

Chapter V

Poverty, insecurity and development risks

Introduction

Previous chapters have pointed to the growing threat in recent decades of serious downside economic risks facing individuals, communities and countries. Heightened exposure has been associated with financial shocks, natural disasters and social conflicts. Yet the deepening sense of insecurity has had just as much to do with the lack of effective policy responses. The *Survey* associates this failure, in part, with a policy bias built around the misguided idea of a self-regulating market economy. There is a clear and urgent need for a new balance between the market and the public interest along with a more integrated social and economic policy framework which can provide and preserve a secure and stable economic future.

It is also clear from the earlier discussions that exposure to downside risks has not been distributed evenly both across and within countries. The poorest households and communities are particularly vulnerable and all too often their only available response is through short-term coping and survival strategies which tend to increase their exposure to future risks. In many cases, poverty turns what should have been transient shocks or disturbances into chronic insecurity.

The present chapter looks at some of the policy challenges centered around the poverty-insecurity trap in developing countries. The first section examines the institutional conditions that help embed markets in a stable, secure and more inclusive process of development. The gap left when these institutions are weak or missing is a major source of exposure to downside risks. The following section examines the role of the developmental State in filling that gap, which has traditionally been associated with measures to socialize the risks faced by an emerging class of domestic investors in return for their channelling resources towards the industrial sector, as a means of expanding formal employment opportunities and reducing poverty. These measures remain the basic ingredients for alleviating poverty in most developing countries. However, they may not always address the vulnerabilities facing poor households and communities. Accordingly, the next sections will look selectively at some of the mitigation, adaptation, and coping measures that might help achieve a more secure and inclusive growth path. The final section considers whether measures to break the poverty trap in developing countries are best applied universally or when targeted at those most vulnerable.

Poverty often turns transient shocks into chronic levels of insecurity

Markets and social cohesion

In the years following the Second World War, the major achievement of the Western democracies was to avert a resurgence of the waste, despair and violence that had scarred the interwar landscape by promoting economic growth, driven mainly by market forces, combined with full and stable employment and steadily rising wages. Governments set out to improve the efficiency of the market system by correcting failures of markets, especially non-competitive markets, and to accelerate growth by promoting collaboration among en-

terprises, representatives of organized labour and public agencies in the areas of long-term investment, research and development, education and training, and so on. This approach involved utilization of a new set of policy instruments, which ranged from indicative planning and income policies at one extreme to trade liberalization and tax breaks at the other. Such policies, in combination with Keynesian demand management, laid the basis for what was known at the time as the mixed economy and created what is now, in retrospect, often perceived as a golden age. At the same time, the welfare State consolidated advances in social policy made over the previous half-century. In doing so, it replaced fragmented systems of social protection (which had collapsed in the face of the economic shocks of the 1920s and 1930s) with a more reliable and cohesive system of public services and social insurance built around the idea of universal citizenship. The Universal Declaration of Human Rights¹ set the benchmark by proclaiming:

Everyone has the right to a standard of living adequate for the health and well-being of himself and of his family, including food, clothing, housing and medical care and necessary social services, and the right to security in the event of unemployment, sickness, disability, widowhood, old age or other lack of livelihood in circumstances beyond his control.²

Yet none of the above should be taken to imply that the golden age was free from shocks and stresses, which was clearly not the case, or that there were no State failures.³ Indeed, mounting fiscal pressures on the welfare State were already apparent in many countries in the 1970s, even as they faced new demands for extended coverage. What is being suggested, however, is that modern capitalist economies are most productive when embedded in a political and social system where the more destructive characteristics of the market are subject to effective constraints.

Markets need to be embedded in appropriate socio-political institutions

Markets, as Adam Smith recognized long ago, are above all social constructs, which need to incorporate various shared norms, habits and values (extending beyond those of self-interest, competition and risk-taking) if they are to be part of an effective economy and stable polity. As suggested in chapter IV, these include legitimacy, order and fairness, which cannot be provided by the market itself. This entails far more than simply claiming that markets are invariably imperfect, whether because of overpowerful economic actors, asymmetric information, externalities and so on. Rather what is implied is that markets are always in some sense managed, most fundamentally by the values and social constraints of the society in which they operate. The “varieties of capitalism” (Hall and Soskice, 2001), both in their evolution over time and at any given period of time, are intertwined with the variegated institutional expression of such different values and constraints.

Markets need to be “governed” and “civilized”

The institutions that must be in place if markets are to emerge and function in an orderly manner include those responsible for granting and protecting property rights and reducing transaction costs. They also include regulatory bodies established to monitor and correct abuses of market power as well as effective coordination mechanisms to stabilize markets, particularly by averting short-run macroeconomic imbalances. At the same time, various institutions are needed to provide support and incentives for long-term growth and innovation in cases where market failures are rife. Together, these institutions constitute the means to “govern markets” in such a way as to foster their creative role and support risk-taking (Wade, 1990).

¹ General Assembly resolution 217 A (III).

² Ibid., article 25, para.1.

³ In a recent assessment, Reich (2007) has referred to the “not quite golden age”.

However, unleashing the creative potential of markets must be matched by efforts to temper their more destructive impulses which can threaten political stability and social cohesion. The institutions that aim at “civilizing markets”, that is to say, at making their operation compatible with social cohesion and political stability, include, first of all, those responsible for guaranteeing such provision of goods and services to all the members of a society as the society considers adequate and, particularly, those institutions that improve social welfare. Redistributive institutions, which aim at modifying the structure of wealth ownership and income so as to raise distribution to levels considered desirable or at least tolerable by society, and bargaining institutions, which aim at reducing the conflicts generated by the normal functioning of markets, provide an additional source of social cohesion. Finally, institutions of voice are needed to strengthen participation in decision-making processes, relating not only to distributive outcomes but also to the functioning and scope of the markets themselves.

Within this wider context of unleashing, governing and civilizing markets, public policies are best understood as stimulating collective action in pursuit of a common interest, rather than as being linked exclusively to the actions of the State. Although the responsibility for leadership often falls on the State, the institutions that may be developed to carry out the public functions outlined above include non-State actors and must take into account not only market failures but also government failures (and those of other forms of collective action). Recognizing these complexities of governance underscores the importance of creating a strong institutional framework—a high institutional density—with active participation of multiple social actors and with adequate accountability. In its absence, the spaces that communities and countries rely on for providing security and stability are likely to be fragile or absent.

The erosion of such spaces appears to have accompanied the deregulation of market forces and the rolling back of the State, whether in developed, developing or transition economies. That process has advanced at differing rates in different countries, although the pace and depth have often been greatest in developing and transition economies (Glyn, 2006; Mkandawire, 2004). Underlying this shift was the belief, infused with considerable optimism, that by getting price incentives right, income gaps (within and across countries) would close and any future adjustments would be smaller and easier to manage. Moreover, the institutional vacuum left by the withdrawal of State welfare guarantees would quickly be filled through an influx of more informed individuals, benefiting from stronger property rights and improved access to market services.

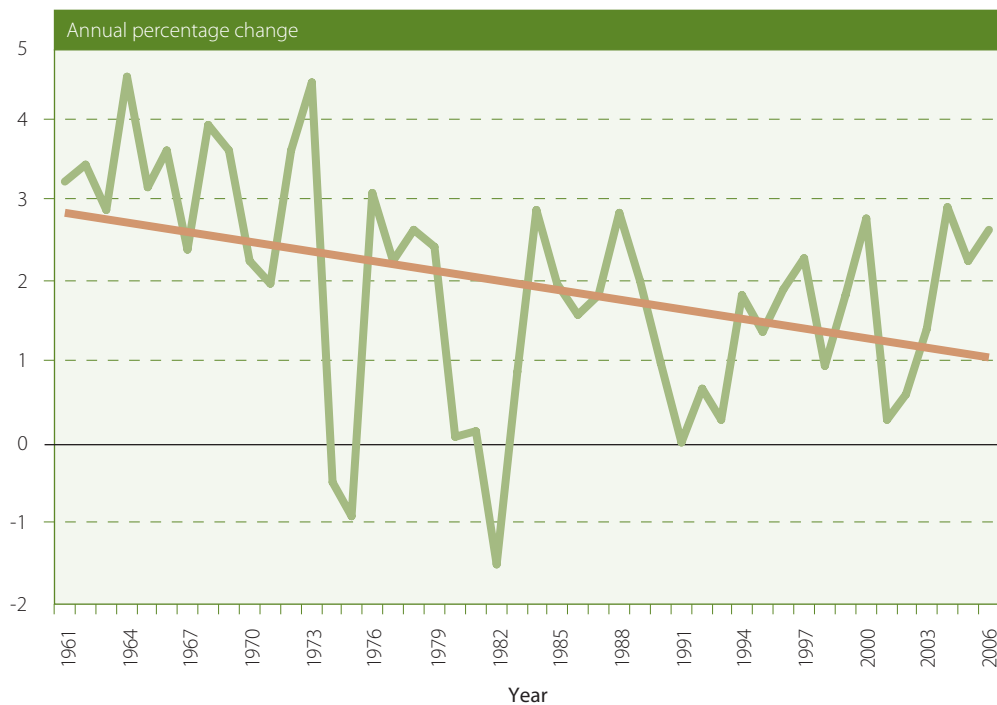
In fact, the record in terms of closing income gaps has, as discussed in previous *World Economic and Social Surveys*, been uneven, and has taken place against the backdrop of a generally slowing global economy (figure V.1). Moreover, the expectation that these forces would generate more stable outcomes has not been supported by the recent record of boom-bust cycles, gyrating asset, currency and commodity prices, and ever larger economic shocks, as discussed in chapter II. Indeed, the process of deregulating markets has brought forth new distortions and biases which are creating new sources of insecurity.

Deregulation of markets and rolling back of the State have aggravated insecurity

The developmental State and social policy

The mixed economy model which had emerged after the Second World War acquired distinct characteristics in developing countries. These were often linked to a politically charged development agenda adopted by newly independent countries under pressure to close the economic and social gaps distinguishing them from those higher up on the de-

Figure V.1
Global per capita growth, 1961-2006



Source: World Bank, World Development Indicators.

velopment ladder; but they also tended to be associated with the forging of a very different kind of social contract than had previously existed—one in which a much more prominent place was given to managing industrial development and achieving fast-paced capital formation so as to meet those goals. The historical record suggested that social policy could play a prominent role not only in recasting notions of solidarity and citizenship but also, if properly designed, in catching up with those higher up on the economic ladder.

The experience with finding the right balance of social and economic policies in developing countries for promoting a more inclusive and secure growth path has been mixed. In many cases, the resources needed to extend social protection have lagged too far behind policy pronouncements and intentions, leaving large gaps in quality and coverage. Oftentimes, limited State resources have been captured by special interests with little interest in using social policy as an effective tool for enhancing economic development, let alone for addressing the vulnerabilities of wider constituencies. More recently, a narrow conception of what constitutes good development policy has closed down the search for a more integrated economic and social policy agenda.

In any economy where the market plays a prominent role in managing resources, a large share of income accrues to a small minority of owners of productive assets. The size of that share can and does vary significantly and there is a good deal of ongoing debate about the exact links between inequality and economic growth. However, there is no reason to doubt that the spending behaviour of this minority is a major determinant of growth performance and social stability,⁴ inasmuch as it is to the owners of these productive assets that the choice falls of how to spend the profits they generate, that is, how to distribute them among personal consumption, purchasing financial assets abroad or

⁴ See Keynes (1919) for a description of how this fitted into the pre-1914 European social contract.

reinvesting them in existing lines of economic activity, and expanding into new areas of wealth creation.

In this context, investment can provide an important social as well as an economic justification for the concentration of income in the hands of a minority, acting as a kind of social tax on profits that restricts their use for personal consumption. However, the ideal level of investment does not reveal itself automatically. Indeed, the connection between profits and investment can be a particularly difficult one to establish in poorer countries where the investing class is often relatively small and the investment climate particularly risky. Experience has shown that building a strong nexus between profits and investment is one of the hardest challenges facing policymakers in developing countries (United Nations Conference on Trade and Development, 1997). The discussion in chapter II has suggested that the challenge has, if anything, become even harder in recent years.

Success stories have been closely associated with the East Asian experience, where developmental States adopted a series of measures to socialize investment risk and to raise profits above those generated by competitive market forces. The long-term success of these countries rested on the State's forging a social contract in which the nascent entrepreneurial class accepted, in return for State support, some degree of direction with respect to its investment decisions. This was both to ensure expansion of jobs in labour-intensive manufacturing as a means of absorbing unskilled labour (including from the rural sectors) and reducing poverty, and to effect a shift to more technologically demanding activities which were more likely to guarantee rising living standards in the future.

Given the generally more capital-intensive nature of late industrialization, such an approach often required a heavy export bias in policy support (along with managed entry of competitors, both domestic and foreign, into key growth sectors) which allowed employment expansion beyond the limits set by the domestic market (United Nations Conference on Trade and Development, 2003). Similar measures were taken after 1945 in other successful catch-up economies, notably Japan, as well as some of the smaller economies on the European periphery such as Finland, Ireland and Portugal (Vartiainen, 1995; Reinert, 2007).

These successful late industrializing economies all have mixed economic policies featuring various social measures, including the universal provisioning of social services, designed to manage the strains and stresses associated with rapid growth and structural change. Many European countries, for example, introduced flat-rate pensions at a comparatively early stage of their development in response to various political tensions, at a time when those countries had a per capita income and economic structure similar to those of many middle-income developing countries today.⁵

There is no doubt that specific social, political and economic factors play an important role in shaping policy options in the development process. However, developing governmental capacity and institutions for promoting welfare, and the adoption of universal policies for the general level of welfare carry broader relevance. And, it is precisely in contrasting different models of the developmental State that it is possible to see how different social and economic arrangements can lead to similar outcomes (box V.1).

Profits need to be invested in expanding domestic productive capacity

East Asian countries succeeded through socializing investment risk

Late industrializing countries, both in Asia and in Europe, mixed targeted economic policies with social measures

⁵ Many late industrializing European States were ahead of the early starters in terms of social policy, with a clear sequence running from workplace insurance through health and maternity insurance to old age and disability provision and, finally, unemployment insurance and family allowances. For a brief history, see Pierson (2003); for relevant discussions, see also Vartiainen (1995).

Box V.1

Social policies in late industrializing economies

The early roots of Scandinavian social policy, which included establishing and developing social security, health and educational systems, was fostered by a strong and independent farmers movement, and the consequent establishment of peasant political parties during the first two decades of the twentieth century. Compulsory schooling had been introduced as early as 1814 in Denmark and in the 1840s in Sweden and Norway, well before industrialization took off. However, this progress in education proved instrumental in the achievement of rapid industrialization and subsequent economic upgrading, and also provided a strong political base for universal social protection (Hort and Kuhnle, 2000, p. 4).

Still, during the interwar years, Scandinavian countries were still highly rural economies characterized by high levels of inequality, where agriculture accounted for between one third and one half of the active labour force (Vartiainen, 1995, p. 158). In Norway, for example, as late as the 1930s, the richest city was 60 times wealthier than the poorest rural municipality and 10 times wealthier than the poorest city; and there was a 15-fold gap between the richest and poorest rural municipality (Falch and Tovmo, 2003). Scandinavia also had some of the highest levels of industrial conflict in Europe and high levels of unemployment and underemployment, particularly in the rural areas. The task of alleviating poverty, easing social tensions, reducing unemployment and raising growth fell to newly elected social democratic Governments in the 1930s and was achieved through a combination of universal social policies, active labour-market policies and collective wage bargaining at the industry level in cooperation with Government and employer organizations (Moene and Wallerstein, 2006, p.149). A centralized wage bargaining system essentially limited profits in declining low-productivity sectors (by setting a relatively high wage) while expanding profits in high-productivity sectors (by setting a relatively low wage). This contributed both to a more egalitarian income structure and to a fast pace of growth thanks to the reallocation of labour and capital to high-productivity sectors. Increasing productivity and wages, in turn, provided the fiscal base for an expanding social sector that ensured that those facing adjustment would receive appropriate protection and support, which was extended on a universal basis to create a more encompassing notion of solidarity and citizenship (Moene and Wallerstein, 2006, p. 155; Chang and Kozul-Wright, 1994, pp. 866 and 874).

Social policy was institutionalized in the Republic of Korea and Taiwan Province of China at lower levels of socio-economic development than had been the case in the European countries (Hort and Kuhnle, 2000, p. 167) and was used principally to promote selective social investments by the developmental State in support of a fast pace of overall growth and political objectives set within a largely authoritarian political structure. This produced a more targeted approach than the welfare developmentalism of Scandinavia. The role for general social protection of the vulnerable was initially left to families so as to avoid welfare programmes. For instance, social insurance programmes such as occupational welfare programmes and vocational training were initially limited to industrial workers (Yi and Lee, 2003) and were introduced mainly to ensure that workers remained loyal to their firms and the labour force remained well trained. This, in turn, explains the introduction of compulsory education at an early stage of industrialization in the Republic of Korea and the large investments in secondary education, tertiary education and research and development (Lall, 1991). Such social measures essentially emphasized job capability rather than job security, and social development was subordinated to the overall economic development strategy in the Republic of Korea and Taiwan Province of China.

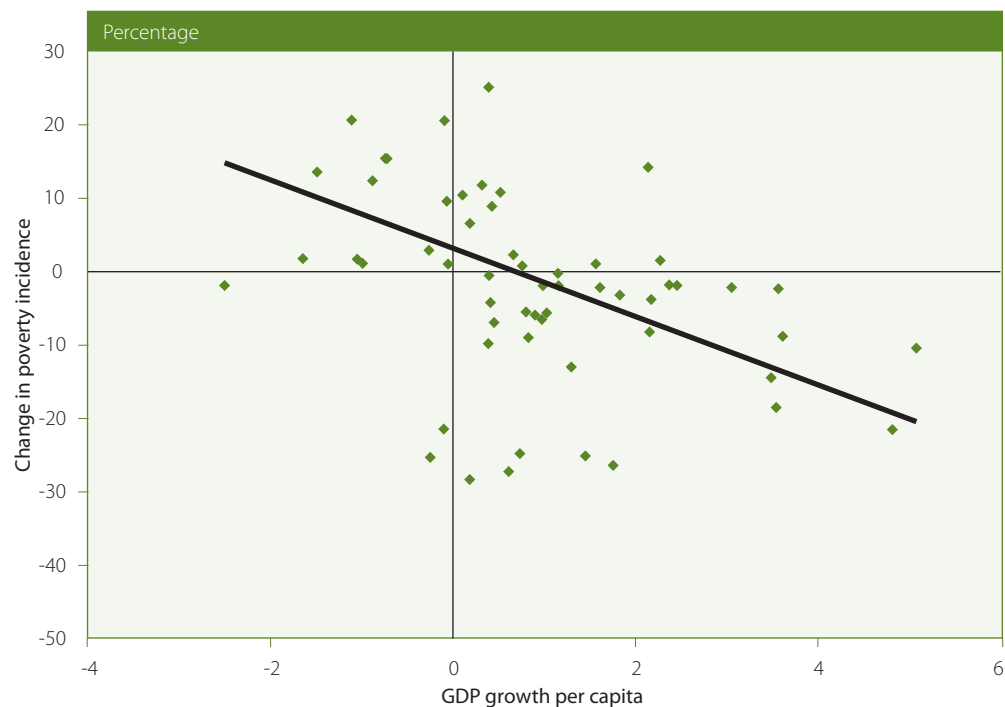
However, the emphasis of that strategy on strong employment growth in the manufacturing sector along with improvement of the economy's skills base did imply an expansion of social protection. The concept of universality, on the other hand, emerged amid more recent developments in the Republic of Korea and Taiwan Province of China and must be understood in terms of both the process of greater political democratization and, in the former case, as a response to the economic crisis at the end of the 1990s, as the latter highlighted the inadequacy of existing social protection mechanisms which were based on strict means tests and did not help the poor. Universal coverage of national health insurance was thus introduced in Taiwan Province of China in 1995. It was extended to the whole population of the Republic of Korea as late as 2000 (Kwon, 2005, p. 9). Nevertheless, while social inclusion is now given greater emphasis in these two countries, social policy is still primarily subordinate to economic development.

Poverty and vulnerability to downside risks

A basic lesson to be drawn from successful development experiences is that sustained poverty reduction depends on a fast pace of growth. However, the connection between growth and poverty is not a direct one. Some fast-growing economies have failed to tackle poverty, while some slower-growing economies have had a more successful record in this area (figure V.2). Two crucial mediating variables which determine the nature of the growth-poverty nexus are the distribution of income and the employment content of growth.

Fast aggregate growth is a necessary but not a sufficient condition for poverty reduction

Figure V.2
Growth and poverty reduction, 1981-2004^a



Sources: UN/DESA, based on United Nations Statistics Division, National Accounts Main Aggregates database; and World Bank, PovcalNet.

Note: The measurement of poverty corresponds to the poverty line of \$1 a day (PPP).

a Developing countries with available data.

The East Asian experience confirms that countries with a more equal distribution of assets (particularly land) and income can grow faster than countries with a higher degree of inequality. Various growth enhancing channels arising from redistribution, including higher productivity among smallholders, human capital investments, scale economies linked to larger domestic markets and political stability, have been identified. On this basis, Dagderiven, van der Hoeven and Weeks (2001) found, for a group of 50 developing countries, that in a large number of mainly middle-income developing and transition countries, redistribution had been more effective than growth in eliminating poverty; that in others, a mixture of redistribution and growth was most effective; and that in yet other, mainly very poor countries, fast growth alone was the most effective mechanism.

The other link between growth and poverty is employment intensity of growth. In a recent study of 13 developing countries, Khan (2007) found that the East Asian experience, characterized by a rapid expansion in the industrial workforce and a drop in agricultural employment as growth accelerated, had not been replicated to the same extent in some of the more recent fast-growing Asian economies (China, Viet Nam, India and

Cambodia) either because inequality worsened and/or the employment intensity of growth was weak. The declines in poverty were, as a consequence, lower than might have been expected given their headline growth figure, and in one case, Cambodia, poverty actually increased. In the case of China, after 1995, the rate of poverty reduction decelerated as growth became more urban centred and inequality increased. In other cases (Bangladesh and Uganda), a more moderate growth performance was compensated by unorthodox sources of employment creation in the rural economy with some (albeit tenuous) positive impact on poverty alleviation.

These links among growth, distribution and employment can be obscured if there is an undue focus in the policy discussion on levels of abject poverty. In this respect, the dollar-a-day benchmark may not provide the best guide to policymakers for addressing the structural vulnerabilities that determine whether or not growth translates into poverty reduction.⁶ In recent years, there has been a shift from a *physiological* model of deprivation, focused on the non-fulfilment of basic material or biological needs, to a *social* model of deprivation, focused on such elements as lack of autonomy, powerlessness, lack of self-respect and dignity, human rights, etc.⁷ The latter links poverty alleviation much more strongly to a larger development agenda; however, it should avoid confusing poverty with insecurity.

Insecurity is associated with being vulnerable to falling into poverty or falling into greater poverty. This “downside risk” is a combined function of the *exposure* and *response* to adverse pressures, which include idiosyncratic events such as illness, and workplace accidents and crime, as well as covariant events such as climatic shocks, harvest failure and economic downturns. Exposure to these downward threats varies with the size, frequency, timing and bunching of the particular shocks in question, as well as the spatial proximity to them (and the threat of contagion), but is also linked to the systemic or more cumulative stresses determined by the pattern of relations among growth, distribution and employment.

These systemic stresses were exposed by the Asian financial crisis, in countries that had fared quite well in reducing long-term chronic poverty (United Nations, 2005b). More recently still, Perry and others (2006), reviving the language of Gunnar Myrdal, have suggested that the Latin American region is caught in a vicious circle of persistent poverty, insecurity and unstable growth, which has been perpetuated by a persistent and widespread tendency to underinvest in productive assets and social capital.⁸ This conclusion has been confirmed for other developing regions by a growing body of research (Jomo and Baudot, 2006).

It follows that efforts to break the poverty-insecurity trap will require a policy framework that not only generates higher growth but also examines how investment strategies adopted by both the public and private sectors address the underlying vulnerabilities which expose households and communities to larger downside risks. The main operational objective is to devise long-term poverty reduction strategies for addressing these “root” causes of chronic poverty through a mixture of measures that not only target the vulnerabilities leading to economic security but also allow for better management of the risk through mitigation and coping measures (table V.1).

Poverty and insecurity
are interrelated

Breaking the poverty-
insecurity trap requires
going beyond aggregate
growth promotion

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- 6** A recent study by Pritchett (2005) has concluded that effective poverty reduction strategies require a large enough poverty target to address systemic challenges. He suggests that a global poverty agenda should establish an upper global poverty level of about \$10 a day. The number may or may not be appropriate; the underlying rationale, however, is clearly important for policy evaluation purposes.
- 7** On some assessments, this has entailed picking up the basic needs agenda which had dominated poverty discussions for a short period of time in the 1970s but was dropped after the debt crisis of the early 1980s.
- 8** See, also, Lopez and Perry (2008).

Table V.1
Managing risks and vulnerabilities

Macropolicies	
<i>Macropolicies</i>	<i>Social security and social protection programmes</i>
Mitigation	Mitigation
Macroeconomic policies (growth-oriented, counter-cyclical and pro-poor)	Social security and pension mechanisms
Agricultural development policies Infrastructure investment	Structural cash transfer programmes Targeted price subsidies
Financial regulation and supervision	
Adaptation	Adaptation
Asset transfers (land, credits)	Public health and education
Development of savings mechanisms for the poor and vulnerable	Access to microfinance schemes
	Minimum wage and labour-market policies
Coping	Coping
Migration and remittances (policies)	Workfare programmes (which are triggered when unemployment rises)
Credits, debt restructuring, debt relief	Disaster relief
	Food subsidies
	Cash transfers

Risk reduction measures are taken in advance of an emerging shock or stress and aim to reduce the likelihood that the shock or stress will occur. The central aim (for the problem at hand) is to make societies and people more resilient towards shocks and insecurity by giving them the assets and means to better manage risks. Examples include macroeconomic policy measures to reduce the risk of financial crises, as well as labour-market policies that improve employment standards. Mitigation measures are taken in anticipation of a shock with a view to minimizing its deleterious consequences. At the individual or community level, there are many informal mechanisms of risk mitigation including diversification of sources of income, producing large families for farm labour or for income-generation, adopting contractual arrangements, such as sharecropping, which trade off profits for insurance. Examples from a public policy perspective include extension of microfinance and provision of social insurance.

Coping measures are those that take effect only after a shock occurs. Such measures can include informal mechanisms for coping with risk such as selling assets, drawing on savings or stocks of grain, obtaining help through remittances from family members abroad, accessing credit from informal moneylenders and so on, along with more formal responses, whether through the market, (for example, various insurance mechanisms) or in terms of public policy (through transfers under, for example, social assistance schemes and price subsidies). Many of these schemes are identical to those aimed at the chronic dependent poor.

Non-catastrophic events can be frequent but with non-severe effects (transitory illness, temporary unemployment) and households can cope with those mostly from their savings, loans, family transfers or private insurance. For very poor households, however, such events may still be devastating and require a “welfare”-type response to prevent them

Measures are needed for reducing downside risk and coping with the consequences

from turning into personal and community disasters. Still, given resource constraints and depending on the nature of risks and exposures, a balance may have to be sought between policies that reduce or mitigate risks, and make households more resilient towards shocks and capable of better managing risks, for example, through strengthening their assets (adaptation), and those that provide support in alleviating the immediate distress caused by shocks (coping).⁹

Some of the strengths and limitations of coping instruments have been examined in the context of specific challenges discussed in previous chapters. This chapter will focus on a selection of reduction (pro-poor macroeconomic), adaptation (microfinance) and coping (transfers) measures.

Risk mitigation

Risk reduction measures lower the probability and severity of negative income shocks

Risk reduction (or mitigation) measures aim to lower the probability and severity of negative income shocks. Though there is much that can be done in this regard at the individual and community levels, a prominent role still belongs to the government, which can use various macroeconomic and other policies to reduce negative income shocks.

Macroeconomic policies

Macroeconomic policies that can be used by Governments for risk reduction have been discussed in more detail in chapter II. Generally, these policies need to be counter-cyclical, pro-investment and aimed at greater social cohesion through strong job creation. They should benefit the poorest communities in developing countries which are particularly vulnerable to downside risk associated with economic shocks and growth stagnation; they can also acquire a stronger pro-poor dimension if tailored to local conditions and the constraints on growth.

Rapid growth of labour-intensive industries is the key

In this respect, policies should direct resources to sectors that employ and provide livelihoods for the poor. Rapid employment growth in labour-intensive sectors is key. In most developing countries, the majority of the poor are employed in agriculture and small enterprises, which will be a strong focus of pro-poor policies, as discussed in the next section. Macroeconomic policy must avoid an anti-rural bias and stimulate activity in labour-intensive agriculture. Many traditional adjustment programmes have failed in this regard. Still, with rapidly expanding urban populations across the developing world, labour-intensive manufacturing (and related services) will be key to addressing poverty challenges over the longer term.

The experience of the 1990s has shown that strong growth will not materialize if macroeconomic policies do not target a competitive and stable real exchange rate and low-to-moderate real interest rates which encourage investment in labour-intensive tradable sectors (see chap. II; and Cornia, 2007). Strong institutions for the regulation of the financial and banking sector are also required, with financial policies integrated with more traditional industrial policy measures so as to ensure that the growth process is driven by sectors with a labour-intensive bias. This also allows capital accumulation to be funded through the mobilization of domestic resources and encourages stronger local financial intermediaries, thereby avoiding some of the dangers of pro-cyclical capital inflows.

⁹ For an earlier discussion about links between poverty and insecurity, see World Bank (2001).

In many cases, a pro-poor policy position will require a much stronger focus on public investment, including infrastructure and human capital, given its strong propensity to crowd in private investment at lower levels of development. However, more than anything, developing countries need the requisite space within which to combine macroeconomic, trade and industrial policies into a consistent strategy.

A pro-poor policy position will require a much stronger focus on public investment

Agricultural development policies

Of the developing world's 5.5 billion people, about 3 billion live in rural areas with half in smallholder (agricultural) households. The food crisis that has emerged in 2008 demonstrates yet again the vulnerability of this population to adverse long-term trends and unexpected shocks. Historically, most successful cases of industrialization began with progress in agriculture. In more recent years, the experiences of China, India and Viet Nam also show how agricultural growth can lay the basis for subsequent growth of industry and the rest of the economy. Cross-country analyses further show that growth originating in the agricultural sector is oftentimes much more effective in reducing poverty and insecurity than growth originating in non-agricultural sectors. In the case of China, for example, it has been found that growth originating in agriculture was 3.5 times more successful in reducing poverty than growth in non-agricultural sectors; and the figure has been found to be even higher for South Asia (United Nations, Economic and Social Commission for Asia and the Pacific, 2008, p. 127). In Latin America, this ratio was found to be 2.7.¹⁰ In fact, reduction of rural poverty from 37 to 29 per cent between 1993 and 2002 (while the rate of urban poverty remained constant at 13 per cent) has been the main factor behind the recent decline in overall poverty from 28 to 22 per cent over the same period. It is also important to note that about 80 per cent of the reduction in rural poverty was due to improvement in rural areas themselves rather than to outmigration.¹¹ It is unfortunate, therefore, that many developing countries have neglected the agricultural sector in recent years. The adoption of adjustment programmes imposed on many countries, particularly in sub-Saharan Africa, after the debt crisis of the early 1980s has not corrected this bias, and in many cases may have actually made it even worse (United Nations Conference on Trade and Development, 1998).

There are no quick policy fixes, but an effective set of incentives must be in place to provide farmers with a predictable financial surplus and encourage them to invest some of it so as to raise productivity and diversify output. Extension services need to focus on specific supply-side problems, improving the technical knowledge of farmers, and making it easier to obtain inputs as well as credit. Such specific measures to strengthen productivity and extend markets can be greatly enhanced by infrastructure investment and greater research and development. A shift in the ratio of public spending to gross domestic product (GDP) in the agriculture sector is an urgent priority in many developing countries. This ratio currently stands at just 4 per cent for "agriculture-based" economies (those with 30 per cent or more of their GDP originating from agriculture) compared with 12 per cent for more "urbanized" economies (which derive less than 10 per cent of their GDP from agriculture).

Agricultural growth requires incentives, extension services, and investment in infrastructure and human capital

The Economic and Social Commission for Asia and the Pacific (United Nations, Economic and Social Commission for Asia and the Pacific, 2008) has recently estimated that raising the average agricultural productivity of the Asia-Pacific region to that

¹⁰ See World Bank (2007, p. 6) for further details.

¹¹ Ibid., p. 3, for the statistics presented here.

of Thailand could take 218 million people out of poverty and would reduce inequality, as measured by the Gini coefficient, by 6 per cent. Agricultural research and development, education of the rural population and rural infrastructure, particularly electricity and roads, are the key determinants of labour productivity; and investment in these areas would have a major impact on poverty reduction.

Varied conditions of agriculture across countries require customized policies

In addition to these general policies, different forms of agricultural production may require specific support measures. For example, in countries where agriculture comprises mainly smallholders, improving their productivity is an important task. Accomplishment of this task may in turn require improvement of their access to such resources as land, water, education and health. Promotion of producer associations may also be important in such settings for achieving more efficient farming operation and for uncovering marketing opportunities and actually making use of them. On the other hand, in agriculture characterized by massive un- and underemployment, expansion of non-farm employment and facilitation of rural-urban migration may assume priority. Finally, in urbanized countries, more importance may need to be attached to switching to product items that are higher in the value chain, utilization of the increasing switch to supermarkets as the main outlet for agro-produce, reduction of the rural-urban income gap, and preservation of the environment and ecology. Developed countries also need to consider reducing subsidies offered to their farmers so as to improve access to their markets by agricultural producers of developing countries, as well as reducing the wasteful use of their own agro-ecological resources.

Risk adaptation

Despite efforts at the national, regional, community and individual levels to reduce risks, it is difficult to expect that they can be completely eliminated. It is therefore important to take measures that can help people live with risks. These measures are classifiable into two types: *ex-ante* or *risk adaptation* measures; and *ex-post* or *risk coping* measures, that is, measures that one can take when negative income shocks have already occurred. The distinction between these two types is somewhat problematic, because what one can do *ex post* often depends on what one has done *ex ante*. Thus, some of the measures described as *risk coping* could also be described as *risk-adaptive*, and vice versa.

Asset distribution

An egalitarian land distribution has beneficial effects on economic security

An unequal distribution of productive assets is one of the root causes of poverty and insecurity. Improving land distribution can therefore be an important policy instrument for reduction of economic insecurity. As research has shown that small farmers can often be more productive than large farmers (Ray, 1998; United Nations, Economic and Social Commission for Asia and the Pacific, 2008), a more equal land distribution would therefore allow a higher volume of total output. It would also allow the poor to have better access to education, health and other social services, thereby helping them to build up human capital. A more healthy and educated labour force in turn helps to raise agricultural productivity by facilitating introduction of new technology and crops. Finally, a more equal distribution of assets also allows the poor to participate more meaningfully in the country's political process, which in turn helps to increase their share of the country's budgetary resources.

International experience bears out the proposition regarding a positive link between egalitarian distribution of land and a better growth outcome. Most of the reduction in rural poverty has been the result of progress made in East Asia and the Pacific, where the number of rural poor declined from 1,036 million in 1993 to 883 million in 2003. By contrast, the number of the rural poor actually increased in both sub-Saharan Africa and South Asia over this period. Observers generally agree that the land reforms carried out in East Asian economies in the 1940s and 1950s had created a more egalitarian land ownership pattern that allowed a wider participation and sharing in the growth process, and that similar success has been registered with subsequent land reforms in the region (United Nations, 2006, chap.V). In the latter reforms, however, the transfer of property rights was more limited than in the earlier ones, and reforms were tailored to prevailing socio-economic conditions, producing a variety of experiences.

Land redistribution is often difficult to achieve politically and can usually be undertaken only under extraordinary circumstances, for example, following a revolution or war. However, there are land reform models which are politically more feasible, such as South Africa's Settlement and Land Acquisition Grant (SLAG), set up to enable rural households to purchase arable land (see box V.2).

Box V.2

Land redistribution in South Africa

Various measures have been taken by the Government of South Africa aimed at providing the disadvantaged and the poor with land for residential and productive purposes. In particular, a single, yet flexible, grant mechanism providing up to a maximum of 16,000 rand (R) (equivalent to approximately US\$ 2,000) per household was established to enable beneficiaries to purchase land from willing sellers. Land redistribution has taken several forms (for example, group settlement with some production; group production; commonage schemes; on-farm settlement of farm workers; and farm worker equity). A range of additional financial resources, such as the planning grant and facilitation and dispute resolution services, supported the basic grant.

This approach has not involved prior acquisition of land by the State. Limits were set with regard to both the amount of grant that a particular household could obtain and the household income, so as to ensure that the programme benefited many and reached low-income households.^a The sellers in the market could be large landowners themselves or property developers who would take land from landowners, divide it up into parcels of suitable size and sell to potential beneficiaries. The buyers, in their turn, often grouped together in order to obtain the grant, design projects, and acquire land collectively. The Communal Property Associations Act enacted in 1996 encouraged such group formation. However, the paternalistic implementation of such collective acquisitions by the Department of Land Affairs (DLA) led to centralization, bureaucratization and long delays, thus interfering with the spirit and goals of the programme. As a result, between 1995 and 2000, only 0.6 per cent of the country's commercial farmland had willingly been sold under the programme, and the number of beneficiaries remained limited to 60,000. This achievement compared poorly with the original target of transferring almost 30 million hectares (about 30 per cent of the country's arable land) under the programme. Apart from the paternalistic and bureaucratic modus operandi, there were other objective obstacles, such as (a) non-coverage of upfront costs by the grants, (b) lack of human capital on the part of beneficiaries needed to practise modern farming, (c) inertia acting against geographical mobility and (d) inadequate rural and extension services.

To accelerate the land transfer process, in 2001 the Government launched a revised programme, entitled "Land Reform for Agricultural Development", which decentralized implementation and thus helped to speed up the process. In addition, all beneficiaries were now required to make a contribution (in cash, in labour or in kind), the purpose of which was to strengthen their commitment to the project.^b However, the introduction of the contribution requirement also meant that the

^a Originally, under the Settlement and Land Acquisition Grant (SLAG), the monthly income of potential beneficiary households was supposed not to exceed R1,500. For further details, see *World Economic and Social Survey 2003* (United Nations, 2003), chap. VII.

^b The minimum personal contribution required for the minimum grant was set at R5,000 (about US\$ 650 in 2003).

Box V.2 (cont'd)

• The 2003 Survey (p. 215) concludes: "What is required is the political will to give greater priority to redistributive land reform within broader rural development strategies and to invest in the infrastructure and services required to support the activities of land redistribution beneficiaries, with the aim of turning many rural people into landowners."

revised programme would be targeted more towards expansion of small and medium-sized commercial farms than towards poor peasants without any land or assets.

These factors notwithstanding, the South African market-based land reform programme provides significant evidence that the obstacles to land reforms may not be as politically insurmountable as they are often perceived to be. The experience of South Africa also demonstrates that market-based land reform need not be fiscally onerous. Data show that the annual capital expenditure on the original South African land redistribution programme in the peak fiscal year (1998/99) was equivalent to only 0.2 per cent of the total annual Government budget. However, success of land reform requires complementary efforts towards providing better infrastructure, input delivery and extension services. The experience of South Africa indicates that costs for providing such complementary services remained less than 1 per cent of the general Government expenditure in 2001. Thus, given the political will, market-based land reforms are financially feasible and can play an important role in enhancing economic security of the poor.^c

Minimum wage policies

The working poor are also very insecure

Even with successful land reform, the majority of the poor rely on wage labour as their only means of generating income. Over 50 per cent of the labour force in developing countries is engaged in work in agriculture, much of which is very poorly paid and insecure. Improving employment conditions for these workers would have a large and direct impact on improving household security.¹² In general, the political representation of these workers is very poor and the likelihood of effective formal legislation is limited. Expanding non-farm rural employment does appear to have offered the opportunity for improving conditions in Asia and Latin America, though less so in Africa (Demeke, Guta and Ferede, 2003; Gordon and Craig, 2001). However, as mentioned above, over the longer term, promotion of labour-intensive industrialization is key to poverty reduction in generally labour-surplus economies.

Productivity growth is not translating into wage growth

Mere expansion of employment, however, may not be enough to achieve poverty alleviation and insecurity reduction even in this sector (International Labour Organization, 2005b, p. v). In a world dominated by the working poor, a key concern is whether rising productivity levels translate into rising wages. This is not necessarily the case. An example is provided by India, where, between 1980 and 1999, per capita GDP in purchasing power parity (PPP) terms increased from about \$750 to about \$2,500, while the real manufacturing wage index declined from about 140 to 70 (*ibid.*, p. 53, table 4). In Mexico, while the North American Free Trade Agreement (NAFTA) has led to an expansion of employment in maquiladoras from 446,436 to 1.3 million persons between 1990 and 2000, there has been virtually no growth in wages (*ibid.*, p. 89).

Low or declining wages can provide a temporary growth boost, particularly as linked to expanding export sectors. However, sustained economic growth depends on productivity improvements and a growing domestic market. In this respect, to the extent that minimum wage legislation encourages wage growth, it has been seen as a possible way to help achieve alleviation of poverty and reduction of economic insecurity, which in turn can have a positive knock-on impact on productivity growth. Empirical evidence on these connections is scarce. A positive impact on wages in large enterprises in the formal sector due to minimum wage legislation is reported in most studies. Some have also reported a similar impact on wages in smaller enterprises, including in the rural sector, with an accompanying positive effect on poverty reduction (Lustig and McLeod, 1997; Gindling and

¹² See Mugrai and Ravallion (2005).

Terrell, 2005), although others find this to be conditional on a strong growth performance (Morley, 1992). However, even when legislation is present, there remain serious enforcement problems in many developing countries and many see it as, by itself, a particularly blunt instrument for providing more secure livelihoods (United Nations, 2007b).

Microfinance

One of the ways in which the poor and vulnerable can adapt to risk and insecurity is through improved access to financial markets. The poor have historically been excluded from the world of formal credit and other financial services and relegated to that of usurious moneylenders. This often results, for the poor, in a condition of perpetual indebtedness and ultimately the loss of whatever collateral was offered to obtain a loan. Attempts to provide modern credit services to the poor have generally foundered in the face of high transaction costs and their lack of any assets that could be offered as collateral.

Microcredit represents an attempt to solve these twin problems through the innovative use of group lending, whereby peer pressure serves as a substitute for collateral and group responsibility serves to minimize transaction costs. Microcredit financing had begun on an experimental basis in Bangladesh in the late 1970s; in 2006, there were more than 7,000 microcredit institutions in operation, serving about 500 million people in more than 50 countries, including some developed countries. These aim for a more virtuous cycle, whereby a rise in income enables a household to take some risks, which in turn allows it to raise its income still further.¹³

Though microcredit programmes are not insurance programmes per se, they can play such a role through income and consumption smoothing.¹⁴ Of course, such a diversion can upset investment planning and the danger exists that, through financial, social, and psychological penalties imposed on loan default, microcredit could even increase the vulnerability of the poor. In view of these limitations, according to some scholars, straightforward insurance programmes can be more effective in helping the poor to deal with insecurity.¹⁵

Attempts at providing insurance services to the poor have generally foundered in the face of difficulties related to administration, high transaction costs, and the familiar problems of adverse selection and moral hazard. Still a “repressed demand” for such services has been documented (Mosley, 2007).¹⁶ It is therefore not surprising that the

The poor are often excluded from formal financial services

Micro-insurance programmes are spreading

¹³ Evidence for the effectiveness of such programmes in achieving sustained poverty reduction is mixed; for a review, see Morduch (1994, 1995, 1999b).

¹⁴ There was, in fact, a formal insurance element in some microcredit programmes designed to ensure the recovery of the loan in case of death or incapacitating injury suffered by the borrower. This covered risks of the lender and not those of the borrower. The fact that microcredit is used for consumption smoothing purposes is also well recognized. Referring to Pitt and Khandker (1998), Morduch (1999b, p. 1605), for example, indicates that “(M)icrofinance borrowing is shown to improve the ability to smooth consumption across seasons, and *entry into the programmes is partly driven by insurance concerns*” (emphasis added). Further, he reports that his own investigation confirmed the consumption smoothing effect of microcredit programmes and concludes (p. 1606) that “(S)ubstantively, the results suggest that benefits from *risk reduction may be as important as (or more important than) direct impacts on average levels of consumption*” (emphasis added).

¹⁵ See Clarke and Dercon (2008) for further details.

¹⁶ By “repressed demand”, Mosley means unmet insurance demand in general, but does not dwell on the issue of the prices at which demand and supply are evaluated. In this regard, Mosley speaks of “substantial thwarted demand for insurance services”. He also expresses the view that whatever insurance services were offered were meant for or targeted at the male population only, indicating a gender aspect to the repressed demand.

organizational innovation that allowed credit to reach the poor has proved attractive as a delivery mechanism for insurance services, too. Churchill (2006), for example, provides a large compendium of micro-insurance programmes which lists as many as 74 programmes from across the world. So far, the majority of micro-insurance programmes have focused on life and health risks, although more recent programmes have expanded into areas such as crop insurance (see chap. III for an assessment). Mosley (2007) offers an examination of a selection of programmes and reports having found a positive impact, including to those who were not direct buyers.¹⁷

Many micro-insurance programmes arose as a side activity of microfinance institutions otherwise focused on microcredit. However, with time, “standalone” micro-insurance organizations have also emerged. Institutions offering micro-insurance may be classified also on the basis of their motivation and, from this viewpoint, may be categorized as either “for profit” or “non-profit”. For-profit institutions are similar to commercial companies; non-profit institutions, however, may operate either as companies or as non-governmental, social or cooperative organizations.

Despite the spread of micro-insurance programmes, as described above, overall the insurance needs of the poor still remain, for various reasons, largely unmet (see Clarke and Dercon, 2008; Mosley, 2007). First of all, insurance is a more complicated product than credit; hence the take-up is slow and low.¹⁸ This causes a problem of financial viability: low take-up increases the cost of insurance, keeps the insured risk pools smaller, and makes reinsurance costlier, which in turn reduces take-up.¹⁹ In fact, there seems to be an inverse relationship between the break-even premium and the portfolio size. The trade-off suggests that there are basically two means of overcoming the problems faced by micro-insurance programmes: one is to raise premiums, which is self-defeating; the other is to subsidize such programmes until the self-sustaining level of uptake is reached (see box V.3).²⁰

In face of the hurdles noted above, micro-insurance programmes in different parts of the world are experimenting with different options. It may be too early to derive definitive lessons from these experiments. However, in general, they point to the necessity of focusing on single risks, piggybacking on existing microfinance operations, and so on. In view of the positive externalities of micro-insurance programmes and of their initial survivability problem, the use of subsidies to such programmes would seem justifiable.

Building up savings can be an effective way of adapting to risks. Many researchers have shown that even the poor want to and can save, and that appropriate mechanisms can help realize this potential. In fact, Hulme, Moore and Barrientos (2007) are

Micro-insurance programmes face difficulties in initial take-up and other hurdles

There needs to be a shift in focus towards micro-savings programmes

17 Mosley (2007) tabulates findings from case studies of the following five programmes: (a) Foundation for International Community Assistance (FINCA), Uganda, (b) Bangladesh Rural Advancement Committee (BRAC), (c) Grameen Kalyan (Grameen welfare organization), (d) Society for Social Services (SSS), Bangladesh and (e) Bhartiya Samruddhi Investments and Consulting Services (BASICS), Ltd, India. The first four are health schemes, while the fifth is a weather scheme. He suggests the following channels through which positive externalities may be generated: (a) knowledge achieved by experimentation; (b) “bonding social capital” benefits achieved through lower individual and group vulnerability; (c) “linking social capital” benefits achieved through an improvement in clients’ awareness of service quality; and (d) “beneficial contagion” effects.

18 The general problems with insurance, as alluded to above, are: (a) information asymmetry, (b) transaction costs, (c) enforcement constraints and (d) ambiguity aversion. Even microfinance institutions find it hard to overcome these hurdles.

19 See Clarke and Dercon (2008, p. 10).

20 Such a trade-off between scale and unit cost does apply to other microfinance services, and, in fact, for most business propositions. However, the trade-off may be particularly stark for the business of micro-insurance.

Box V.3

Subsidizing microfinance programmes

Even though microfinance programmes are formally private sector operations, they often require explicit or implicit State subsidies. The issue of subsidies has provoked various responses. First, many microfinance institutions claim that they break even financially and even produce some surplus. In fact, according to *The MicroBanking Bulletin* of July 2003, 66 out of 124 (about 50 per cent) microlenders surveyed were financially sustainable. Second, other microfinance institutions claim that even though they are not yet financially solvent, they are steadily progressing to that stage, and soon will be fully financially independent. The argument for providing a temporary subsidy to microfinance institutions until they can reach the scale and efficiency necessary for them to break even financially is essentially an “infant industry” protection argument.

However, a third response takes the view that it is unreasonable to demand that microfinance institutions break even financially. According to this view, the utility and usefulness of microfinance programmes should not be judged by narrow financial yardsticks. Instead, a broader view is required in order to evaluate the multidimensional role that microfinance programmes play in the life of the poor. Furthermore, proponents of this view contend that the emphasis on financial viability will force microfinance institutions to move away from the poor and focus attention on the non-poor or the not-so-poor, thus thwarting the initial mission of microfinance institutions. They therefore perceive an inconsistency between the criticism that microfinance institutions are not reaching the extreme poor and the criticism that those institutions are not demonstrating financial viability. In fact, it is microfinance institutions that serve poorer categories of households that are generally more subsidy-dependent. According to the survey mentioned above, the financial viability rate among microlenders focusing on the low end was 37 per cent (18 out of 49).

To argue for subsidies for microfinance, Morduch (2006), for example, has coined the expression “smart subsidies”, while recognizing that the term may appear to be a “contradiction in terms”. He explains that “smart subsidies maximize social benefits while minimizing distortions and misplaced targeting” (p. 11) and presents the following four lessons:

- (a) Subsidized credit does not equal “cheap credit”;
- (b) Profitability does not equal efficiency;
- (c) Profitability does not equal sustainability;
- (d) Profitability does not guarantee access to commercial finance.

Morduch (2006) suggests that these lessons show that if appropriately designed, subsidies can preserve the free market efficiency outcomes, such as hard budget constraint, a clear bottom line, and competitive pressure, and yet help increase the scale of microfinance outreach, access to commercial finance, and depth of outreach to the poor (pp. 10-11).^a

Morduch (2006) does not want to limit microfinance subsidy to the start-up phase only, believing as he does that if subsidies are reasonable for the start-up phase, then they are also reasonable when microfinance institutions try to expand to “wholly new areas”. He therefore argues against the five-year limitation on subsidies suggested by the Consultative Group to Assist the Poor (CGAP) donor guidelines. He also demonstrates that subsidies are needed to allow borrowers to graduate from very small loans (which lenders cannot make without subsidies) to loans of larger amounts, when break-even becomes possible. He further notes that subsidies are also needed to arrange for a multidimensional assistance package, including food aid and social services, which is necessary to ensure that the microcredit programme achieves effectiveness and success with the extremely poor.

Despite his arguments for microfinance subsidies, and his contention that smart subsidies can help “achieve social objectives that are not readily achievable when working through strictly for-profit institutions”, Morduch still believes that, in general, subsidies should be “time-limited” and “rule-bound”, and that depending on subsidies is not a viable long-run option. Accordingly, he also seems to advocate subsidy to only “a subset of institutions”, referring most likely to microfinance institutions that are more poor-focused and/or operate under relatively more difficult conditions (in, for example, remote or sparsely populated areas).

^a See also Morduch (1999a, b) and Armendariz de Aghion and Morduch (2005).

Box V.3 (cont'd)

b Clarke and Dercon (2008) note that “The costs are just too high”, and suggest that “subsidizing microcredit may be a cost-efficient way of improving the lives of the poor” (p. 17).

In contrast with Morduch, Clarke and Dercon (2008) seem to offer more unconditional support to subsidies for microfinance programmes. They maintain that, given existing technologies and transaction costs, microfinance programmes will never be commercially viable, and hence need to be viewed partly as commercial programmes and partly as welfare programmes, and as thereby requiring subsidies in the long run. In other words, in their view, providing subsidies to microfinance institutions may be a cost-effective means of reaching the poor and improving their lives. Pointing to the paucity of data showing financial viability of microfinance programmes in general, Clarke and Dercon express the opinion that, given the current cost of technology and expertise, microfinance for the very poorest will never be profitable.^b The authors believe that the pioneers of microcredit, such as Grameen, have developed loan contracts that do not “distort incentives or decisions but still manage to serve the poor”. Furthermore, citing Karlan and Zinman (2007a and b), Clarke and Dercon suggest that it remains difficult for microfinance programmes to become profitable by raising prices of their product and thus take the view that subsidies may be necessary on a long-term basis.

Clarke and Dercon (2008) further note that subsidized insurance can potentially avoid the problems arising from weak safety nets, since, if such insurance is properly designed, anyone can acquire a policy and be covered themselves against the serious risks that he or she faces. Hence, subsidies should be given to encourage uptake and inclusion. They recommend that subsidies be targeted towards trialling and evaluating innovative micro-insurance programmes rather than provided directly to existing micro-insurance products.

Mosley (2007) also argues strongly for subsidies for micro-insurance programmes, particularly in view of their positive externalities and the problems of survival that they face initially.

somewhat rueful about the redirection of attention from savings to (micro) credit in recent years, for they perceive this as representing a historic shift in emphasis from thrift as the foundation of finance for the poor in the early twentieth century to a reliance on credit and debt as a way out of poverty in the early twenty-first. Along these lines, despite the fact that community-based savings groups and other informal savings systems had had a long history, microcredit organizations and institutions were for a long time barred from accepting savings from their clients.

The poor are often prevented from securing access to formal savings programmes through a mixture of unfamiliarity, distance, costs, and the indivisibility of available saving instruments in the formal banking sector. Alternative savings institutions/programmes that are more suited to the needs and capabilities of poor households can remove such barriers and allow those households to save and to use their own savings as a means of coping with risks.

Savings as (self) insurance has many features that are superior to those of insurance. For example, while insurance can generally be used to cope with only certain pre-specified types of risks, savings can be used to deal with any type of risk, as long as the damages involved do not exceed the amounts of savings. Second, whereas insurance helps only ex post, savings can be used to undertake both ex ante and ex post measures to deal with risks. Thus, savings as an insurance mechanism is much more flexible. Third, use of savings does not require prior approval. Hence, savings ensure independence in respect of deciding how to deal with risks. All these advantages are in addition to the fact that savings can, while insurance programmes usually cannot, generate an “income effect”. Noting the insurance role of microcredit and microsavings programmes, many have characterized these as *quasi-insurance* programmes.²¹

Savings are often a better form of self-insurance

²¹ Mosley (2007) offers the following four examples of quasi-insurances: (a) risk-minimizing credits for the ultrapoor, (b) Emergency loans from “village banks”, (c) Microsavings schemes and (d) Loan savings linkages.

To the extent that microcredit programmes have proved relatively more successful in reaching the poor, they are now being expanded to include delivery of savings services to the poor. The process has led to the emergence of two types of microsavings institutions. The first type comprises of those that engage in both microcredit and microsavings, producing a joint product. An early leader in this regard was Bank Rakyat Indonesia, which by 1996 was offering saving services to over 16 million households. Deposits have been small, with average balances in 1996 of \$184, suggesting that the average depositor was less well off than the average borrower (with an average loan balance of over \$1,000). However, this represented over \$3 billion in savings and gave Bank Rakyat Indonesia a cheap source of funds for re-lending, while providing households with the means to build up assets and better smooth consumption. The second type comprises those institutions for which engagement in microsavings constitutes the sole activity. An example of the latter type is the SafeSave programme of Bangladesh. Under SafeSave, staff solicits savings from members on a daily basis, thus helping households “convert their ability to save in regular but small amounts into a useful lump of money” (Morduch 1999b, p. 1607).

Evidence gathered by Hulme, Moore and Barrientos (2007, p. 8) suggests that there are tens if not hundreds of millions of savings accounts in various classes of financial institutions that are generally aimed at markets below the level of commercial banks, and that a substantial fraction of these institutions’ clients are probably poor or near poor. The market for microsavings services is therefore large. According to the microfinance virtual library, it should be possible to raise \$2 billion from borrowers’ savings alone. The Country-Level Savings Assessment data gathered by the Consultative Group to Assist the Poor (CGAP) show that a high proportion of both rural and urban households currently have no bank accounts, indicating a huge unrealized demand for deposit services among poor clients, many of whom report keeping savings in cash or in other informal and semi-formal institutions. Microfinance institutions therefore have a huge demand to fulfil through improved savings products. On some assessments, policymakers who are looking to strengthen their microfinance programmes would be better served by giving greater attention to microsavings schemes, making these affordable, widely available and less costly. Savings also need to be more remunerative, earning real positive interest rates (Hulme, Moore and Barrientos, 2007).

The average size of all microfinance programmes—credit, savings and insurance—are becoming larger over time thanks to several factors. First of all, these programmes generally follow the principle of graduation, so that, taking microcredit as the example, upon successful repayment of the previous loan, borrowers become eligible for a higher loan amount in the next round. Second, as microfinance institutions mature and become more secure, they introduce new loan programmes of larger size. For example, Grameen Bank Bangladesh now provides loans of large sizes which are enabling borrowers to construct or undertake capital improvement of their existing houses. Grameen is also introducing loans for small businesses. However, this larger size may strengthen the criticism that microfinance does not reach the extremely poor. At the same time, these programmes are still too small to generate an investment surge that can push an economy towards growth take-off. It remains to be seen what sort of evolution microfinance undergoes in the coming years.

There is a vast demand for savings services among the poor

Microfinance needs to aim at larger size and more investment-oriented goals

Risk coping

Risk coping, as mentioned above, refers to ex post measures that can be taken by the Government, communities and households to enable people to live through negative shocks when these have already occurred.

Workfare/employment programmes

One of the oldest measures for providing relief to people facing income insecurity entails the offer of employment through various types of workfare programmes. Though originally these programmes had mainly been undertaken as ex post emergency measures for coping with crisis situations, with time they were also being used as ex ante arrangements for helping the vulnerable to adapt to risk and even for reducing risk for them. Thus, many developing countries are expanding their workfare programmes and utilizing them as an alternative means of providing social insurance. For example, India has recently adopted a programme that guarantees 100 days of work to all who need it in rural areas.

As the experience of workfare programmes has been widely studied, an understanding of their merits and demerits is quite well established.²² In rural areas, such works, by guaranteeing some income continuity in the face of adverse economic shocks, can spare farmers from having to run down productive stocks and can even encourage them to undertake riskier, and more productive, investments. Moreover, work done under workfare programmes, if properly planned and executed, can create valuable assets such as roads, irrigation canals, dykes, schoolhouses and storage facilities, although, in practice, the programmes are not uniform or always satisfactory in terms of their quality and productivity.²³ Further, their use in response to shocks and disasters allows the poor not only to save, but to save more productively. Empirical studies offer considerable evidence of the insurance impact of workfare programmes. For example, Cain and Lieberman (1983) find that the volume of land sales is highly correlated with floods and droughts in villages without workfare programmes, whereas no such correlation exists in villages having such programmes. Similarly, Ravallion (1991) finds that access to relief work (including the Employment Guarantee Scheme) appears to have allowed many of the poor in the villages of India to avoid sale of land as a form of adjustment. He believes that the presence of the Food-for-Work Programme helped Bangladesh prevent deaths during the 1988 floods, while the absence of such programmes was one reason why more people had died in the aftermath of the 1974 floods.

However, there has been persistent criticism regarding the high administrative costs of such schemes, their poor record in terms of providing jobs for people from the poorest and least secure households, the crowding out of comparable work from the

Workfare programmes can create valuable assets for the wider community

²² See, for example, Bandyopadhyay (1988), Basu (1981), Besley (1995), Besley and Coate (1992), Narayana, Parikh, and Srinivasan (1988), Ravallion (1991, 2003).

²³ It may be noted that, in certain contexts, public workfare programmes have greater potential to create productive assets than would be possible in the private sector. For example, workfare programmes undertaken by public authorities could adopt schemes to build irrigation canals with greater ease than the private sector with its problems of coordination and cooperation and of restrictions arising from the existence of private property rights. China's success in building rural infrastructure by mobilizing surplus labour during the Maoist period and in developing Township and Village Enterprises during the post-1978 reform period points to this comparative advantage, so to speak, of public workfare programmes. However, realization of the full productive and insurance potentiality of workfare programmes depends to a great extent on the governance capability of a country, at both the central and the local level.

private sector, and their capture by powerful politicians. Another controversial issue concerns the wage paid on such schemes. Setting the wage at or even below local subsistence levels, for example, is hardly likely to address the vulnerabilities associated with poverty. Moreover, if this is intended to induce self-targeting, the result may be self-defeating, as only those with some other income source could afford to take such work. Paying such low wages could also lower the average wage in surrounding jobs.

Despite such criticism, the experience and impact assessments suggest that workfare programmes hold considerable potential for providing a form of economic security to poor families who have able-bodied members willing to work in exchange for benefits. Concerns about crowding out are probably exaggerated and can, in any case, be addressed by appropriately timing the programmes, adroitly designing them in terms of wage (benefit) level and amount of work required, ensuring that work under them proves to be productive and creates valuable assets, and ensuring that they are complementary to rather than in conflict with pre-existing benign security arrangements.

The concerns about coverage are probably more relevant, however. Workfare programmes cannot benefit households that do not have members able to undertake the work required by the programmes. For those households, other types of programmes are necessary. Moreover, countries where wages are bolstered by some regulatory device, such as a minimum wage, are probably not suited to the establishment of large-scale public works schemes intended to be a form of social protection.

Welfare and cash transfer programmes

As noted above, workfare programmes, despite their merits, are not suitable for providing social protection to all who are in distress. Families that do not have members willing and able to undertake the work required by these programmes cannot benefit from them. Welfare programmes that do not have work requirements can fill some of these gaps. In addition, welfare programmes may focus on certain specific goals other than just current income-generation, which is generally the focus of workfare programmes. In particular, welfare programmes designed to help the poor build human capital and thus break the intergenerational cycle of poverty have become quite popular in recent years. It may be noted that even work-promotion programmes need not always take the form of public workfare and, instead, may entail subsidies that are provided for private employment and given to either workers or employers.

There are a wide variety of welfare programmes. For example, in the survey by Coady, Grosh and Hoddinott (2004) of 122 programmes covering 48 countries, as many as 79 were classified as “transfer” programmes and another 23 were categorized as “subsidies”.²⁴ Of those belonging to the transfer category, 49 took the form of “cash” transfers, 18 were “near cash” and the remaining 12 comprised in-kind “food transfers”. Along the same lines, 18 of the subsidy programmes reduced the cost of food, whereas 5 entailed “non-food” subsidies. Although the programmes surveyed by these authors represent neither a census nor a random sample, they point to a wide prevalence of welfare programmes in different parts of the world.²⁵

²⁴ The remaining 20 belonged to the “public works” category (of which 12 were in the “job creation” subcategory and 8 in the “programme output/social product” subcategory).

²⁵ The authors themselves acknowledged that “(W)hile our efforts to construct a database of targeted interventions were exhaustive (or at least exhausting), there are good reasons to believe that the database is neither a random sample nor a census of all targeted programmes and their impacts” (Coady, Grosh and Hoddinott, 2004, p. 83).

Workfare programmes can be an effective tool in dealing with the economic insecurity of people left out of formal employment

Not all needy families benefit from workfare programmes

Welfare programmes can help to meet the general need for income as well as to achieve specific developments goals

A set of challenges centre around the level and structure of benefits and the related issues concerning financing and budgeting of the programmes. Setting the benefit level low may help to increase the coverage, reduce incentives for people to enrol unduly and keep the budget manageable. However, low benefit levels may also make the programme ineffective and reduce the chances for participants to graduate. On the other hand, setting the benefit level high may lead to undue enrolment, restrict the coverage, create resentment among those left out of the programme, generate disincentives for enrollees to graduate and create undue budgetary pressure. There is also the possibility of differentiating the benefit level in accordance with household characteristics. Such differentiation, while of help in raising the effectiveness of the programmes, increases the demands placed on administration and management of the programmes. Benefit levels in welfare programmes that are currently under operation are generally thought to be on the lower rather than on the higher side.

There are a variety of options available in the design of the delivery mechanism, including cash, checks, vouchers, in-kind benefits and so on. As regards the method of transfer, in the case of cash, a service window or an ATM machine could be used. An important aspect of delivery concerns whether the recipient will have to travel to receive the benefits or whether the benefits will be delivered to his or her residence. The former arrangement has the advantage of reducing the administrative costs of the programme but it may be more discriminatory.

Affordability of welfare programmes is a hotly debated issue. This was discussed in *World Economic and Social Survey 2007* (United Nations, 2007a) in the context of pensions. The debate is rooted partly in differences of perception of the social necessity and role of these programmes. Benefits provided under welfare schemes can take both cash and in-kind forms. For a long time, however, there was opposition to cash transfers as a means of combating poverty and insecurity and even of dealing with emergency. It was argued that cash transfers would promote idleness and dependency and prove costly.²⁶ However, there is now a growing movement in favour of them. This switch has strong advocates among non-governmental organizations, though development agencies, both multilateral and bilateral, also seem to be catching up.

Cash transfer programmes can be classified as either conditional or unconditional. Conditional cash transfer programmes require recipients to fulfil certain conditions such as sending children to school, attending training programmes, visiting health centres, and so on. Unconditional cash transfers do not impose any such condition on the recipients. From another point of view, cash transfer programmes may be classified into lump-sum transfer programmes and periodic transfer programmes. Most cash transfer programmes are of the “periodic” type; an example of a lump-sum cash transfer is that given for construction of houses or other such capital projects. Cash transfer programmes may also be classified from the viewpoint of the particular purpose they are to serve or the particular category of people to which they are targeted. From this viewpoint, cash transfer programmes may be grouped according to the following purposes: (a) general poverty/insecurity alleviation, (b) education promotion, (c) old age support, (d) health promotion and disability (in particular AIDS) support and (e) other.

In general, advocates of cash transfer programmes point to their ease of disbursement, low administrative costs and ability to reach the poor directly and boost their

Cash transfer programmes are growing in popularity

Cash transfer programmes are easy to administer but they raise incentive issues

²⁶ “The fear of giving money is almost pathological among aid agencies, even though, or maybe because, it would be simpler and cheaper to give cash than any other form of help” (Sesman, 2004).

self-esteem and productive capacity.²⁷ These are all advantages that become more apparent in the context of rising insecurity following a large-scale shock or economic downturn. However, researchers have noted some potential demerits of cash transfer programmes, too, among which are promotion of idleness and dependency, and potentially distortionary and discriminatory effects, as well as their proneness to corruption. Despite these possible drawbacks, programmes of cash transfer are spreading, albeit with some regional variations (see box V.4).

Box V.4

Cash transfer programmes

Cash transfer programmes in Latin America

Cash transfer programmes in Latin America are mainly focused on the young and aim in particular, at helping children of poor families become educated and thus break the intergenerational poverty cycle. The downside is that such programmes may appear to discriminate against families that do not have young children. *Oportunidades* is an important example of a cash transfer programme implemented in Mexico. According to Standing (2007, p. 17), the Mexican cash transfer programme is a “central part of the country’s social protection system” and has evolved into “a complex mechanism of social engineering” reaching about 3 million households at any one time.

Bolsa Familia, which is the flagship of Brazil’s cash transfer schemes, had, by 2006, reached over 11 million households living below the official poverty line, or over 44 million people. The scheme represents the consolidation of a number of income transfer schemes, and the payment is conditional on several human development objectives and is nominally means-tested. Other cash transfer schemes of Latin America include *SISBÉN (Sistema de Identificación de Potenciales Beneficiarios de Programas Sociales)* and *Familias en Acción* (Colombia); *Programa de Asignación Familiar* (Honduras); Programme of Advancement through Health and Education (Jamaica); and *Red de Protección Social* (Nicaragua), which pre-dated the Brazilian model, having become operational in 2000.

Cash transfer programmes in Africa

In contrast with those in Latin America, cash transfer programmes in Africa have often been used as part of disaster relief and have focused on the old and sick. In view of the AIDS epidemic, it is not unexpected that support for the sick, particularly AIDS victims, has emerged as an important part of cash transfer programmes in Africa. Ethiopia’s Cash for Relief (CfR), funded by the United States Agency for International Development, is an important example. Another is Ethiopia’s Meket Livelihood Development Pilot Project. Evaluation shows that money received under these programmes was spent not only on consumption, but also on paying off debts, acquisition of livestock, undertaking investment to improve land productivity, etc. The cash transfer programmes implemented in Ethiopia by the United Kingdom of Great Britain and Northern Ireland-based non-governmental organization Save the Children have also been found to be cost-effective and non-inflationary.

Somalia’s Emergency Cash Relief Programme has been implemented in the drought-affected and politically contested north-eastern part of the country. Some 13,380 socially vulnerable households had been each given a one-time grant of \$50 under this scheme. Observers report that even this small cash grant helped people reduce their debts, purchase food and water, and invest themselves with some sense of “empowerment”. It has been claimed that the cash support helped the community to survive. Other programmes of cash transfer in Africa include Zambia’s Kalomo Social Cash Transfer Scheme, funded by the Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) (Eschborn, Germany) programme; and programmes especially directed towards people infected with AIDS in Namibia and South Africa.

²⁷ For further details, see, for example, Standing (2007).

Box V.4 (cont'd)**Cash transfer programmes in Asia**

Cash transfer programmes are becoming popular in Asia, too. Attention has been drawn to the success of the Bangladesh Food for Education programme in promoting female education. With the passage of time, food is being replaced by cash in this programme. Other cash transfer programmes in Bangladesh include Assistance for the Old and Assistance for Widows. In Mongolia, the Cash for Herders programme is claimed to have led to investments that regenerated herders' livelihoods.

Remittance policies

Remittances are a growing and relatively stable source of income

Labour migration, particularly on a significant scale, is usually a sign that the exporting economy is not generating a sufficient number of decent jobs for an expanding workforce. On the other hand, it does open the possibility for new sources of development finance (Ratha, 2007). In fact, remittances seem to have become the most important source of external finance for many developing countries, and can also improve the terms of access to international financial markets.²⁸ For some countries, remittances account for one third or more of gross national income (GNI) and in many cases, the figure hovers around 20 per cent (see Ratha and others, 2007). It is no wonder, then, that remittances have become an important factor in risk coping and mitigation, at both macro- and micro levels.

Remittances, at least to date, appear to be more stable than private capital flows and less subject to boom-bust cycles and can provide a counter-cyclical stimulus (Kapur, 2004). For example, Ecuador's remittance earnings increased from \$643 million to \$1.4 billion between 1997 and 2001, a period during which the country experienced social upheaval and political chaos (*ibid.*). Mexico and Argentina had a similar experience during their financial crises of 1995 and 2001, respectively. Similarly, remittances steadily increased in East Asian countries during the financial crisis of 1998-2001 (Sharma, 2008). Remittances have therefore emerged as a kind of self-insurance mechanism for developing countries in the face not only of economic downturns, but also of political crisis (as was the case for Lebanon during its civil war and Haiti) and natural disasters (as was the case for countries of Central America in the aftermath of Hurricane Mitch).

Low-income families generally benefit from remittances

Though countries differ in this regard depending on the dominant type of migrant labour, remittances generally reach low-income families, thus benefiting precisely those who are generally more insecure. This is particularly true for countries whose emigrants are primarily low- or unskilled workers. For example, evidence shows that 60 per cent of Mexican and 40 per cent of Paraguayan remittance-receiving households fall in the lowest quintile of the income distribution (Acosta, Fajnzylber and Lopez, 2007).²⁹ Similarly, inasmuch as most emigrants from South Asian countries are low- or unskilled labourers working in oil-rich Middle Eastern countries, their remittance money also primarily reaches low-income families. Remittances therefore generally produce a more egalitarian distribution, whereas aid-related processes (through misappropriation, etc.) often exacerbate inequality. In a sense, remittances serve as a welfare programme financed and

²⁸ For example, in 2001, Banco do Brasil issued US\$ 300 million in bonds using the future yen remittances from Japan, and similar bonds have been used by financial institutions of Mexico, El Salvador, Panama and Turkey to raise cheaper and longer-term financing from international capital markets (Johnson and Sedaca, 2004; Sharma, 2008).

²⁹ However, there are countries where remittance income distribution is biased towards the rich. Examples of such countries in Latin America include Peru and Nicaragua (Acosta, Fajnzylber and Lopez, 2007).

implemented by a country's nationals working abroad. As a result of the above, it is not surprising that remittances generally have a greater impact on poverty alleviation than many other sources of national income. According to Ratha (2007), remittances have helped reduce the poverty rate by 11, 6, and 5 percentage points in Uganda, Bangladesh and Ghana, respectively.

A large part of remittances is spent directly on consumption. Surveys in several Latin American countries show that about 84 per cent of the remittance money in El Salvador and 46 per cent in Mexico is spent on household (consumption) expenses (López-Córdova and Olmedo, 2006). A significant part is spent on health and education, helping households to retain and build up human capital and thus to improve their long-term economic position.

Some researchers have suggested that the propensity to save out of remitted incomes is higher than it is for regular income (Orozco, 2003); remittances then become a source of investment financing. For example, the surveys mentioned above also show that about 10 per cent of remittances in Brazil and Guatemala were spent on business investment. Investments out of remittance money are generally small-scale, labour-intensive and geared towards the production of locally demanded goods and services. A remittance-fuelled growth is therefore likely to be more pro-poor.

Measures to strengthen remittance flows can therefore make not only a direct contribution to household security but also an indirect one by strengthening long-term growth prospects. For example, Governments might make sending remittance money easier and less costly, so that a greater proportion of earnings abroad could be sent back home as remittances. They might also adopt policies to ensure that remittances are sent through official channels, instead of through underground or illegal ones, so that it would become easier for the formal financial system to benefit from remittances. They could also take measures to leverage remittances and channel them for public purposes. For instance, in the last decade, Hispanic immigrants across the United States have organized themselves into hometown associations that finance public works projects and small businesses in the towns from which they have migrated. The Government of Mexico has taken the initiative of leveraging the remittances of hometown associations by creating a "three-for-one programme" whereby all hometown association remittances used to improve infrastructure or establish businesses are matched dollar for dollar by the Mexican Federal, State and local authorities (Kapur, 2004).

While emphasizing the beneficial effects of remittances, it should not be forgotten that growth in developing countries can suffer as a consequence of lack of human capital. The best strategy would therefore be to encourage migration by unskilled labour while creating conditions attractive enough to keep skilled and educated labour back home. However, developing-country Governments by themselves may have little control over the first component of this strategy. Moreover, remittances may also negatively affect labour participation, intensity of job search, and risk-taking at home. Research has produced mixed findings on this issue. Funkhouser (1992), based on evidence from Nicaragua, has reported a decrease in labour participation but an increase in self-employment. Yang (2005), on the other hand, has reported a positive effect of remittances on labour participation, particularly by adults. To the extent that part of it may be due to increased enrolment in schools, decrease in (child) labour participation stemming from the flow of remittances should not be treated negatively, as noted by Chami, Fullenkamp and Jahjah (2003). In general, since the income level of remittance-receiving households is still generally low, the labour-disincentive effects of remittances may not be that pronounced.

Remittances boost consumption and promote health and education

Government policies can enhance the positive effect of remittances

More important, probably, is the effect of remittances on government policy formulation. On the negative side, the availability of remittances may increase complacency and reduce the pressure on Governments to carry out reforms designed to improve efficiency and domestic resource mobilization. On the positive side, remittances may help countries reduce their dependence on aid and loans and thus free them from various conditionalities associated with aid. In Bangladesh, for example, between 1990 and 2006, while remittances as a proportion of GDP increased from 2.4 to 9.8 per cent, the corresponding ratio for official development assistance (ODA) decreased from 8 to 2 per cent (Sharma, 2008). This reduced dependence on ODA can help developing countries have more policy space, which they can use to implement pro-poor growth policies, as described above, and thus make significant strides in overcoming economic insecurity.

Towards an integrated approach to dealing with poverty and economic insecurity

Integration of arrangements across formal and informal sectors

Informal employment in developing countries is a challenge for those devising social policies

Fast growth, expansion of formal employment, with decent wages and benefits, public systems of education and health care, and so on, provide the basic foundation for a strong social safety network with broad-based coverage for the whole population. However, to the extent that the coverage of formal employment remains limited, as is particularly the case in developing countries, so that many of the poor and vulnerable are either self-employed or under- or unemployed, or to the extent that, as was the case in some East Asian countries during the financial crisis of the late 1990s, the formal economy has retreated quite sharply, it will be necessary in many poor countries to adopt various direct intervention programmes to provide income and security. Discussion in the previous sections has pointed to many such programmes and most countries will, in practice, combine several such programmes to reduce levels of insecurity. The particular combination of public and private, both formal and informal, arrangements needed to create the right social protection network will vary from country to country.

Still, in all cases, in the search for the right mixtures, there will be a need to concentrate on maximizing complementarities across the available programmes. First, there may be complementarity *across groups*. Thus, different groups of insecure people at the same time and at the same location may require different types of programmes depending on their specific characteristics and needs. For example, while in a village in times of distress, families with able-bodied working-age members may need *workfare* programmes, families without such members may need *welfare* programmes. Second, the complementarity may run *across time*. Thus, while in the immediate aftermath of a flood and the associated crop loss, a village may benefit from *food aid*, after some time (when the challenge of immediate survival has been dealt with and normal work has picked up), a programme of *cash transfer* may be more helpful. Third, the complementarity may run *across space*. Thus, villagers in a location with highly erratic rainfall may benefit more from a rainfall insurance programme, whereas residents in a locality with stable irrigation facilities may not need such a programme. Fourth, there may be complementarity between *public* and *private* sector initiatives. For example, various microfinance programmes, which are by and large private sector initiatives, may complement various workfare and welfare programmes, which are usually public sector operations. As mentioned earlier, unlike most

other direct intervention programmes, microfinance originated as, and has remained, a predominantly private sector operation. So far as budget affordability is concerned, microfinance programmes can therefore provide an alternative or be a useful complement to the public sector-funded programmes. Fifth, there may be complementarity *across programme attributes*. For example, micro-insurance programmes can make microcredit programmes more beneficial. Similarly, microsavings programmes can facilitate functioning of micro-insurance programmes (box V.5).³⁰

Complementarity among various microfinance programmes

Box V.5

Microfinance now encompasses programmes of microcredit, microsavings and micro-insurance. Each of these programmes has its unique niche, though a closer analysis shows that they may be complementary to each other in many ways. One dimension of this complementarity is of an *organizational nature*. For example, it was found to be expedient in many cases to have the same organization offer various microfinance services as joint products. Such an organizational set-up may be beneficial in several respects. First of all, it may reduce cost, and thus ensure the initial survivability of new programmes by letting them piggyback on already operational programmes. Second, besides permitting them to economize on overhead and transaction costs, such a set-up may help new programmes in deeper ways, for example, by allowing micro-insurance programmes to avoid problems of adverse selection and other information and enforcement problems.

A second type of complementarity arises out of the *specific roles* that different microfinance programmes can play. Even though microcredit, microsavings, and micro-insurance can all play an insurance role, the specific ways in which they play this role are different in each case. Various microfinance programmes can therefore complement each other and their functions can be combined so as to meet the specific needs of a household or community.

It has been noted that while insurance programmes are risk-specific, savings can serve as a more general-purpose insurance. Clarke and Dercon (2008, p. 11) expand the idea further by classifying risks into “small” and “large/catastrophic”, suggesting that while “quasi-insurance” programmes, such as microsavings, may be effective in dealing with the former category of risk, specific micro-insurance programmes can be more effective in dealing with the latter. The actual practice indeed seems to support the notion of such a specialization. A large number of micro-insurance programmes indeed focus on risk to life.

Clarke and Dercon (2008) further note that the above-mentioned complementarities may be used to redesign the “credit life insurance” component of conventional microcredit programmes so that it becomes beneficial both to the lender and to the borrower. Such a redesigned credit life insurance can counteract the increased vulnerability that microcredit may otherwise create for certain borrowers in certain situations. More concretely, Dercon suggests that in some situations signing up for micro-insurance might be made mandatory for microcredit clients. This is basically a proposal for organizational integration using complementarity of an organizational nature as mentioned above.

However, it should be noted that there are also downsides to organizational integration of various microfinance programmes. First, people who are not interested in micro-insurance may now feel discouraged from accessing microcredit. Thus, the proposed compulsory bundling may restrict expansion of microcredit. Second, allowing such bundling may also lead to collusion among microfinance service providers and give rise to market power. Hence, caution is necessary with regard to implementing proposals for organizational/programme integration.

³⁰ The BRAC Income Generation for Vulnerable Group Development (IGVGD) programme (Bangladesh) is often cited as an example of successful utilization of complementarities among various direct intervention programmes. Under the programme, extremely poor people, who are left out of conventional microcredit programmes, are provided with food aid and microsavings services, which enable them to make a “low-risk transition” from the relatively non-risky environment of the subsistence economy to the risky environment of the cash economy. In general, concrete analyses of concrete situations are indispensable for determining the right type of direct poverty and insecurity alleviation programmes necessary. In fact, such analyses may lead to new, innovative efforts or a new configuration of previously known efforts. There is therefore no substitute for concrete analysis of concrete situations utilizing the most detailed information that can possibly be gathered.

“Benign” and “pernicious”
types of traditional security
arrangements exist

One particular issue that requires closer examination is the role that pre-existing, traditional, and informal security mechanisms can play in delivering social protection. The question that is of particular interest is whether these are undermined and displaced by new, modern, and formal security arrangements or whether there can be some complementarity between these two types of security arrangements for the poor. In considering this question, it should be noted that pre-existing, traditional security arrangements can be either “benign” or “pernicious”. Borrowing from friends, relatives or fellow villagers on the basis of altruism or reciprocity may be an example of the benign type of traditional security arrangement. Traditional “funeral societies”, prevalent in many countries of Africa, in which members contribute on a regular basis so as to be able to obtain a lump-sum amount when death strikes, may offer another example of a traditional benign security arrangement. Similarly, Rotating Savings and Credit Associations (ROSCAs), popular in many countries, where members make regular payments in order to be able to receive a lump-sum amount in turn, may represent another such example. On the other hand, usurious borrowing from local moneylenders (in exchange for collaterals) is an example of the pernicious type of traditional security arrangement.³¹

Modern poverty alleviation
programmes may
complement and build on
traditional “benign” security
arrangements

According to some scholars, traditional security arrangements of the benign type are few and far between. They point to the very prevalence of traditional security arrangements of the pernicious type as a proof of the inadequacy of the benign type. From this viewpoint, there is not much reason to worry about the “crowding out” effect of new programmes (Morduch, 1999b; Ravallion, 1991).

By contrast, Clarke and Dercon (2008) urge caution against undermining or supplanting pre-existing security arrangements.³² They note that traditional security arrangements are fragile and depend crucially on proper alignment of the interests of all participating members. Anything that undoes this alignment is likely to disrupt such arrangements. Clarke and Dercon therefore recommend that, in designing new programmes, effort should be made to make use of the pre-existing arrangements and to build upon them. In particular, they note that relying on groups, instead of individuals, in designing the modern interventions can be more helpful as regards preserving and making use of the pre-existing, traditional security arrangements. Certainly, in those countries that still have large rural populations, growth strategies will likely have an agrarian bias and the State sector may need to channel scarce resources towards infrastructure development. Consequently, in these situations, it is likely that support measures will need to be tailored to a more prominent role for community- and family-based support measures.

Universality versus targeting

Donors have generally
promoted targeting
in social policy

A good deal of controversy surrounding social policy centres on whether efforts at alleviation of poverty and increasing security should follow the principle of “universalism” or

³¹ It should be noted that the distinction between traditional and modern arrangements or between formal and informal ones is relative. For example, it is moot whether Rotating Savings and Credit Associations ought to be called traditional, since these emerged in the nineteenth century and in that sense they belong to the “modern” era. However, to the extent that these may already exist when new interventions are being considered, they may be deemed traditional. Similarly, it is not clear whether usurious borrowing from traditional moneylenders should be called informal, because generally such borrowing entailed *impersonal* contracts with clearly stipulated conditions which were often accompanied by some kind of written instrument (the signature or thumbprint of the borrower). Similarly, it is not clear whether some microfinance programmes should be characterized as formal or informal.

³² See also Dercon (2001, 2002).

that of “targeting”. Since the 1980s, donor agencies have generally advocated targeting usually on both efficiency grounds and as a response to binding resource constraints. In many cases, this was a deliberate attempt to limit the role of the State, on the assumption that one can alleviate poverty with less resources (Besley and Kanbur, 1990).

However, the experience with targeting has revealed several shortcomings including high administrative and transaction costs, perverse incentives and financial non-sustainability in the face of weak political support (Mkandawire, 2007). According to a study by the Asian Development Bank Institute which examined six Asian countries: “With relatively high levels of leakage the expectation is that in practice most targeting measures are high-cost means of transferring benefits to the poor” (Weiss, 2004). Self-targeting schemes appear to be the “cheapest” but this comes at the cost of under-coverage (Mkandawire, 2007, pp. 319-320). Of particular concern is the way in which targeting, almost by definition, leads to segmentation and differentiation. In service provision, targeting can lead to a dual structure—one part created for the poor and funded by the State, the other created for the rich and supported by the private sector. Geographical targeting often leads to horizontal inequality so that the poor in one area benefits more than the poor in another, non-targeted area. As discussed in chapter IV, this combination of polarization and spatial inequality can be explosive politically and is often the basis of ethnic conflicts.

Some observers have also raised questions regarding conditionality linked to targeting, pointing to the perverse outcomes that conditionalities often generate (Standing, 2007). A tragic example is provided by programmes in Namibia and South Africa where the means-tested disability grant to AIDS victims (which reaches 20 per cent of the total affected population) is withdrawn if the patient’s condition improves and his or her capacity to work increases. As a result, many AIDS patients stop taking the medication after experiencing some improvement and let their condition worsen so as to continue to receive the assistance. The expression “sickness-poverty trap” has been coined to refer to this kind of situation. According to Standing, the experience of Namibia and South Africa contrasts with that of Zimbabwe where in similar programmes, formal conditionalities are largely ignored, thereby yielding better results.

In general, the experience points to the fact that targeting leads to reduced budgets devoted to poverty and welfare, so that “the more for the poor means less for the poor” (Gelbach and Pritchett, 1995), suggesting that the optimal policy for the poorest and most vulnerable is not necessarily the one that targets benefits as narrowly and efficiently as possible (Sen, 1995).

In fact, most Governments tend to have a mixture of both universal and targeted social policies. In the more successful countries, however, the overall social policy has been universalistic and targeting has been used simply as one instrument for making universalism more effective (Skocpol, 1991). The particular combination appears to be linked to how the developmental State manages developments in the labour market, beginning from modest, often means-tested, programmes for limited groups of the population. However, early institutional solutions may have an effect on the later expansion and development of social programmes; for example, those first introduced based on the principle of economic means-testing may be more likely to develop into universal programmes than those established for clearly defined groups of the economically active population. In contrast, a focus on general education has proved to be of great importance for successful subsequent economic development and national wealth.

Targeting and conditionality can generate poverty traps and other perverse effects

Targeting leads to reduced spending on poverty and welfare

Targeting should serve universalism

Scandinavia and East Asia offer examples of different means of expanding social protection in support of development

Development strategies can never simply mirror successful experiences from the past. However, both the more “inclusive welfare developmentalism” strategy pursued in Scandinavia, and the more selective strategy used, for example, in Taiwan Province of China and the Republic of Korea, can offer useful lessons for today’s middle-income countries searching for a more effective balance of social and economic policies (see box V.6).³³

Box V.6

Some possible lessons to be derived from the Scandinavian welfare experience

Specific historical social and economic factors in Scandinavia may have been conducive to the development of a participatory political culture, consensus-building, a strong role of local and central government, and the overall support for the principle of universalism. However, developing governmental capacity and institutions for promoting welfare and the adoption of universal policies for the general level of welfare, carry broader relevance.

The scope of social planning—including establishing and developing social security, health and educational systems during the first half of the twentieth century—was clearly a result of democratic political processes aimed at balancing demands for and goals of economic growth and social justice.

A focus on general education and universal health services may prove to be of great importance for subsequent successful economic development and national wealth. State and public responsibility for a healthy population should be insisted on from the start in the context of creating national wealth and strength. The early stress on universal, compulsory education is not necessarily motivated by the urge for economic development. However, it can be instrumental for rapid industrialization, modernization of the economy and economic upgrading.

Social security and welfare State arrangements embody political and social preferences, formed by culture, traditions, economic and technological developments, social structure and social relations. There is no objectively “correct” path for governmental social policies. Values and preferences concern, among other things, perceptions about fairness, social justice, social cohesion, stability and equalization of life chances. One core challenge in respect of any social security system is how to organize it in such a way as to ensure that it provides incentives to work, which seems to be an important goal of most Governments. One possible effect of an unemployment insurance system would be its facilitation of the process of restructuring in industry and business. Economic security may reduce workers’ and employees’ resistance to change. Obligatory government schemes, which cover employees and workers independently of specific employment conditions or specific characteristics of firms or employers operating at a given place and time, may be advantageous with respect to labour mobility, structural economic change and economic growth. National schemes for unemployment insurance are basically work-friendly.

There is no simple link between the scope of the welfare state and taxation levels, nor between its scope and long-term economic performance (growth, employment rates, labour productivity or adjustment to economic shocks). However, a well-developed welfare State, with sophisticated social security arrangements, may get through a crisis more easily—or at least at a more moderate social cost (in terms of poverty and inequality).

In a more globalized world, we may expect more rapid changes in labour markets, greater mobility, more flexible work, and more career shifts during the period of labour-market participation. These new patterns may induce changes in pension systems designed to make them more transparent and less dependent upon the “best years” and “last years” of earnings, and thus fairer, in the sense that the pension would reflect contributions during all working years. Another lesson for other countries may be that in the era of globalization (that is, greater economic integration in the world), the need for a consolidated, national social security system is objectively greater than before.

Source:
Kuhnle and Hort (2004).

³³ Several of today’s middle-income economies have income levels and economic structures similar to those of Scandinavian economies of the 1930s.

Box V.7

Into the wild: the case for a basic minimum income

The International Labour Organization (2004a) has raised the question whether a basic minimum income—essentially a regular and unconditional cash grant from the State—could become an unconditional right for all citizens. The core objective of a universal basic income would be to protect populations against the downside risks from either idiosyncratic or covariant shocks of a non-catastrophic nature. Such *ex ante* schemes are generally seen to be more effective than *ex post* schemes in providing a minimum level of economic security, and cash transfers have generally proved to be the most rapid means of helping people in times of crisis. Given the various negative incentive problems associated with means-tested and targeted benefits, there appear to be strong grounds for a universal approach to income security. Any discussion of such a proposal immediately raises two fundamental questions: Is it politically feasible? Is it affordable?

Notions of fairness are culturally prescribed, and an unconditional grant would be unacceptable in many countries. Taking the United Kingdom of Great Britain and Northern Ireland as a case study, Atkinson (1996) proposed a “participation income” paid to all those aged 18 or over, which would reduce (so the study argues) the number of people dependent on means-tested benefits, while over 50 per cent of families would be better off, women in particular. The related idea of a “negative income tax”, first suggested by Friedman (1962), has been explored at the Federal and State levels in the United States of America as an option for means-tested benefits. These explorations eventually gave rise to the so-called Earned Income Credit introduced in 1975 but, generally, it was found to be difficult to devise a scheme that would match the cash and in-kind benefits already available without undermining the incentive to work (Allen, 2002). In Belgium and the Netherlands, a minimum income guarantee is granted to people who are out of a job and do not have or have lost other entitlements, such as family allowances or pensions. The amount of income granted often varies in relation to age, family and employment situations of the beneficiaries. Ongoing discussions in these countries on the transformation of income-security programmes into unconditional minimum income schemes are of particular interest in respect of a potential universal basic income. Related schemes are already in place in some developing countries that have the full or partial aspects of a minimum basic income. These schemes are often differentiated by the scope of coverage and the specific entitlements that populations can be granted, for example, minimum income guarantee (India), food for work (Afghanistan) and Bolsa Familia for the poorest (Brazil).

The costing of such schemes also raises questions. Some of these have been dealt with in the discussion in the 2007 *World Economic and Social Survey* (United Nations, 2007a), on universal pension schemes. These schemes are often funded through general tax revenues. The *Survey* estimated that a universal pension system keeping older persons out of extreme poverty—by setting benefits at \$1 per day for everyone aged 60 years or over—would cost 1 per cent of gross domestic product (GDP) or less for about two thirds of developing countries (*ibid.*). In other words, this would seem to be an affordable option, even for many of the poorest countries. Blackburn (2007) has taken this argument a step further and proposed a global pension fund to administer a universal pension scheme financed by a modest tax on global financial transactions and corporate wealth.

Perhaps the best known example of an operational basic income scheme is the Alaska Permanent Fund Dividend, which, since 1982, has paid an annual grant to every Alaskan, including children, who was a resident during the previous year and indicated the intention to remain. The Alaska Permanent Fund Dividend is funded from the State’s oil revenues, which accounts for over 40 per cent of its value added (Goldsmith, 2001). The payment has averaged US\$ 1,000 per person and in 2007 a family of four received close to \$6,000. Spending has been on consumer durables as well as on savings for children and college funds.

This scheme, which on average absorbs 2.2 per cent of Alaska’s GDP, provides a benchmark for replicating the basic income idea elsewhere. Few countries can count on windfall natural resource rents like Alaska. Hence, funding may have to be provided from general tax revenues or from a contributory scheme. The nature and coverage of fiscal systems vary significantly on a country-by-country basis. In principle, given that the aim would be to bolster economic security rather than redistribute incomes, the feasibility of a basic income scheme would depend on the breadth of the fiscal base.

Box V.7 (cont'd)

To obtain an idea of the affordability of a basic income scheme, one could use the taxable income of the highest quintile of the population as the financing constraint. Based on a sample of 85 countries and using the example of Alaska by setting 2.2 per cent of GDP as the constraint, the global budget for a universal basic income for 85 countries would amount to \$1.1 trillion in 2007. Given that the total net income of the top quintile for the sample of countries is about \$11.6 trillion, on average the tax would amount to under 10 per cent of this segment's income. That figure leans heavily, however, on the income of the rich in developed countries and in a few Latin American countries with relatively high income inequality. The tax burden on the rich in the poorest countries would likely become unrealistically high. Further estimations for 159 countries reveal that in 129 developing countries the annual payout or basic income per individual would be less than \$360 (or less than \$1 dollar a day). An additional \$1.3 trillion would be needed to cover the shortfall and ensure that all would at least receive a basic income of one dollar per day. The rich in developing countries would probably not be able to make the larger contribution to cover this additional cost. Hence, a certain amount of resources would have to be transferred from rich to poor countries in order to make such a global basic income scheme viable. A multilateral transfer mechanism could be devised to facilitate this.

Some observers however note that the dominant welfare model is too heavily based on the twentieth century industrial wage-labour paradigm. Standing (2007) refers to this as the "old-dualistic model" and argues that in the current era of post-industrial society and globalization, the paradigm may have become less valid. According to this argument, the shift in paradigm calls for a fundamental change in the approach towards welfare. Standing (p. 22) thinks that a universal social pension is a feasible first step in the direction of establishing the universal right to income security, and thereby promoting sustainable livelihoods and personal development. He expresses the optimistic view that "sooner or later universal basic income security will emerge as the sensible and equitable objective from the experience with targeted, conditional cash transfers" (p. 27).

According to this assessment, a universal, regular and unconditional cash grant could replace the provision of means-testing which entails significant administrative, incentive and coverage problems (see box V.7 above). There are already examples of such universalistic schemes though their wider political acceptability and financial feasibility are open to question.