDP growth, thus suggesting that financial development reduces income inequality beyond the relationship between finance and aggregate growth; and
- reduces the fraction of the population living on less than $1 a day and the poverty gap even when controlling for average per capital GDP growth"

The poor, in effect, pay a "poverty penalty" for their lack of access to financial services when participating in certain markets.

POVERTY RATIO VS. DEPOSIT ACCOUNTS



Source: World Bank Data Catalog and CGAP/The World Bank Group, "Financial Access 2010: State of Financial Inclusion through the Crisis," 2010

The Conceptual Rationale

Over the last decade, Amartya Sen's capabilities approach has developed into one of the leading alternatives to standard economic frameworks for thinking about poverty. Whereas traditional welfare economics looked at wealth or utility as the primary indicators of well being, more vital is the ability to transform wealth into maximized utility. Different cultures and people value different capacities in this regard, but most important is to encourage what an individual is able to be or do.

Linking the capabilities approach with the ability to save is the economist Michael Sherraden, who has said that "assets are a key to family and community development based on capacity rather than maintenance. Welfare policy for the poor has focused on income-for-consumption, which is essential but not enough. In order to develop capacity, families and communities must accumulate assets and invest for long-term goals."

As Marianne Bertrand, Sendhil Mullainathan, and Eldar Shafir have written, "social scientists regard the behaviors of the economically disadvantaged either as calculated adaptations to prevailing circumstances, or as emanating from a unique 'culture of poverty' rife with deviant values." Their research has shown that neither of these are true and that the poor, like everyone else, do not possess perfectly rational capacities for choice, nor are they "especially deviant."

Instead, the conditions of poverty create much narrower margins for error. The findings from the field of behavioral economics show that reducing poverty lies in being able to adapt products and processes to meet the specific needs of the poor. Providing the poor with access to the relevant financial products thus widens those margins of error, and brings them into markets which give them the possibility of moving out of poverty.

It is also worth noting that in today's economic climate of monetary easing and Keynesian stimulus packages, the political will to institute direct transfers to the poor and the economic rationale (since the poor are more likely to spend it than the rich) are mutually supportive. In most of its current form, aid, which is more focused on the supply-side, is poorly positioned to optimally increase consumption levels at the bottom of the pyramid.

While it will require new commitments and new reform, investing in strategies that support savings-linked conditional cash transfers might prove to be the highest leveraging tool in ODA's arsenal. This third way, described below, would mean creating basic transactional accounts (BTAs) in which target populations can receive, save, and manage their resources in formal accounts and employ those accounts for other social investment goals.

III. WHAT IS THE THIRD WAY?

The third way is, in short, to direct a significant part of ODA funds toward account-linked, savings-enabled CCTs. The mechanism for using ODA to create more direct channels to deliver aid to households does not need to be created from scratch. Technological advances, through major reductions in transaction and delivery costs, and increases in convenience and security, have resulted in explosive increases in financial services coverage for the poor and underserved. A greater understanding and ability to coordinate multiple stakeholders in public and private partnerships in this field, improved research and design of innovative financial products, and the greater availability of valuable research and evidence have also contributed the necessary experiences and insights integral to implementing these advances.

These advances can be easily applied toward enabling the third way. As a tool already associated with the social and economic growth agendas of developing countries, ODA is, by its very nature, uniquely positioned to advocate for financial access and asset building for all.[5] This section moves beyond the rationale for the third way to exploring how this idea could work, both technically and theoretically, and discussing different potential models using third way mechanisms to address context-specific development challenges and goals.

We propose that forthcoming, pledged ODA funds be used to create and seed formal BTAs that also act as savings accounts by allowing deposits by the poor. By facilitating financial infrastructure development and the necessary multi-stakeholder platforms, BTAs could produce multiple benefits.

Revolutionary Technological Advancements in Financial Access

The pace of technological innovation has led to individuals, households, and indeed developing nations themselves leapfrogging certain traditional stepping-stones on the path to development. Regarding financial services delivery in particular, new technologies that enable agent and mobile banking have reduced certain traditionally-prohibitive "last mile" costs, such as those associated with bricks and mortar branch overhead costs as well as costs associated with handling in-person, small-balance transactions for a financial institution. These advances hold the potential to enable massive, if not universal, provisions of cost-effective and highly accessible bank accounts to even some of the most remote, economically excluded populations.

Of course, there are other pieces of the puzzle to consider: the challenge of authenticating users who may not have the required documentation; the investment and coordination requirements for both banks and telecommunication providers to ensure a seamless interoperable platform; developing low-cost payment systems that are secure and capable of managing high volumes; instituting a robust and dispersed agent network and enrollment system; and finally, ensuring that both financial and technological literacy issues on the part of the end client are resolved.

Regarding the recurring issue of identification and user authentication, promising advances have been made in the field of biometric identification, which are being taken to scale. India's Unique ID project, headed by former Infosys CEO Nandan Nilekani, has ambitious plans of providing every citizen with a unique ID number that will also act as a link to universal financial inclusion by providing the identification necessary to open a bank account, as well as to transact in the system.

[5] The authors also believe that there is a significant case to be made to the OECD taxpayer who funds this ODA through this concept of 'direct assistance' as evidenced by the recent success of various private fundraising efforts that employ 'person to person models of giving and receiving.'

Today, ODA is not only well positioned to play a crucial role in accelerating the pace of financial inclusion, but it could also be a high-leverage tool to promote the savings and asset-building opportunities needed to foster economic and social empowerment of the poor. ODA is already linked with the social and economic growth missions of developing countries. More particularly, ODA giving agencies have established technical and diplomatic relationships with governments, many of which are engaged in conditional and non-conditional cash transfer social policies. In fact, ODA is already contributing to the functioning of these programs in some cases.

We propose that forthcoming, pledged ODA funds be used to create and seed formal BTAs that also act as savings accounts by allowing the poor to make deposits. By facilitating financial infrastructure development and the necessary multi-stakeholder platforms, BTAs could produce multiple benefits. They would allow poor households to receive, save, and manage their resources more efficiently—whether through aid-based transfers, remittances, or their own earnings—providing instant access to the formal economy and a legal financial identity.

These accounts would facilitate financial inclusion and support the financial security of poor and vulnerable individuals and households, and could reduce the costs of aid delivery and the significant leakage of aid associated with corruption, kleptocracy, and bureaucracy. In addition, such accounts can provide access to credit and debit transactions, and increase financial access through building financial histories.

As such, the third way carves out a new, unique pathway for foreign assistance, one that leverages market forces and the latent demand of the poor in order to accelerate the pace of poverty reduction. The convergence of BTAs with additional value-added conditional cash transfer schemes can create a potential catalyst for development, and a seismic shift in the way we "do aid."

The Foundation: Basic Transactional Accounts

The lifeblood of the third way lies in BTAs. BTAs are low-to-no fee[6] and low-to-no interest bank accounts into which ODA funds can flow and the recipient can transact as well as store value. BTAs should be provided by financial institutions, which can guarantee the safety and accessibility of the poor's resources.[7] Additionally, the "basic" nature of these accounts reduces costs for the involved financial institution, enhancing its prospect for being both scalable and sustainable over the long term.[8] Ideally, any form of a financial institution could host ODA-supported BTA accounts. The decision by governments as to which method of transfer to support and what form of delivery mechanism is employed will depend on the specific context and resources available.

It is a key contention of the authors that the BTAs by their nature and purpose may only achieve break-even profitability or marginal profitability at best. The needs of the poorest require the ability to transact minuscule amounts frequently. As such, it is not an activity which would be of interest to the usual "microfinance" sector. Of course, this does not preclude private operators, but rather only implies that the initial provision of BTAs might best be done by institutions, such as state or postal savings banks, that may have an explicit pro-poor mandate or favorable internal capital-allocation dynamics, and understand the nature of the positive externalities of providing such a public good. For private operators, BTAs should be seen and understood as the first rung on the ladder of financial inclusion, which the poor can use to eventually graduate to full-service credit and savings products, among others, as their means and assets grow.

Who Receives the Accounts?

The World Bank reports that societies that discriminate on the basis of gender are associated with having greater poverty, slower economic growth, weaker governance, and a lower standard of living. Investing in women and female entrepreneurs is a critical step to lifting the 70 percent of the world's poor, who are women, out of poverty. Evidence also suggests that giving women access to finance has resulted in an increase in their decision-making roles in family planning, children's marriage, buying and selling property, and sending their daughters to school. There have also been positive impacts reported on self-confidence, along with improved involvement and status within the community. Thus, ensuring that women are the target recipients of transfers seem to promise multiplier effects on development outcomes beyond ordinary financial inclusion.

[6] Taking into account the commercial viability of these accounts, perhaps fees could only be limited to a point. For instance, account holders could be offered up to 5 transactions per month without a fee, and then pay some market rate thereafter.
[7] Informal micro-finance institutions (MFIs) and informal savings groups are unregulated and hence either are not permitted to keep savings or may not always be the safest option for the poor to store their savings.
[8] Safety and accessibility are the highest demanded product features for transaction and savings accounts of the poor. See Daryl Collins, Jonathan Morduch, Stuart Rutherford, and Orlanda Ruthven, "Portfolios of the Poor: How the World's Poor Live on $2 a Day."

Possible Delivery Channels

A variety of options for delivery channels for 'third way' flows currently exist, yet all depend on the reach, depth, and quality of financial access within a country or community. As a start, it makes more sense to work within existing structures and institutions, utilizing those mechanisms that provide the greatest reach at the least cost to both the recipient and the delivering institution. On a side note, a key constraint in the diagnostic stage will remain a lack of data, therefore the first step for many development agencies may be to share and coordinate their own experiences and initiatives in this area.

Government-led postal or savings banks are well equipped in many countries to deliver banking services to low-income or remote communities due to their extensive branch and retail presence. Most already operate under a mandate to serve remote and poor populations. Additionally, many of these banks interact with the poor in fulfilling transactions, such as bill payments, and may have already overcome the barrier of lack of trust.

Regardless of an explicit social mission, market forces should clearly operate to incentivize the sustainable provision of effective financial services. However, commercial banks and others have, to date, found the costs of mobilizing small-balance deposits and servicing pure transaction accounts (for example where most of the transactions are balance enquiries) to be prohibitive. Indeed, evidence shows that even after deposit account openings, many of these accounts lie dormant[9] –showing that achieving the right balance between proximity, convenience, return on investment, liquidity or illiquidity, and trust (including solving the customer service interface barriers) remains a challenge for many institutions attempting to serve the poor.

Luckily, game-changing technological advances in branchless and mobile banking continue to enhance the commercial attractiveness of basic, small balance accounts, but the last mile still needs to be completed in cracking the code of building successful agent networks where many more have failed than succeeded. Thus, many commercial financial institutions with robust branchless banking networks and advanced m-banking capacity would also make appropriate implementing partners. Other delivery channels are explored below.

Banking Correspondents and Retail Agents

Banking correspondents and retail banking models are increasingly used to reach remote populations without undergoing the expense of a traditional bricks and mortar branch. Typical agents include lottery outlets, grocery stores, pharmacies, supermarkets, mobile operators, and 'mobile' agents (such as boats that serve remote archipelago populations). In some cases the post office may also act as an agent for other banks. See Appendix 2 for a case study of a pilot partnership between Mexico's CCT program, Oportunidades, and Diconsa, the biggest retail store chain in the country.

Agents typically are trained to facilitate money transfers, answer balance enquiries, accept payments, and generally facilitate transactions. More advanced agent networks perform cash-in, cash-out functions (such as withdrawals and deposits), make small loans, and in rare cases, also enroll new clients, thus performing know-your-customer authentication and fulfilling AML/CFT regulations.

Many challenges lie in instituting robust correspondent models. The costs involved in setting up these networks are not inconsiderable, and as some have suggested, involve a chicken and egg problem. Banks have to identify agents in settings where a critical mass of customers can be accessed (in order to make it profitable). For customers to use agents (and thus achieve the transaction volume needed to make it profitable), however, there needs to be a critical mass of agents providing access. Ensuring that both of these grow and meet in the middle is seen as the key to profitability.

Governments are realizing that banking correspondents and retail banking models may be one of the quickest ways of increasing financial inclusion, especially in rural areas that lack the infrastructure for m-banking services. Brazil and India have modified regulations for financial institutions to use banking agents. Both countries have seen an increased penetration of financial services to the poor, but coverage still is woefully inadequate, and challenges in pricing, convenience, regulation, security, and trust still remain.

[9] Research by Finmark Trust on Mzansi accounts opened by 2008 indicates that about 42 percent of accounts lie dormant in South Africa, according to "South African Financial Diaries and the Mzansi Initiative: Five Years Later," by Bankable Frontier Associates.

ODA funds can be used in a multitude of ways to support the goal of account-linked conditional transfers. One is in the provision of technology, infrastructure and capacity buildiïng for governments and local financial institutions in building the systems, networks, and processes to enable these transfers.

However, the potential of the banking correspondent model is high. In a recent interview with the Times of India, Usha Thorat, the Deputy Governor of the Reserve Bank of India, stated that thanks to banking correspondents, "with doorstep service, wages are accessed easily and money is saved. Technology has made it possible. So, this is the only model." Using the third way, individuals would also receive aid through these basic banking correspondent accounts.

Mobile Banking

Cell phone or mobile banking holds tremendous promise in facilitating the delivery of aid and management of aid flows to individuals and households. Kenya's M-PESA program has already revolutionized m-banking capabilities. The service allows M-PESA's nearly 12 million users to make a variety of basic banking transactions using their phones and local banking agents. They can visit an agent, often in places that sell Vodafone airtime, and give the agent cash to send to a relative or pay a bill, which is sent electronically to the recipient. The recipient can then access their money at any of the almost 20,000 retail agents licensed by Vodafone, all over Kenya.

Of course, the model is most easily transportable to markets that have large numbers of mobile phone users, motivated and well-coordinated government agencies, established telecommunications infrastructure, and the conditions necessary for a robust agent network. In fact, the U.S. government and the Gates Foundation are experimenting with leveraging m-banking for aid distribution by subsidizing technological investment among Haiti's banks, which is necessary to directly distribute aid to earthquake victims.

Critics believe that m-banking leaves users more vulnerable to identity and credit theft, and that text messages, the electronic receipt for transactions that are typically saved on users' phone, are not an ideal platform for transactions. Others worry that the lax regulatory environment for m-banking may encourage its use by terrorists and their financiers. However, with proper regulation and coordination, mobile phones may be a more efficient and less expensive means of delivering aid directly to the poor.

Card and ATMs

Account-connected reloadable debit cards, or limited-function prepaid debit cards and biometric ATMs, can also distribute aid directly to individuals. The cards, often sponsored in partnerships between state banks and other organizations, are compatible with ATM machines, and can be used as cashless payment for point-of-sale transactions and for electronic bill pay and cash transfers at participating sites, like general stores. While cards do often incur either monthly service or transactional fees, they also provide additional options to diversify payments and savings mechanisms. Brazil, South Africa, and Argentina have all employed card-based models successfully. In Pakistan, where about 2 million flood victims will receive a Visa-branded prepaid card funded by the government (for about $230 per person) and issued by United Bank Limited (UBL), partners are also working with NADRA, the national identification agency, to lay the groundwork for electronic payments in the future.

While most of these programs are designed for the poor, they do require proper ID and proof of residency, which can be difficult for many living on the fringes of society. Additionally, while ATMs are a less expensive alternative than bricks and mortar banks, they are still underprovided (in addition to the frequent unavailability of widespread point-of-sale terminals), especially in rural communities. Some also raise security concerns with PIN-required transactions, procedures regarding loss of cards, and theft, making biometric authentication all the more necessary.

To build a truly functional third way infrastructure in a variety of institutional contexts, it is likely that some combination of these delivery models will have to be employed. For instance, customers can have mobile access to their accounts to check balances and transfer money while using ATMs, agents, and branches to make deposits and withdrawals. Also, as primary targets of this aid, administrators may also consider how to specifically promote the employment of women as the "agents" in the agent-based models, as has successfully been done in India by the payment system provider A Little World (ALW).

Direct Budget Support Can Help Build the Infrastructure for Financial Inclusion

Above we lay out the basic foundations of the third way proposal: Use ODA funds for the delivery of aid into BTAs, and designate female heads of households to access and manage their money via the most accessible delivery channel suitable for the context.

ODA funds can be used in a multitude of ways to support the goal of account-linked conditional transfers. One is in the provision of technology, infrastructure, and capacity building for governments and local financial institutions in building the systems, networks, and processes to enable these transfers. This is already happening in the Maldives where the World Bank is investing, together with the government, in a single, interoperable system for all banks and telecommunications providers in order to facilitate mobile banking access to all residents in the Maldives, beginning early 2011.[10]

Routing ODA funds through these accounts so that they directly reach the poor would create a recurring cash-flow that would keep 'pulling' recipients to the account interfaces, encouraging savings and transactions, and of course promoting demand-led development impact. An additional option is to support the poor in financial and technological literacy, which pose a significant problem.

However, while we argue that a more direct delivery of aid holds the potential for enhanced efficiency and effectiveness, sovereignty, political, and regulatory barriers will likely prevent certain cross-border transfers. To achieve that, recipient country governments must play a critical role in designing 'third way' strategies, targeting the poor, coordinating regulation, and providing the appropriate supply-side resources that meet the demand of the poor to access finance, receive access to education and health facilities, and improve their livelihoods.

The third way for ODA would enable donors to invest in the technological and financial infrastructure that enables basic transaction accounts for all. With access to their household BTAs, recipients will be able to withdraw their aid at any designated transactional point, be it ATM, branch teller, or banking agent. Preferably, recipients would also have the option to use m-banking technology to access their account balances and transfer money. Low-income households will benefit from access to a safe place to store and receive other resources, whether from income-generating activities, remittances from relatives in the city or abroad, disbursements of social payments such as pensions, CCTs, child allowances, or additional disbursements of aid—for instance, in time-sensitive emergency situations.

Adding other Livelihood Enhancing Programming

While BTAs will address last-mile problems of financial services delivery via their linkages to m-banking and branchless banking options, the BTA is not in itself the end goal. Rather, BTAs should be considered a necessary tool for broader ends. While they provide the initial necessary receptacle for third way aid transfers, they are intended to serve additional purposes.

Initially, recipients would use their BTAs to save and manage money and payments. Governments could then leverage BTAs, adapting them or using them to more explicitly nudge recipients to make other beneficial choices. This would come in the form of add-in product features that encourage savings and asset building behavior (such as 'commitment-savings products'), or add-on programs including CCTs that encourage human, economic, or social capital growth. The form these would take depends heavily on the needs, goals, and contexts of the countries, communities, and households involved.

While the particular design parameters of these programs are outside of the scope of this paper, Appendix 3 highlights some specific yet illustrative ideas—ranging from new and intriguing to successful and tested—for more "intentional" uses of ODA transfers intended for poverty reduction for specific contexts.

[10] An interesting feature of this platform is that every resident with a National Identification card can enroll in a limited version of a full account at providing banks, over the airwaves.

IV. THE WIN-WIN-WIN — POTENTIAL RESULTS

The potential results for the proposed, third way of channeling ODA resources could present a trifecta scenario: for donor governments, whose taxpayers desire more transparency and efficiency in government spending; for financial institutions who benefit from infrastructure and technological investment and regular infusions of capital from aid; and, most importantly, for the aid-receiving individuals in recipient countries. The third way could also accelerate those Millennium Development Goals that are largely behind pace. Most directly, the strategy could provide a huge push toward halving the number of people who live on less than $1 a day and halving the proportion of people who suffer from hunger. Since BTAs would be set up by female heads of households, the economic empowerment explicit in third way strategies would encourage equality and investment in human capital across gender lines in areas such as health and education.

In the current ODA system, recipient governments and NGOs are effectively serving as middle men to the ultimate and intended recipients. Too much of this aid is often spent inefficiently by governments and NGOs. Cash transfers into bank accounts have the potential to not only reduce the existing aid-giving bureaucracy; they could enable much timelier and more efficient aid delivery. This streamlined process could prove especially useful in the aftermath of natural disasters, providing an alternative to relying on stretched NGOs and overburdened central recipient governments to reach those in need.

Individuals

In a third way scenario, individuals will see a far greater amount of aid, sent directly to their accounts, in a much faster timeframe. By opening BTAs, individuals can have access to appropriate financial services, a place to safely receive and manage their money, and become potential recipients for other conditional transfer programs or subsidies. Simply by having appropriately designed bank accounts, those at the base of the pyramid would enter the formal business and transactional fold, making credit, savings, and insurance services logical next steps. These additional financial services encourage entrepreneurship and an emerging middle class, which also benefits business institutions, and the greater economies of domestic governments. Economic inclusion also leads to a sense of greater citizenship and formal inclusion, leading to a strengthened social contract.

Financial Institutions

Although some banking institutions are still wary of the up-front costs of fully embracing financial inclusion for the poor, it is hard to ignore the long-term benefits of such an enormous potential client market. With foresight, institutions could harness the great potential to deliver not only traditional deposit-enabled bank accounts, but also to establish platforms for other services like savings, microcredit, and microinsurance, crop, and health products, all of which serve as vital risk management mechanisms for the poor. Creating a third way for ODA by its nature requires donor investment in financial systems infrastructure, mobile and branchless technologies, regulatory changes, and other capacity building from which financial institutions will benefit. With a steady stream of direct aid transfers, these institutions could also see a healthy and recurring flow of capital, thus reducing the cost of servicing small-balance accounts. Modern technology, furthermore, especially mobile phones, has recently made these services much less expensive to distribute and will ultimately provide a more profitable model for institutions that have embraced financial inclusion policies. State banks, some of which receive subsidized capital, may also be uniquely placed to lead the charge, due to their reach and coverage of the poor and their mandate, as the case may be.

Governments (Donor and Recipient)

Both donor and recipient governments should also find aid distribution through account-based cash transfers beneficial. Traceable, electronic disbursement of aid means that governments will no longer have to employ individuals or pay for trucks and gas to deliver most aid, while simultaneously reducing domestic graft and corruption. Once the system is in place, future social protection payments can also be distributed directly. Direct aid delivery, by supporting financial inclusion, also enables financially capable and economically active citizenry, many of whom have always lived and worked under the formal sector radar. Eventually, the third way can help spur entrepreneurial enterprise, which is a potential boon to any domestic government and economy. This encourages a "feedback loop" where empowered demand can reinforce the quality of supply, further increasing demand, and breaking cycles of stunted growth and decreasing returns of ODA.

Emerging data bear out the efficiency and effectiveness arguments behind the third way approach. CGAP and DFID's 2009 paper, "Banking the Poor via G2P Payments," details just how much money might be saved by switching to electronic delivery—gains that the third way would attempt to leverage within ODA delivery. As the authors wrote and as previously noted, in most countries far less than 25 percent of government to person payments to the poor "land in a financially inclusive account—i.e., one that enables recipients to store Government to Person (G2P) payments and other funds until they wish to access them and make or receive payments from other people in the financial system, and one that is accessible, in terms of cost and distance." These payments include CCTs, unconditional cash transfers, and workfare programs.

Most importantly, electronic payments have been shown to radically reduce the cost of administering payments as a percentage of the payment, as well as reduce corruption. In Brazil, for instance, the cost of administering Bolsa Família grants was cut from 14.7 percent to 2.5 percent of the value of the grant dispersed. In South Africa, the costs of delivering social security fell 62 percent after the government partnered with private banks. If these promising results hold up, the improvements in ODA impacts could be astounding.

V. THE CHALLENGES: POLITICS & REGULATION

Engineering a paradigm shift in a generations-old way of funneling and disbursing ODA will meet opposition from some affected parties and encounter logistical difficulties. Instituting the third way will require careful consideration of how best to navigate political sensitivities, reduce corruption and ensure accountability, enable feedback loops, market the programs, and address regulatory challenges.

Politics

Recipient governments may be cautious regarding any streamlining of the aid-delivery bureaucracy. Convincing stakeholders to help facilitate the groundwork for a direct payment program that has the potential to significantly reduce the aid-giving bureaucracy may prove difficult in cases where there is insufficient political leadership. Recipient governments may also raise autonomy concerns, and NGOs whose funding is dependent on ODA may resist a possibly diminished role. As a 'Southern' originating idea, however, the authors believe that developing-country governments will be receptive to it, especially given the volume of positive evaluation evidence collected.

One additional and potentially contentious issue is the amount of the transfers. Payments that are too large may upset local economic balances in ways that have unintended political consequences. If payments are too small, however, programs will be unable to fulfill their full potential in incentivizing change. Transnational transfers on a large enough scale will affect a host of regulatory bodies, laws, and organizations requiring involvement from governments and institutions on both sides of the transaction, and a vast amount of paperwork in multiple languages. Moreover, any political instability in the recipient country could jeopardize such programs. Should ODA CCTs ever reach the point where donor governments are making direct transfers to recipient nation beneficiaries, many of these problems and sensitivities could be compounded. The method and logic of calculating monthly transfers should be within the purview of an independent, technical body that is insulated from the vagaries of political and electoral cycles.

Another major challenge in designing financial inclusion and asset-building conditional transfer programs is to set up financial services that actually work for the poor, while reducing corruption. As reported by Lorena Alcazar in July 2010, CCTs can be corrupted by program officers "falsifying information to receive transfers, or politicians [who] use them to get votes." Programs must be careful to monitor eligibility criteria, establish robust mechanisms for participant feedback, keep costs lower than traditional delivery mechanisms, and convince banks that participation is in their best interests.

While these complicated issues may prove difficult initially, the upside of such CCT programs is that they will naturally create invaluable data on a great number of people living in poverty. Governments and institutions would be able to track aid receipt, program usage, which financial services are working for the poor, and improve their targeting of the poor for future programs.

Regulation

While the regulatory challenges to delegating transactions to telecommunication firms or agent networks are not insignificant, they are also manageable.

As Claire Alexandre, Ignacio Mas, and Dan Radcliffe wrote in August 2010, existing "banking regulations need to be adapted to these new possibilities of banking beyond bank branches." The authors point to five key areas where regulations will need to adapt, including: distinguishing between branches that offer full financial services and those that are merely transactional; regulations that protect both banks and their retail partners from risk; and tiered Know Your Customer (KYC) regulations that don't institute unfair barriers to the poor.

Identity protection is another issue that requires careful attention. A potent regulatory infrastructure will need to be implemented to protect sensitive information and some donor governments—especially the United States and E.U. countries—will have to be diligent in addressing the political and security concerns of vetting beneficiaries.

In South Africa, in the case of the Mzansi banking product, anti-money laundering and counter-terrorism policies required that financial institutions verify a customer's name, date of birth, national identity number, and address. But South Africa's official identity document does not include an address on it, and many South Africans do not have formal addresses. South Africa's Minister of Finance stepped in, allowing an exemption for low-value accounts. In certain cases, such carefully conceived and instituted exemptions assessed on the basis of risk will be necessary to achieve widespread financial inclusion.

VI. NEXT STEPS: POLICY RECOMMENDATIONS

The nature of giving is changing; so too should the nature of receiving. Significant yet surmountable barriers and challenges aside, universal bank accounts into which aid could flow is feasible and, in our view, highly desirable. The creation of appropriate and even purposeful bank accounts—here termed Basic Transactional Accounts—for the world's poor cannot happen overnight, yet new technologies are increasingly driving momentum toward universal access to formal financial services.

The experience in Fiji with the multi-donor Pacific Financial Inclusion Programme housed in UNDP's regional center—which has worked in areas of financial inclusion and policy, set up branchless banking models and undertook a large-scale financial literacy initiative—suggests that donor agencies have an important role to play in facilitating the multi-stakeholder platform necessary to build the institutions and infrastructure. On the other hand, while donor support in some cases is essential to the creation of universal BTAs, in other cases the private sector may lead the momentum behind technological change, and obviate the need for donor support. In Kenya, the surprising profitability of M-PESA and the rapid uptake in subscribers has led to Safaricom and Equity Bank rolling out a new joint product, M-KESHO, which offers micro-savings, micro-credit (after six months), and microinsurance to all M-PESA users.

Indeed, linking ODA and direct delivery of aid to financial services seems like common sense, but until recently, it has not been explored as a serious option. ODA is uniquely placed to advocate for financial access for all. Additionally, ODA giving agencies and organizations have already established relationships with governments, there are already ties to social and development missions, and in most cases they are already familiar with cash transfer programs. Also, using pledged ODA funds to enhance financial inclusion would have long-term benefits. Individuals and families will be able use their accounts as true, formal bank accounts. They could receive remittances, establish credit history, make payments, and take out microinsurance.

This paper presents a third way for ODA: a new, potentially transformative idea to influence the way the global giving community thinks about the nature and purpose of aid. While this idea stems from a grand vision, one which we hope will spur ample debate and experimentation, we conclude this paper here with recommended next steps to take that vision forward.

Consider Allocating ODA Gap Funds to the Third Way

The promises of fulfilling existing ODA pledges and the resulting increased funds provide the perfect pool from which to fund the expansion and further testing of account-linked conditional transfer programs that are best positioned to address long-term solutions.

The September 2010 UN Summit on achieving the Millennium Development Goals by the target date of 2015 signaled an enormous opportunity, as OECD members renewed their commitment to contribute 0.7 percent of their gross national income (GNI) to official development assistance (ODA) by 2015. In 2009, the average effort of the Development Assistance Committee of the OECD (DAC) members was 0.48 percent. Aid would have to increase by over $150 billion to reach the target of 0.7 percent of GNI.

The promise of this increased aid presents an opportunity to implement a new model for ODA without having to pull from current, already-allocated ODA.

As donor and recipient governments try to fulfill their ODA pledges made at the Gleneagles' and Millennium summits in 2005, considering a new and innovative path for ODA could revitalize foreign aid.

Engage in Debate

We propose the creation and convention of a multi-stakeholder third way taskforce at the United Nations consisting of multilateral and bilateral donors, relief and aid organizations, financial institutions, telecom and mobile company executives and experts, regulators and behavioral economists, and other researchers from relevant fields. The purpose of this taskforce will be to engage in a thoughtful, intense debate on the value of the third way concept, determine specific goals to be achieved, reforms to be advocated, and challenges to overcome. The taskforce's output would constitute a consensus third way Strategy document.

Test the Idea

Using heat maps created by the Growing Inclusive Markets Initiative at UNDP, the third way taskforce will select five suitable countries to test out the third way concept, including experimenting with some variation on delivery methods as well as the value-added social protection strategies. Research questions to be tested could include:

- What regulatory policies best enable these kinds of flows as well as the ability to open and access bank accounts?
- What combinations of delivery channels and access mechanisms best lead to effective financial inclusion of aid recipients?
- What levels and types of subsidies/incentives are most appropriate to influence asset building behaviors for different types of contexts?
- What is the impact of various third way aid flows and additional social protection programs on recipient households?

Final Thoughts

It is time for a new way for ODA. Progress out of poverty relative to investment is abysmally low, begging for new, bold ideas. At minimum, the donor community should embrace the opportunity to leverage new and exciting technologies to push the boundaries of financial access and aid delivery. The ultimate vision laid out in this paper—ODA as an instrument of universal financial inclusion and direct, sustained economic and social empowerment of the world's poor and vulnerable—is indeed ambitious. Yet, without minimizing the challenges and barriers that exist to fulfilling it, it is feasible. Considering a third way for ODA is the first step in the right direction.

APPENDIX 1: DEMAND FOR SAVINGS BY THE POOR

Revealing the Demand for Savings by the Poor

"Tying Odysseus to the Mast" by Ashraf et al (July 2005): This study evaluates the demand for and impact of a commitment savings product introduced through a microfinance bank in the Philippines. Through a randomized experiment and regression analysis, it finds the characteristics of people most likely to take up the savings product. For example, the study finds that women with hyperbolic preferences (those who exhibit impatience in the present, but are patient in the future) are most likely to take up the product; education level predicts product take-up in women (those with a higher education level are more likely to take up); gender predicts take-up (women are more likely to take up the product than men); and income predicts take-up (middle-income individuals are more likely to take up the product than low- and high- income individuals).

"Deposit Collectors" by Ashraf et al (December 2005): This study evaluates the impact of, and the demand for, a deposit collection service as an add-on to a customer's savings product. Take-up is predicted by a customer's distance to the bank (the further the participant is from a bank branch, the more likely they are to take up the service). It finds that married women are more likely to take up the service than single women, suggesting that household bargaining mechanisms are at play; to a certain level, higher household income positively predicts take-up (although the effect becomes negative at very high levels of income); and less educated, younger women are significantly more likely to take up the product.

"An Analysis of the Factors Affecting the Demand for Savings Services by Rural Savers in Uganda" by Bakeine (July 2001): This study on savings mobilization in Uganda is based upon surveys and focus groups. It finds that rural savers prefer illiquid products; that 99 percent of the rural savers surveyed prefer a proximate service delivery point; if affordable public transportation is available, the influence of physical proximity on demand diminishes; and an interest rate of ten percent (as opposed to the current five percent) would attract 75 percent of those who would otherwise decline the service.

"Stocks and Flows—Quantifying the Savings Power of the Poor" by Collins (2005): This study is part of the Financial Diaries series. It tracks the detailed income and expenditure cash flows for a sample of South African households throughout a year, presenting data on the types of savings instruments (and other financial services) they use. The study observes how often the poor use financial instruments, how much of their income they set aside as savings, and how this helps to improve their long-term financial status. The analysis shows that the sample households consume about 75 percent of their income, and therefore are left with 25 percent to use for insurance, savings, or debt service. The households show increases in their short-term net worth, although it is not clear that these increases can be sustained over the long term. By chronicling the financial activities of the participating households, this study is meant to demonstrate demand for financial services by the poor to financial institutions wishing to provide savings and other services to this population.

"Money Talks: Conversations with Poor Households in Bangladesh about Managing Money" by Rutherford (May 2002): This study is also part of the Financial Diaries series. It is based on financial records kept for one year with 42 households in Bangladesh. Researchers interviewed households twice per month and recorded demand for financial services through qualitative interviews. The study finds that the poor actively manage their financial resources through a variety of formal and informal financial instruments (the author found 33). Most households combine a number of these services, ranging from formal banks and insurance company services to local informal services. Households use a wide range of financial instruments to build "lump sums" of money for immediate expenditure, rather than to build up long-term large financial assets or to hold high-value long-term debt. The author finds that the poor demand a secure place to store money and access to overdraft facilities or other forms of small-scale household credit.

"Fine-Grain Finance" by Ruthven (December 2002): Like other studies in the Financial Diaries collection, this study tracks a sample of households over the course of a year and records their income and expenditure cycles. Focused on poor, medium, and better off families in two Indian villages, the study chronicles the financial service providers (e.g., family, friends, pawn brokers, MFIs, banks) used by these households. The study discusses how effectively households at different prosperity levels can access financial services. Savings services are found to be an important service for better off households, but are underutilized by poorer households due to irregular incomes and a high number of financial shocks. Demand is assumed based upon the use (or non-use) of financial services and is supported by qualitative interviews with household members.

APPENDIX 2. CASE STUDY: OPORTUNIDADES AND ACCOUNT-BASED DELIVERY THROUGH RETAIL AGENTS

In November 2008, a pilot program was launched to test and evaluate a partnership between Mexico's CCT policy, Oportunidades, and Diconsa, the biggest retail store chain in Mexico. Diconsa boasts a network of 22,700 stores selling basic food products at cost in underserved areas, with approximately 13,000 of these stores less than 4km away from about 1 million unbanked Oportunidades beneficiaries.

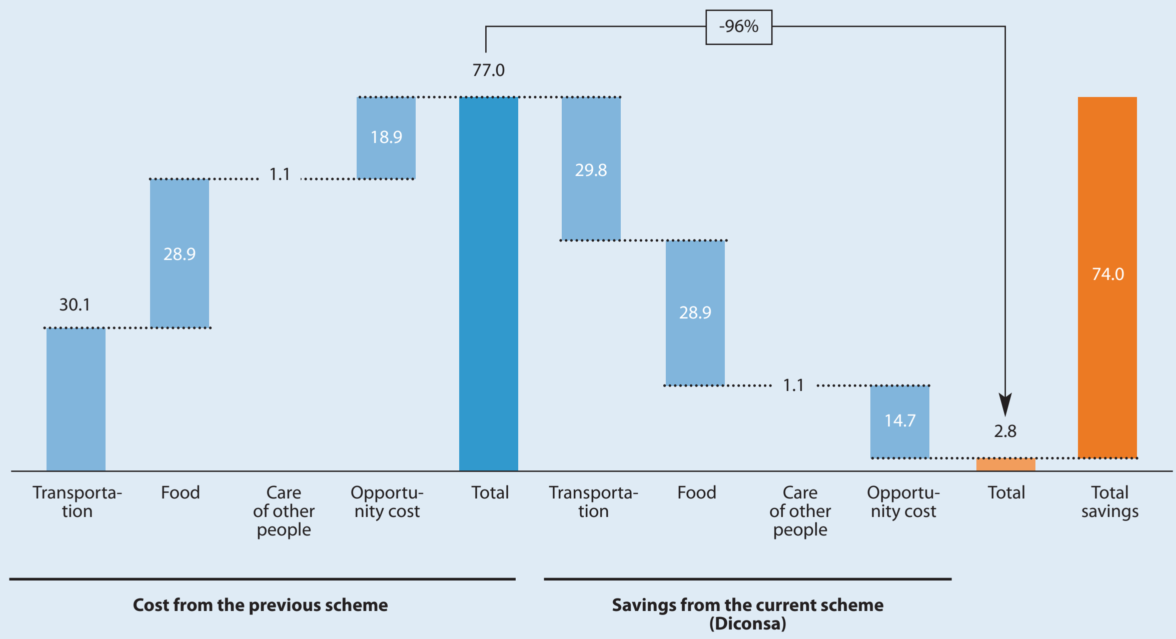
In the pilots, some 230 Diconsa stores were supplied with a POS device and training on how to use it to disburse Oportunidades payments. The pilots have shown that electronic payment technology can be implemented in rural localities. Diconsa clerks have adequately learned how to use the POS device. Cash management has been effective and 99 percent of payments were completed on the scheduled dates. In spite of low socioeconomic backgrounds, beneficiaries learnt how to use an electronic card. Importantly, very few have lost the card and the large majority kept the card in good shape. There have been few incidents of problems with the technology or with Diconsa clerks. It should be highlighted that the stores have never run out of cash.

It was found that the new payment method decreased transaction costs and opportunity costs of beneficiaries from $30.1 pesos to $0.49 pesos, and from $16.9 to $2.22 pesos, respectively. The figure below shows the costs of cash payments on the left and the costs savings by type of cost on the right.

Besides the reduction in cost, Diconsa store sales have increased between 20 percent and 30 percent compared with control Diconsa stores. The purchase of goods has also shifted towards different kinds of goods. Milk, for example, has seen a 40 percent increase in participating Diconsa stores vs. non-participating neighbors.

Furthermore, a small survey of 260 beneficiaries participating in the pilot was conducted, and 99 percent of them said they preferred this electronic payment method over the previous cash and signature method.

COST AND COST SAVINGS OF ELECTRONIC PAYMENTS



Source: CIDE/Fundación Idea study of the pilot programme at Veracruz

APPENDIX 3. ADDITIONAL IDEAS FOR LIVELIHOODS ENHANCING PROGRAMMING FOR THIRD WAY CASH TRANSFERS

Savings-Linked CCTs

Recently, the New America Foundation has argued for linking traditional, increasingly ubiquitous CCT programs to savings accounts aimed at building the financial and human capital assets of the poor. In Peru, where this concept has been tested with encouraging results, CCT recipients are linked to Personal Capitalization Accounts (PCAs) held at formal banks. PCAs (commonly called individual development accounts in the USA), are a time-bound general asset building/conditional savings transfer scheme with three key features: a matching grant as an ex-post reward for opening an individual bank savings account; time-bound recurring matching subsidies to incentivize regular savings; and mechanisms to support investment in education, home improvement, maternal, infant and reproductive health, and micro-entrepreneurial activities. As Jamie Zimmerman and Yves Moury have noted, "External evaluations of the (Ford-funded) pilot programs indicate that the PCA approach is a highly effective and efficient (low cost/benefit ratio) strategy for mobilizing savings by poor families." The program provided matching funds at a level of 16 percent of deposits. On average, Carolina Trivelli and Johanna Yancari found, the women deposited US$ 488 and withdrew US$ 396 total, with a "final balance—even if modest—represent[ing] a relevant amount for the savers' economy: 6.6% of their houses' median value."

Conditional Savings Transfers

Conditional Savings Transfers are intended to create the right institutional mechanisms for encouraging savings habits for long-term asset building and target social goals. CSTs would require governments to contribute, as the Consultative Group to Assist the Poor (CGAP) wrote in 2009, "to private savings in some agreed proportion, either through direct contributions or tax incentives." Flexible, longer-term schemes would allow the account-holder's government to make additional deposits and even match the savings placed in a pension in order to enable lump sum savings that would facilitate future investments or provide a valuable cushion. A decrease in the account holder's funds without replenishment should lead to a reduction of the matched funds through CSTs or matched-savings programs to ensure that the poor withdraw money only for valid precautionary reasons.

Child/Youth Savings Accounts (CSAs/YSAs)

CSAs and YSAs have been defined by Jamie Zimmerman, Jeff Meyer, and Ray Boshara as "savings products, policies, and programs that are specifically designed to facilitate a child's or youth's accumulation of assets at an early age." Financial institutions across the world are increasingly developing and offering these products as a way to promote savings habits at an early age, build long standing relationships with clients, or for corporate social responsibility reasons. A survey done by the New America Foundation has found that over 20 financial institutions from around the world are providing CSAs, including large multinationals like Barclays Bank in Ghana and ANZ in the Pacific, and savings institutions like the Kenya Post Office Savings Bank and the National Savings Bank of Sri Lanka, and well known microfinance institutions like Equity Bank in Kenya and PNG Bank in Papua New Guinea.

Commitment Savings and Old Age

A third type of conditional saving transfers could focus on supporting old age commitment savings for the poor, and micro pensions focusing on supporting widows, the disabled, and other disadvantaged groups. With increasing life expectancies, developing countries are facing aging populations as one estimate, by Stuart Rutherford, predicts that the "over 60 population in developing countries will go from 375 million to 1.5 billion and 80 percent of old people in developing countries have no regular income." As Rutherford notes, however, such micro pensions are analogous to medium term (10 to 20 years) saving commitments products, rather than "miniature versions of developed-country private pensions, because most would-be clients are not formally employed and do not 'retire.'" Indications of the pent-up demand for such products, especially by women trying to building savings for widowhood and old age, have also been observed by the Grameen Pension Scheme, which "requires all borrowers with loans above TaKa. 8,000/- (US$ 138) to deposit a minimum of Taka. 50/- (US$ 0.86) each month in a pension savings account" and in return "after 10 years borrowers will receive a guaranteed amount (Taka 11,214) which is almost double the amount she has put in during 120 months" according to Dipal Chandra Barua. The Grameen Pension Scheme has grown from a total asset base of 4.8 million dollars in 2001 to 163.5 million dollars in 2006. In the absence of a well functioning social safety net that provides social security for all the poor, ODA could play a role in supporting micro pensions for the poor through conditional savings transfers that target specific high-risk populations and provide matching guarantees for their contributions in commitment savings accounts.

Remittances

Recent research by Nava Ashraf, Diego Aycinena, Claudia Martinez., and Dean Yang has revealed that the "direct ability to control savings in the home country can lead both to higher remittances and a greater savings rate in the household," with a substantial increase in demand when remittances are paired with saving commitment products. Given the demand for remittance-linked saving commitment products and attempts by governments to engage Diaspora communities in local economic development, one can imagine that remittances-linked commitment savings accounts (potentially matched by conditional savings transfers) would be especially attractive. They focus directly on supporting household level asset building, rather than traditional philanthropic activities that currently exist (like church building), or public sector programs that might dissuade migrants from channeling funds back to their home country.

Agriculture Accounts

Development economists have also recently shed light on how the right product design for commitment savings products, with the right timing for disbursement, can "nudge" farmers to maximize fertilizer usage. Optimal fertilizer usage has huge returns in terms of farm yield and income. One study in Busia, Kenya, notes: "fertilizer use leads to a 36 percent increase in returns over a season or 69.5 percent on an annualized basis (Duflo, Kremer and Robinson 2008)." In a four-year long study, Duflo et al found that choosing to put part of their proceeds into a commitment savings account for the purchase of fertilizer led to a 56 percent increase in usage of fertilizer in the next planting season, as compared to 17 percent increase among those who were offered fertilizer at planting time. The ability to save in a timely way for specific commitments can play a critical role in influencing financial decisions of poor farmers, mitigating the harmful effects of facing the day to day demands that constrain their ability to plan. Furthermore, well-designed transfers that encourage savings can optimize the usage of productive assets and inputs like fertilizer.

Direct savings-linked transfers can also assist individuals to better plan for disaster and emergency scenarios. Flood victims in Pakistan, farmers affected by drought in Africa, earthquake survivors in Haiti, and families caught in conflict zones like Somalia will all be better able to manage unforeseen scenarios with savings-linked aid designed precisely for emergency, recovery, and reconstruction efforts. Approving and distributing aid to victims after disasters can take months, even before the complicated distribution process between donor, recipient governments, and NGOs under the current system. Responding to disasters reactively is not only inefficient, but is often further delayed in the chaos of home evacuations and logistical complications on the ground. Instead, by supporting savings-based emergency aid to individual BTAs, governments and organizations can proactively assist the poor in especially vulnerable areas in better planing for emergencies, while also increasing financial inclusion and encouraging long-term savings habits. While there will always be a need for immediate, physical relief and food aid in these scenarios, savings-linked, emergency aid transfers could be a potent response to proactively helping disaster victims.

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