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# Protecting the Vulnerable:

The Design and Implementation  
of Effective Safety Nets



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# Transfers and safety nets:

*“short-term palliatives,”*

*“a waste of money”?*

*“The poor are roughly equally poor, and there are so many of them, and resources so limited, that transfers are a non-starter.”*

*”Leakage and corruption mean that these policies tend not to reach the poor”*

*“These policies entail a serious trade-off against growth which is what matters to fighting poverty”*

**Proposition 1:** A market economy can generate too much risk and inequality, when judged from the viewpoint of aggregate output.

**Proposition 2:** Certain redistributive policies can be good for growth, by providing insurance or helping credit-constrained poor people be more productive.

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**Proposition 2:** Certain redistributive policies can be good for growth, by providing insurance or helping credit-constrained poor people be more productive.

- 1. An equity-efficiency trade-off?**
- 2. An insurance-efficiency trade-off?**
- 3. How can we achieve efficient redistributions?**

# ***Part 1: Is there an aggregate equity-efficiency trade off?***

- **Nutrition thresholds**
  - Massive unemployment under one asset distribution;
  - full employment under another
- **Credit market failures**: some people can't exploit opportunities
- **Political-economy**: balance of power over spending depends on distribution
- **Membership-based inequalities**  
Geographic/ethnic inequalities that can be self-perpetuating

***These arguments are fine in theory, but what does the evidence suggest?***

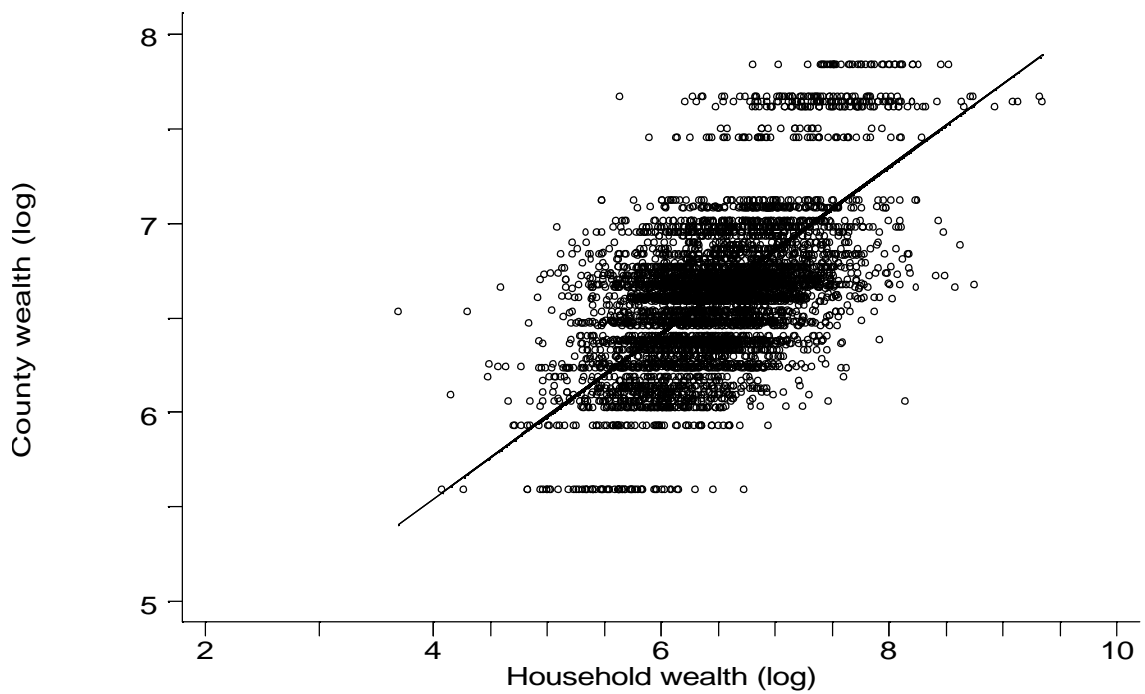
## Evidence from macro (x-country) data

- Evidence that higher inequality means lower growth (with controls);
- Inequality can be too high for sustainable pro-poor growth
- Data concerns; biases (both ways)

## And from sub-national + micro data

- Farm yield-size relationship (linked to market failures)
- Evidence of nonlinearity in household dynamics (China, Russia, Hungary)
  - Cost of inequality: China: 5%; Russia: 10%; Hungary: 20%
- Undernutrition lowers productivity
  - Work productivity
  - Learning and future earnings of kids
- Crime is linked to inequality
- Within-regional inequalities impede pro-poor growth (India, China)
- Geographic poverty traps: escaping poverty depends on where you live

# Geographic poverty traps in rural China



## ***Part 2: Is there an aggregate insurance-efficiency trade off?***

**One view:** “*public insurance encourages longer-term behaviors that promote continuing poverty.*”

**Moral hazard ?**

**an insurance-efficiency trade-off.**

A generous unemployment benefit system discourages personal efforts to find work.

- Similarly, public provision of old-age pensions is thought to discourage savings.

**However, it is hard to argue that  
poor people in the world are  
typically over-insured**

- Body of empirical work demonstrating a high exposure to uninsured risk.
- The poor tend to be more risk averse (higher Arrow-Pratt coefficient of absolute risk aversion).
- And probably more vulnerable to uninsured risk; some supportive evidence in my work with Jalan on rural China.

# **Will better insurance come at a longer-term cost to poor people?**

**Uninsured risk can be a cause of chronic poverty. Two arguments:**

- Dynamic poverty traps
- Production/portfolio effects

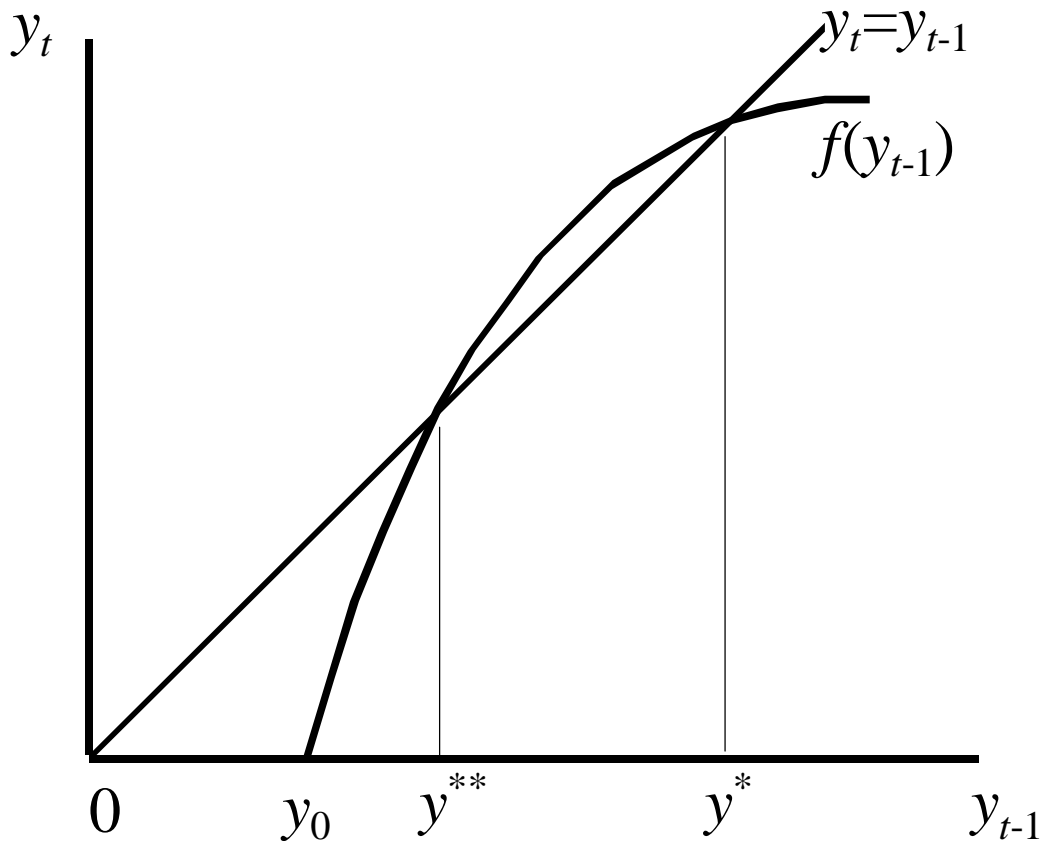
# 1. Dynamic poverty traps

## Threshold effects in consumption

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- Worker who cannot borrow or save and derives income solely from labor.
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Only if current consumption is above a critical level can the worker be productive.

Beyond this threshold, diminishing returns set in; extra current consumption raises productivity but at a declining rate as consumption rises



## Dynamic poverty traps imply:

- long-term benefits from policies that protect people from transient shocks, or provide temporary support for the poorest.
- Instead of a trade-off, lack of an effective safety net is a cause of long-term poverty.

# **Threshold effects are plausible, but what is the evidence?**

1. Basal Metabolic Rate ? a consumption threshold; unless you reach BMR there can be no productive activity.
2. Low consumption creates social exclusion (European welfare state).

# **Threshold effects are plausible, but what is the evidence?**

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**However, the case for intervention rests on believing that the threshold effect exists in the absence of intervention.**

**That is less clear.**

# Panel-data tests for dynamic poverty traps

## China, Hungary and Russia

- No evidence of thresholds: people tend to bounce back from transient shocks.
- However, the speed of income adjustment is lower for the poor (with low steady-state income).
- This can generate income dynamics that look like poverty traps but are not.
- **Caveat 1:** that can still leave considerable uninsured risk.
- **Caveat 2:** the dynamics might be quite different for highly covariate risk:
  - the informal safety net arrangements may then break down,
  - leaving the threshold exposed.

## **2. Production and portfolio choices**

### **Costly behavioral responses to income risk**

- Outmoded agricultural technologies can persist because they are less risky.
- Poor credit-constrained households hold high levels of relatively unproductive liquid wealth to protect consumption.
- Rosenzweig and Wolpin: Indian farmers hold livestock as a precaution against risk even when there are more productive investments.

# Is it the poor who incur the largest costs of uninsured risk?

- Jalan and Ravallion: portfolio responses to idiosyncratic risk in rural China.
- Wealth is held in unproductive liquid forms to protect against idiosyncratic income risk.
- However, neither the poorest quintile nor the richest hold liquid wealth because of income risk; it is the middle income groups that do so.
- It appears that the rich do not need to hold precautionary liquid wealth, and the poor cannot afford to do so.

# Human capital losses due to uninsured risk?

## Evidence is mixed

- Jacoby and Skoufias: seasonal effects on schooling of income risk in semi-arid areas of India.
- Jalan and Ravallion: schooling and (hence) future incomes in rural China are well protected from the income and
- Schady: schooling increased during Peru's macroeconomic crisis 1988-92; lower foregone income.

# ***Part 3. Policy: Can we achieve efficient redistribution with targeted transfers?***

**Accepting that inequality is harmful to growth does not imply that any reduction in inequality will reduce chronic poverty**

- Is the role for policy to reduce current income inequality, or attenuate its adverse impacts?
  - Alleviating the market failures that make inequality matter to aggregate welfare
- Context matters
  - heterogeneity in the performance of the same program in different settings,
  - and lack of heterogeneity in performance of different programs in same setting,
  - weak power of generalizations.

# Implications from the emerging new body of theory and evidence

## 1. The target group may be missidentified

- Common practice is to aim to reach the currently poor,
- Theories of efficient redistribution point to the importance of reaching those who are locked out of credit and insurance.

## 2. Costs of targeting are underestimated

Policy makers have over-optimistic views on how well they can reach the poor by administrative targeting based on readily observable indicators

# Implications cont.,

## 3. Benefits of targeting are underestimated too

- Past work has viewed indicator targeting as a static non-behavioral problem
- For example, location is simply one of the proxies for poverty.
- Poverty traps arising from market failures offer a different perspective, pointing to the potential for dynamic efficiency gains
- **Targeting group memberships may well have greater impact than its role as a purely statistical indicator of poverty.**

# **Lessons for specific policies**

**Transfers**

**Workfare schemes**

**Poor area programs**

**Mobility programs**

# Conditional transfers

- New programs in 1990s
- Combine income transfers with
- attempts to enhance capital accumulation of the poor,
- often using community groups as part of the targeting mechanism.
  - Bangladesh's Food-for-Education (FFE) Program,
  - Mexico's Progresa program
  - Brazil's Bolsa Escola;

# ***Do such programs make sense?***

*Not in our old way of thinking*

- If only concerned with current income gains to participants one would not want to use school attendance requirements, which impose a cost on poor families
- These programs are aiming to balance a current poverty reduction objective against an objective of reducing future poverty.
- Given the credit market failure, the incentive effect on labor supply of the program (often seen as an adverse outcome) is now judged to be a benefit
- to the extent that a well-targeted transfer allows poor families to keep the kids in school, rather than sending them to work.

# Workfare programs

- Work requirements create incentives to encourage participation only by the poor and reduce dependency on the program.
- Good record in screening the poor from non-poor, and providing effective insurance
- Design features are crucial, notably that the wage rate is not set too high.

**However, workfare programs have under-emphasized the value to the poor of assets created.**

- New class of workfare programs emphasize poor-area development recognizing potential efficiency gains
- Argentina's Trabajar Program is an example

# Poor-area programs

## **New economic geography of poverty points to longer-term gains**

- Evidence that a number of indicators of geographic capital have divergent impacts on consumption growth at the micro level.
- The relevant geographic variables include both private and public goods and services.
- Pervasive externalities: Composition of local economic activity has non-negligible impacts on consumption growth at the farm-household level. (Ravallion)
- Prospects for poor areas will depend on how well governments and communities overcome the tendency for under-investment that geographic externalities are likely to generate.

# Making markets work better also has a role

- Moving private capital into poorly endowed areas, and/or labor out of them, is likely to be poverty reducing in the aggregate.
- However, it is questionable that these policies are substitutes for public investment in poor areas,
  - which can be crucial to both attracting private capital
  - and to fostering out migration (better schooling, insurance and labor market information).