

# Reducing Poverty: The Role of Social Protection and Social Risk Management

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## 1. Introduction: Motivation, Issues, Structure<sup>1</sup>

As recently as 1990, social protection was a concept whose time, in the field of economic development and poverty reduction, had not yet come. The World Bank's World Development Report (WDR) for that year proposed a two-part strategy to address poverty: promoting labor-intensive growth through economic openness, and investing in infrastructure and access to basic social services (World Bank, 1990). Social safety nets were essentially an addendum, a provision of support after the fact in response to economic crisis and structural adjustment. The very concept of social protection was ignored, not to mention risk and vulnerability, their relationship to poverty, and ex-ante support measures to forestall or mitigate them.

Ten years later, a lot had changed, and social protection is back in the forefront of economic development and poverty reduction strategy making. The restatement of the International Development Goals (now Millennium Development Goals) by the international community during the Social Summit 2000 (Geneva 2000 or Copenhagen plus 5) and the refocus by international and bilateral organizations on poverty reduction in recent years give social protection, generally defined as public measures to provide income security for individuals, an important role in support of these objectives. In the WDR 2000/01 (World Bank, 2000b), social protection is a primary element in the new three-pronged approach, along with opportunity and empowerment. The conceptualization of social protection as "security" incorporates both individual (idiosyncratic) and macroeconomic (covariant) risks, and the proposed underlying social risk management approach has an explicit forward-looking agenda, moving from an ex-post poverty toward ex-ante vulnerability considerations. The WDR 2000/01 suggests that to deal effectively with the diverse risks faced by the population at large and the poor in particular, these should be confronted—where feasible and economically useful—in an ex-ante manner.

Several developments are responsible for this change in outlook. First of all, the Asian economic crisis of the end-1990s made policymakers aware that high economic growth rates, while necessary for lasting poverty reduction, are not sufficient, and that any

<sup>1</sup> The original draft profited from useful comments and suggestions by John Blomquist, Jeanine Braithwaite, Sudharshan Canagarajah, Margaret Grosh, and Gilette Hall (all World Bank) and from feedback and comments by the participants of the Poverty Forum. This revised version includes more recent information but does not constitute a full rewrite of the paper.

progress made in reducing poverty may be lost quickly when output declines and unemployment rises, if appropriate social policy measures are not in place (World Bank, 2000a). When such a large covariant (negative) economic shock as the Asian crisis occurs, informal safety net arrangements and coping strategies tend to break down or prove insufficient; public support schemes in developing countries, where they exist at all, are often insufficient or inappropriate, and it is difficult to establish such programs while the crisis is going on. The conclusion has emerged, most notably in a report prepared for the finance ministers of the Asian Pacific Economic Cooperation (APEC) forum by a group of international organizations (World Bank et al., 2001), that dealing with such a crisis requires an approach that assesses potential risks and prepares social protection measures, especially social safety nets, in advance, before a major shock hits.

Second, our increasing understanding of the dynamics of poverty and economic mobility has produced new commonalities across countries: most importantly, that some poor people are always poor—poor at all times—and others move in and out of poverty, with the latter group tending to be strikingly large. The reasons why the poor remain poor, or why some move out of poverty while others move into poverty, are beginning to be understood. Along with personal characteristics and endowments (or the lack thereof), there is increasing evidence that seemingly transitory shocks can have long-term consequences.<sup>2</sup> This finding suggests the need for an ex-ante view of poverty—vulnerability—and a thorough investigation of the best social protection/social risk management instruments for dealing with it.

Finally, globalization has produced increased risks that need to be dealt with. Recent trends in the evolution of trade, technology, and political systems have made possible great potential improvements in welfare around the world. Globalization of trade in goods, services, and factors of production has the world community poised to reap the fruits of global comparative advantage. Technology is helping to speed innovation, and holds the potential to remove the major constraints to development for many people. Political systems are increasingly open, setting the stage for improved governance by holding those in power accountable to larger segments of the population. Taken together, these changes create a unique opportunity for unprecedented social and economic development, poverty reduction, and growth.

The same processes that allow for welfare improvements, however, also increase the variability of the outcomes for society as a whole, and even more so for specific groups. There is no certainty that improvements will be widely shared among individuals, households, ethnic groups, communities, and countries. Expanded trade or better technology can sharpen the differences between the “haves” and “have-nots,” just as it can increase the opportunities for all, depending on the prevailing social context and policy measures. Globalization-induced income variability combined with marginalization and social exclusion can, in fact, increase the vulnerability of major groups in the population. In other words, the risks are as large as the potential rewards. To further complicate matters, the trend toward globalization and the higher mobility of production factors reduce the ability of governments to raise revenues and pursue independent economic policies and, thus, to have national policies to help the poor when they are needed most.

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<sup>2</sup> For a collection of recent papers on these issues, see the special 2000 issue by *The Journal of Development Studies* on “Economic Mobility and Poverty Dynamics in Developing Countries,” edited by Baulch and Hoddinott (Baulch and Hoddinott, 2000).

These developments call for a new approach to social protection: one that moves from ex-post poverty reduction to ex-ante vulnerability considerations, that focuses less on the symptoms of poverty and more on its causes and risks. Such an approach also takes account of grim reality: in a world of 6 billion people, less than one quarter have access to formal social protection programs of any kind, and less than 5 percent can rely on their own assets to manage risk. Meanwhile, public transfers to eliminate poverty are beyond the fiscal capacity of most developing countries.

This new approach is embodied in the new conceptual framework known as social risk management (SRM) (Holzmann and Jorgensen, 1999, 2000). It is based on two perceptions:

- The poor are the ones most exposed to diverse risks: natural risks, such as earthquakes and floods; manmade risks, such as war and inflation; health risks, such as illness; and political risks, such as discrimination.
- The poor are the ones least able to deal with such risks, with the least access to instruments such as market based insurance or government-provided income support.

Consequently, the poor are the most vulnerable in society; shocks are likely to have the strongest welfare consequences for them, therefore SRM measure should be designed to protect them most of all. Further, highly vulnerable people, such as the poor, tend to be risk averse and unable or unwilling to engage in activities that might entail higher risks but could produce higher returns. SRM instruments that reduced their vulnerability could make the poor able and willing to take risks, thus gaining the opportunity to move out of poverty.

The new SRM framework is the basis of the security chapters of WDR 2000/01, the World Bank's Social Protection Sector Strategy Paper (SPSSP) (World Bank, 2001) and six regional Sector Strategy Papers; has inspired the approaches by other multilateral institutions, such as the Inter-American Development Bank (IADB) and the Asian Development Bank (ADB); and finds increasing resonance with bilateral aid provider institutions, such as Britain's Department for International Development (DFID) and Germany's Agency for Technical Cooperation (GTZ).<sup>3</sup> While the basic thrust of SRM and the main strategic conclusions of SPSSP are getting increasing support, they present only the beginning of a journey. In order to make the new framework and its strategic conclusions effective for lasting poverty reduction, much more needs to be done at both the conceptual and operational levels. Examples include an operational definition of vulnerability, piloting of risk assessments, and effective social sector expenditure reviews.

To this end, the structure of the remainder of the paper is as follows: Section 2 highlights the central elements of SRM, while Section 3 outlines the main strategic conclusions for social protection. Sections 4 to 7 describe the main conceptual issues and suggested next steps toward implementation, including the need for an operational definition of the vulnerability concept (Section 4), the use of risk assessments as an entry point for a new policy dialogue with governments (Section 5), lessons from economic crisis management and what we have learned for social protection (Section 6), and social

<sup>3</sup> See, for example, ADB (2000), Conway, De Haan, and Norton (2000), DFID-OED (2000), and Lustig (2000).

sector expenditure reviews as means to enhance the effectiveness of public interventions (Section 7). Section 8 presents concluding remarks.

## 2. Social Risk Management: A Dynamic Conceptual Framework for Social Protection<sup>4</sup>

The main elements of the new framework are derived from introducing the notion of asymmetric information in a world of diverse risks in a more explicit way than has been done generally. Compared to an ideal world (à la Arrow-Debreu), this has several important consequences for managing risks:

- The sources and the forms of risk matter, e.g., whether a particular risk is idiosyncratic or covariant. For the former, more reliance can be given to informal or market-based risk management instruments; for the latter, more government involvement tends to be required.
- Since risk is not necessarily exogenous, there are many more strategies to deal with risks than simple insurance, including risk reduction, risk mitigation, and risk coping strategies.
- As private insurance markets tend not to emerge or to break down in view of asymmetric information, there are three main institutional arrangements for dealing with risk: informal, market-based, and publicly provided mechanisms.
- There are multiple suppliers of risk management instruments, including individuals, households, communities, nongovernment organizations (NGOs), market institutions, governments, international organizations, and the world community at large; and distinct demanders, such as the formal urban, the informal urban, the formal rural, and the informal rural worker.
- We must bear in mind the interrelationship between social risk management, social protection, social inclusion, and redistribution.

### a. Social Risk Management Beyond Social Protection

There are many areas of public policy impacting vulnerability and income variability that are clearly outside social protection, such as macroeconomic stability, preventive measures against natural disasters, and infrastructure investment (for example, roads and water supply). Against the background of the social risk management objectives, this suggests an advocacy and analytical role for social protection (see Section 3).

### b. Social Protection and Income Redistribution

Income redistribution figures importantly in SRM and social protection activities, but it is not necessarily the primary goal. In the SRM framework, income distribution enters as an equity objective linked to adverse risk and emerges as an important outcome of good social protection programs at different levels. The support of the critically poor is a main objective of social protection. Since financing cash or in-kind transfers requires taxes on workers or the nonworking wealthy, income redistribution appears as a result. Also, enhancing risk management capacity has high redistributive effects on individuals' welfare, yet does not require interpersonal income redistribution to achieve a more

<sup>4</sup> This and the next section draw on the World Bank SPSSP (World Bank, 2001) and can present only the bare bones of framework and strategic conclusions. For a more comprehensive and analytic presentation of the SRM framework, see Holzmann and Jorgensen (2000).

equal welfare distribution (Holzmann, 1990). On the other hand, not all redistribution is social protection: for example, redistributive efforts accomplished through a tax-transfer mechanism or through the distributive effects of public goods provision lie outside social protection.

### **c. Social Protection Beyond Social Risk Management and Redistribution: Social Inclusion**

Even in a minimalist sense, social inclusion, cohesion, solidarity, and stability are the result of well-designed and well-implemented SRM interventions. For example, a well-designed income support system for the unemployed not only enhances individual welfare by reducing vulnerability, but also achieves social stability as a result. And social assistance measures that increase access to basic health care and education for the poor give parents and their children a better chance of becoming integrated members of society. A more demanding request is that social protection should go well beyond mere financial and income-oriented considerations and adopt proactive policies designed to influence the social structure of an economy. This approach would include investments in the sociocultural infrastructure by supporting informal arrangements and upgrading the nonprofit sector, and it would also strengthen the “social rights approach” of social policy. Finally, it would adopt an extended view of instruments and institutions to be used for social risk management, including the broad concept of “social capital” (Badelt, 1999).

### **d. Sources of Risks and Their Characteristics**

The capacity of individuals, households and communities to handle risk and the appropriate risk management instrument to be applied depend on the characteristics of risks: their sources, correlation, frequency, and intensity. The sources of risk may be natural (for example, floods) or the result of human activity (for example, inflation resulting from economic policy); risks can be uncorrelated (idiosyncratic) or correlated among individuals (covariant) over time (repeated) or with other risks (bunched); and they can have low frequency but severe welfare effects (catastrophic) or high frequency but low welfare effects (noncatastrophic). The main sources of risk and the degree of covariance can range from purely idiosyncratic (micro, or individually specific), to regionally covariant (meso), to nationwide covariant (macro) events.

While informal or market-based risk management instruments can often handle idiosyncratic risks, they tend to break down when facing highly covariant, macro-type risks. To take Africa as an example, the main sources of covariant risks that affect poor people are HIV/AIDS, wars and conflict, seasonal volatility in prices, drought, and macroeconomic shocks. Idiosyncratic risks include illness and widowhood or the breakup of the family. Since many of the risks faced by poor people are covariant in nature, informal management mechanisms at the family or community level are typically not very effective. Among these risks, at least two are induced by human activity (war and macroeconomic shocks), which need no ex-post coping mechanism if they can be prevented from happening in the first place. Access to market-based interventions, such as savings or insurance programs, can mitigate some of the risks (seasonal price volatility or illness). This suggests that different strategies and interventions are appropriate depending on the nature of the risks involved.

## **e. Social Risk Management Arrangements**

Over time, different kinds of social risk management arrangements have evolved. These fall into three main categories: informal arrangements, market-based arrangements, and public arrangements on a large scale. Each of them has relative strengths and limitations.

### **i. Informal Arrangements**

These arrangements have existed since the dawn of mankind and still constitute the main source of risk management for the majority of the world's population. In the absence of market institutions and public provision of support, individual households respond to risk and protect themselves through informal (family or community) or personal arrangements (self-protection and self-insurance). Although they sidestep most of the information and coordination problems that cause market failure, they may not be very effective in helping the household weather adverse events. Examples of this kind of arrangement include: the buying and selling of real assets (such as cattle, real estate, and gold), informal borrowing and lending, crop and field diversification, the use of safer production technologies (such as growing less risky crops), storing goods for future consumption, mutual community support arrangements, and kinship arrangements through marriage.

### **ii. Market-based Arrangements**

Individual households will also take advantage of market-based institutions, such as money, banks, and insurance companies when they are available. However, in view of these instruments' limitations due to market failure, their usage will be initially restricted but will rise with financial market development. Empirical evidence suggests that the establishment of a sound banking system and noninflationary policy serves to reduce risk. Because formal market institutions are reluctant to lend to households without secured earnings, microfinance is also an important instrument of social risk management

### **iii. Public Arrangements**

Public Arrangements for dealing with risk came into being with the development of the modern welfare state, but are relatively scarce and have very limited coverage in the developing world, for fiscal and other reasons. When informal or market-based risk management arrangements do not exist, break down, or are dysfunctional, the government can provide or mandate (social) insurance programs for risks such as unemployment, old age, work injury, disability, widowhood, and illness. Mandatory participation in a risk pool can circumvent issues of adverse selection, in which individuals with low risk profiles avoid participation in insurance pools due to premiums while individuals with high risk profiles join in order to gain access to payouts. Since these programs typically apply to those in formal employment, their coverage in developing countries is generally low. On the other hand, governments have a whole array of instruments to help households cope after a shock hits, such as social assistance, subsidies to basic goods and services, and public works programs. Which of these measures a government chooses to implement depends on its distributive concerns, its fiscal resources, its administrative capacities, and the type of risk involved.

## **f. Social Risk Management Strategies**

Risk management can take place at different moments, both before and after the risk occurs. The goal of ex-ante measures is to prevent the risk from occurring, or, if this

cannot be done, to mitigate the effects of the risk. Individual efforts, such as migration, can prevent risks, but, in many cases, this requires support from government (for example, disaster prevention). Mitigating the effects of risk through risk pooling by definition requires people to interact with other individuals, and poor people are typically less able to participate in either formal or informal arrangements. This leaves most poor households with the residual option of coping with the risk once it has occurred. They are normally poorly prepared to do this and, therefore, often experience irreversible negative effects.

### **i. Prevention Strategies**

These are strategies that are implemented before a risk event occurs. Reducing the probability of an adverse risk increases people's expected income and reduces income variance, and both of these effects increase welfare. There are many possible strategies for preventing or reducing the occurrence of risks, many of which fall outside social protection, such as sound macroeconomic policies, disaster prevention strategies, public health investments, environmental policies, and investments in education. Preventive social protection interventions typically form part of measures designed to reduce risks in the labor market, notably the risk of unemployment, underemployment, or low wages due to inappropriate skills or malfunctioning labor markets.

### **ii. Mitigation Strategies**

As with prevention strategies, mitigation strategies aim to address the risk before it occurs. Whereas preventive strategies reduce the probability of the risk occurring, mitigation strategies help individuals to reduce the impact of a future risk event through pooling over assets, individuals and over time. For example, a household might invest in a variety of different assets that yield returns at different times (for example, two kinds of crops that can be harvested in different seasons), which would reduce the variability of the household's income flow. Another mitigation strategy is for households that face largely uncorrelated risks to pool them through formal and informal insurance mechanisms. While formal insurance profits from a large pool of participants, which results in less correlated risks, informal insurance has the advantage that all the participants have access to more or less the same amount of information.

### **iii. Coping Strategies**

These are strategies designed to relieve the impact of the risk once it has occurred. The main forms of coping consist of individual dissaving, borrowing, or relying on public or private transfers. The government has an important role to play in helping people to cope, for example, when individuals or households have not saved enough to handle repeated or catastrophic risks. Such people may have been poor during their entire lifetime and, thus, may have had no possibility of accumulating assets; the smallest income loss would make them destitute and virtually unable to recover.

### **g. The Social Risk Management Matrix**

The SRM matrix in Table 1 combines arrangements and strategies in various ways that can be refined and adjusted depending on country circumstances and the issue being investigated. The matrix's three-by-three structure highlights the multidimensional character of risk management and the need to select appropriate strategies based on

opportunity costs and comparative advantage. Filling in each cell of the matrix with existing instruments provides a means of examining the SRM status in a given country or a certain group within a country; comparing countries makes it possible to assess differences among them and to determine appropriate and useful changes (Table 1).

While each cell of the matrix can be filled in in most countries, and even more so in regions, since all risk management instruments are likely to be used at any moment in time, the intensity and the scope of application are likely to differ and to change over time. The poorest countries will be characterized by a predominance of informal arrangements and public arrangements concentrated on coping strategies. In contrast, richer countries will apply the whole set of public arrangements and strategies, and market-based instruments and strategies geared toward risk mitigation and reduction will grow in importance.

**Table 1. Strategies and Arrangements of Social Risk Management—Examples**

| Arrangements/<br>Strategies | Informal  | Market-based  | Public   |
|-----------------------------|---|---|--|
| <b>Risk Reduction</b>       |   |   |  |
|                             | <ul style="list-style-type: none"> <li>• Less risky production</li> <li>• Migration</li> <li>• Proper feeding and weaning practices</li> <li>• Engaging in hygiene and other disease-preventing activities</li> </ul>               | <ul style="list-style-type: none"> <li>• In-service training</li> <li>• Financial market literacy</li> <li>• Company-based and market-driving labor standards</li> </ul>              | <ul style="list-style-type: none"> <li>• Labor standards</li> <li>• Pre-service training</li> <li>• Labor market policies</li> <li>• Child labor reduction interventions</li> <li>• Disability policies</li> <li>• Good macroeconomic policies</li> <li>• Prevention of HIV/AIDS and other diseases</li> </ul> |
| <b>Risk Mitigation</b>      |   |   |  |
| Portfolio                   | <ul style="list-style-type: none"> <li>• Multiple jobs</li> <li>• Investment in human, physical, and real assets</li> <li>• Investment in social capital (rituals, reciprocal gift-giving)</li> </ul>                               | <ul style="list-style-type: none"> <li>• Investment in multiple financial assets</li> <li>• Microfinance</li> </ul>   | <ul style="list-style-type: none"> <li>• Multipillar pension systems</li> <li>• Asset transfers</li> <li>• Protection of property rights (especially for women)</li> <li>• Support for extending financial markets to the poor</li> </ul>  |
| Insurance                   | <ul style="list-style-type: none"> <li>• Marriage/family</li> <li>• Community arrangements</li> <li>• Share tenancy</li> <li>• Tied labor</li> </ul>  | <ul style="list-style-type: none"> <li>• Old-age annuities</li> <li>• Disability, accident, and other personal insurance</li> <li>• Crop, fire, and other damage insurance</li> </ul> | <ul style="list-style-type: none"> <li>• Mandated/provided insurance for unemployment, old age, disability, survivorship, illness, etc.</li> </ul>   |
| <b>Risk Coping</b>          |   |   |  |
|                             | <ul style="list-style-type: none"> <li>• Selling of real assets</li> <li>• Borrowing from neighbors</li> <li>• Intracommunity transfer/charity</li> <li>• Sending children to work</li> <li>• Dissaving in human capital</li> </ul> | <ul style="list-style-type: none"> <li>• Selling of financial assets</li> <li>• Borrowing from banks</li> </ul>   | <ul style="list-style-type: none"> <li>• Transfers/Social assistance</li> <li>• Subsidies</li> <li>• Public works</li> </ul>   |

Source: World Bank (2001).

### 3. Social Protection as Social Risk Management: Main strategic conclusions

Viewing social protection within the SRM framework has many strategic implications for addressing poverty in both developing and developed countries. Some seem obvious, others perhaps counterintuitive, and many will need empirical testing through pilots in real country environments to prove their usefulness. This section will highlight some of the main strategic conclusions from the World Bank's SPSSP, subject to further discussion, extension and improvement.

#### a. Social Protection as a Theme

Against the background of the SRM framework, social protection emerges as a theme of socioeconomic development and poverty reduction, such as gender. The reason for this is that the SRM framework applies to many areas outside the social protection sector. These include national shocks (resulting from macroeconomic policy, disasters, or civil strife), the financial sector and microfinance, rural development, the informal sector, infrastructure investments, health, population, and nutrition. If appropriate policies are in place in these areas, then households are much less vulnerable and can smooth much of their consumption with personal instruments. This means that there is a need to build greater awareness of the importance of risk reduction for development. Furthermore, SRM can be used as an analytical tool to assess interventions in the various sectors. Two examples illustrate the advocacy and analytical role that SRM can and should play in selected areas outside the traditional remit of social protection:

#### i. Economic Crises, Natural Disasters, and Civil Conflicts

Economic crises, natural disasters, and civil conflicts are the three most important causes of aggregate shocks and sharp increases in the incidence of poverty (World Bank, 2001: Ch. 9). Between 1990 and 1997, more than 80 percent of all developing countries experienced at least one year of negative per capita output growth as a result of one of these phenomena. Macroeconomic crises cause poverty to increase, which affects not only current living standards but also the ability of the new poor to rise out of poverty, as has recently been evident in Latin America, Asia, and Russia. Natural disasters repeatedly interrupt advances in economic development, cause sharp increases in poverty in the affected areas, and slow the pace of human development. Civil conflict has a similar effect on development and poverty in general, but it represents both a source and consequence of low economic performance. Given these circumstances, the following observations and recommendations are appropriate:

- Since many of these aggregate shocks are manmade, following from inappropriate macroeconomic policy or political conflict, governments must be encouraged to adopt preventive policies and made aware of the disastrous effects that inappropriate policies have had on economic development in general and on poor people in particular.
- Truly exogenous shocks such as natural disasters also lend themselves to preventive policies, such as the construction of earthquake-proof housing or dams or the relocation of people—often poor people—to areas that are less likely to be affected. While costly (and often beyond the capacity of poor countries), these measures may prove to be cost effective from a long-term present value consideration.
- The covariant nature of aggregate shocks means that informal or market-based risk management instruments are often ineffective. Not always, however. For

example, insurance against natural risks can still function if appropriately structured and priced, and international diversification of assets and fiscal stabilization funds can smooth national consumption in an effective manner. The use of international insurance against natural risks is not yet well developed, but should be encouraged, since it has the potential to benefit the poor.

## ii. Infrastructure Investments

Infrastructure investments, such as the construction of a road, an irrigation system, or a dam, have an important bearing on the development of an economy and on what opportunities are available to the poor. In the past, the central and often only criterion for such an investment has been the estimated rate of return. However, many investments lead to a reduction in vulnerability over the long run. For example, the construction of a road between an isolated village and a market town reduces the vulnerability of the village community by making it easier for people to trade their goods, migrate, and access financial market institutions and their instruments.<sup>5</sup> Similarly, irrigation projects are a useful investment for reducing high output risk in agriculture when rainfall is unpredictable. The construction of a dam can be the key instrument for preventing flooding in agricultural and residential areas. These risk reduction or mitigation effects of infrastructure are normally not taken into account in assessing the costs and benefits of a potential investment, and the data and analytical toolkits that are necessary to assess the vulnerability effects do not yet exist.

### b. Balancing Informal, Market-based, and Government-provided Arrangements

None of these arrangements is preferred in all situations, and all of them typically coexist. While the importance of risk management for economic development is increasingly understood in the development community, there is still insufficient knowledge about which arrangements and instruments best support the development process. The most contentious questions relate to, first the role of governments in risk management and, second, which public interventions strengthen informal and market-based arrangements.

In any given country, whether and which public interventions are appropriate should be guided by the strengths, costs, gaps, and constraints of the existing informal and market-based arrangements. This implies that public interventions are important in those areas where informal and market-based arrangements (i) do not function properly because of the severity and scope of a particular risk, (ii) reinforce inequities, (iii) are lacking or dysfunctional, and (iv) can benefit from public action.

While knowledge about governments' capacity to strengthen informal arrangements is limited, ample knowledge exists about public actions that strengthen market-based arrangements. Even with this limited knowledge, it is possible to come to the following conclusions:

- The family in its diverse forms remains the core institution for handling risks, and its capacity to do so will increase as more and better market-based instruments emerge.

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<sup>5</sup> The importance of feeder roads for the reduction in vulnerability has been recently confirmed in a study on rural Kenya; see Christiaensen and Kalanidhi (2002).

- Various informal arrangements are effective in managing risk, but may be detrimental to long-term development goals.
- A strong role for risk management instruments can be provided by communities and nongovernment organizations.
- Market-based arrangements, such as sound saving instruments, are crucial for handling a wide range of risks at the personal level and can contribute significantly to reducing poverty.

### **c. Balancing Coping, Mitigation, and Risk Reduction Strategies**

At face value, the best social risk management would be to make sure that (downside) risks never occur. The next most effective action is risk mitigation, as this reduces the negative effects of risks before they actually happen. Risk coping is essentially the residual strategy if everything else has failed. However, since each of these strategies has both direct monetary and indirect opportunity costs, relying entirely on risk reduction or mitigation may not be either efficient or feasible. The experience of the formerly centrally planned economies has demonstrated that trying to eliminate all risks in advance through quantity planning, official price setting, and public ownership of productive means has serious costs in terms of lower economic growth.

At the other extreme, many of the current government interventions in developing countries, particularly for the poor, concentrate on risk coping. To increase the effectiveness of risk management strategies, these countries should pay more attention to risk mitigation and reduction. The accumulation of assets (such as land, cattle, and financial savings) and the adoption of policies that discourage disinvestment (such as cutting down trees) are of the utmost importance. This does not mean that government should forget about social safety nets, since they are clearly necessary, particularly during periods of natural disaster or economic crisis. Rather, government should introduce programs that support coping while also reducing risk (for instance, by subsidizing education).

Concentrating only on helping poor people to deal with a shock once it has occurred runs the risk of reinforcing a poverty trap and perpetuating the vicious cycle of low returns, low risk-taking, and deep poverty. Balancing coping strategies with reduction and mitigation strategies has the potential to trigger a virtuous cycle in which people can undertake activities with higher variability in returns but also with higher absolute returns.

### **d. Revisiting Social Protection as a Sector**

The risk management framework poses the challenges of rethinking the role of existing public sector programs and expanding the range of interventions to include informal and market-based activities. The framework provides a starting point to understand individual programs and their interaction in helping people manage risk, and extends the sector to include areas of informal and market-based arrangements in which it often has little experience.

Reassessment of risk reduction measures involved in publicly provided social protection should involve

- Assisting governments to make labor markets more equitable and inclusive: this will include a review of labor market regulations and a pragmatic and country-based approach to addressing public labor standards, while distinguishing support for market-based and voluntary standards.

- Enhancing pre- and in-service skills building: this will entail reorienting supported policies to reflect the increased importance of market-driven training and the shift from skills to knowledge.
- Eliminating harmful child labor: removing children from school is a common coping mechanism for poor households, but it endangers the long-term potential of the children. Some uses of child labor are so clearly harmful that a major global effort should focus on their eradication.

The new strategic directions for risk mitigation should include<sup>6</sup>

- Improving old age income security: the multipillar pension system has emerged as a widely recognized benchmark for formal sector pension reform, but reform experience also indicates that coverage is and will remain a major issue of concern in developing countries. This calls for stronger emphasis to ensure provision of retirement benefits for the informal sector and lifetime poor (Holzmann and Stiglitz, 2001).
- Providing appropriate unemployment benefits: many developing countries are rightly questioning the standard insurance approach to unemployment mitigation. This calls for a careful assessment of the experience of alternative instruments, including public works programs (for informal sector workers) and individual unemployment savings accounts (for formal sector workers).

Revisiting risk coping mainly involves safety nets. Promising avenues include interventions that help the poor cope while reducing or mitigating future risks (for example, transfers linked to keeping children in school). Some key strategic questions:

- What is the appropriate balance in supporting different types of safety net programs? The key interventions include transfers in cash or kind, subsidies, and public works. Since each has drawbacks and advantages, more information, more systematically collected and analyzed, on program experience is needed to provide the best possible advice to countries.
- How much is enough? While the global financial crisis has emphasized the need for coping programs, care must be taken that they remain appropriately sized and do not hamper other forms of risk management. Such issues must enter the dialogue of development banks with the International Monetary Fund (IMF) in crisis situations.
- How can coping assistance help with risk mitigation and reduction? From the perspective of the SRM framework, this relates to how assistance can be provided in a way that not only increases current levels of consumption for poor people, but also enables them to better manage risk and climb out of poverty.

The social protection sector has had little experience to date in supporting informal risk management, yet work can and should be started on several fronts, including

- Refining the role of social funds: considering their increased emphasis on community-driven development, social funds should (i) expand the menu of eligible projects, (ii) target vulnerability in addition to poverty, and (iii) strengthen support for software aspects that will enhance the flow of services from installed infrastructure.

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<sup>6</sup> Current work at the World Bank includes a review of noncontributory pension schemes and a review of alternative income support systems for the unemployed.

- Encouraging legal reform to protect poor people's (and especially poor women's) property rights to assets, which includes the revision of inheritance laws.
- Supporting community-based coping related to orphans and HIV/AIDS victims, beginning in the parts of sub-Saharan Africa where the traditional coping mechanisms have been put under an unbearable strain.

International institutions, including the World Bank and ADB, have extensive experience in supporting market-based reforms, and the challenge will be to incorporate risk management aspects into these reforms without distorting fiscal and financial sustainability. Two potentially promising areas stand out:

- Developing microfinance within social protection programs: recent trends in microfinance (toward instruments such as microsavings and microinsurance) and the combination of community-based and market-based arrangements (reinsurance) should help develop new models that may meet both financial and social sustainability criteria.
- Building financial literacy: safe financial assets are the key to poor people's ability to mitigate risk, and there is a potential role for social protection interventions in bridging the gap between formal financial sector reforms and traditional social protection programs, for example, through the promotion of financial sector literacy.

#### **4. Vulnerability: A Concept In Need of Definition and Operationalization**

A main objective of the new framework for social protection is to move from an ex-post toward an ex-ante approach in poverty reduction. The task for government in such a forward-looking approach is to undertake or facilitate risk management that reduces the potential for poverty-related welfare losses before they actually happen. This concern about expected welfare losses is frequently linked with the notion of vulnerability and the unstable nature of poverty, i.e., movements in and out of poverty by individuals and the changing welfare position of poor people due to shocks. This section highlights some key empirical features of poverty dynamics and asks how these characteristics can best be translated into an operational definition of vulnerability.

##### **a. Poverty Dynamics and Income Mobility**

The analysis of poverty dynamics and economic mobility has three dimensions (Baulch and Hoddinott, 2000). The first dimension is the metric, the way welfare is measured (such as by income, consumption, expenditure, or assets). The second is temporal, the time frame over which the metric is assessed. Here, the most important distinction is between cross-section and longitudinal data (following households or individuals over time). The third dimension involves the method used to summarize these measures over time. While there is a rich literature about measuring poverty in a static and ex-post manner, the literature on the temporal component is thin.

To assess the poverty dynamics in the short run, the approach used in a growing but still small number of panel studies in developing countries consists in estimating the percentage of households that are always poor (i.e., poor in any period of time), sometimes poor (i.e., not poor in at least one period) and never poor (i.e., not poor in any of the periods). This categorization is typically done using the metric of income or consumption and a standard poverty line. Comparing 13 panel studies for developing

countries in Latin America, Africa, Asia, and Russia, Baulch and Hoddinot (2000: Table 1) confirm the assessment of still other studies that the percentage of households that are sometimes poor is surprisingly large. It ranges from 20 to 66 percent, with most countries exhibiting shares of transient poverty between 30 to 50 percent. This contrasts with the share of households that are always poor and that range for most of the investigated countries between 10 and 25 percent. While measurement errors may substantially inflate the estimates of total and transient poverty, studies that explicitly correct for measurement error still find significant shares of transient poor. These findings suggest that an ex-post focus on poverty is likely to concentrate on many individuals who will not be poor in the next period, while neglecting those that are not poor now but will be poor in the next period.

A similar picture emerges when panel data is used to estimate changes in the relative welfare position of individuals. Comparing eight transition matrices, Baulch and Hoddinot (2000: Table 4) suggest that less than half of the households remain on the diagonal, that is, maintain their relative welfare position over time, while some 30 to 40 percent move by one quintile, and another 15 to 20 percent move two or more quintiles. Again, these results suggest that significant individual income and expenditure variation occurs over relatively short time periods, underscoring the potential vulnerability of many people.

While the recognition of a strikingly large number of transient poor is receiving increasing empirical support, what is behind these dynamics is still not fully understood. The current wisdom is that poverty reflects a combination of low endowments, low returns to these endowments, and vulnerability to shocks, and that these factors are closely interrelated. A further conjecture is that temporary shocks may have long-term effects on the ability of the vulnerable to escape poverty permanently, and that these consequences are transmitted intergenerationally. Empirical validation of this conjecture would further strengthen the case for ex-ante policies to prevent or mitigate such events.

### **b. Defining Vulnerability**

The preceding discussion suggests that an appropriately defined concept of vulnerability would be useful in the analysis and design of ex-ante social protection policies. A tractable definition would, first, allow empirically meaningful measurement of vulnerability, both statically and over time, at individual and group levels; and, second, permit an assessment of the impact of SRM instruments on vulnerability. While important work is ongoing inside and outside the World Bank, no such agreed-upon definition yet exists.<sup>7</sup>

Reviewing the notions of vulnerability used in the literature reveals many different concepts, depending on the specific application, whether in economics, sustainable livelihood, food security, sociology/anthropology, disaster management, the environment, or the health/nutrition literature (see Alwang, Siegal, and Jorgensen, [2001]). The main tension seems to be between conceptual and empirical strength. No concept employed so far seems to have both.

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<sup>7</sup> Currently available economic approaches for definition and measurement include Alwang, Siegal, and Jorgensen (2001), Pritchett, Suryahadi, and Sumarto (2000), and Jalan and Ravallion (2000). To investigate alternative definitions, the World Bank organized various seminars and workshops, most recently in September 2002, together with the International Food Policy Research Institute in Washington, D.C. For the papers, see IFPRI (2002).

In its simplest form, vulnerability for an individual or household can be measured as the probability that expected future consumption falls below some minimum level. For a household at time  $t$ , let  $c_{ht}$  denote per-capita consumption expenditure and let  $\underline{c}$  denote the poverty line. Then, vulnerability,  $v_{ht}$ , is the probability that the expected per-capita consumption is below the selected poverty line, with an arbitrarily chosen probability threshold  $\Pr$  (of, say, 0, 25, or 50 percent).

$$v_{ht} = \Pr(c_{ht} + 1 \text{ } \underline{c})^3 \Pr \quad (1)$$

To make this definition operational, we need to assume a particular income-generating process for household consumption. This requires us to think a bit about the determinants of household consumption. A household's consumption in any period will depend on a number of factors, including its assets, its current income, and its expected future income (i.e., permanent income). In cases of liquidity constraints or low permanent income, access to risk management instruments will importantly affect future consumption levels and their volatility. Each of these variables will depend on a variety of household characteristics, those that are observable and some that are not observable, as well as a number of features of the aggregate macroeconomic environment. This suggests the following reduced form of consumption:

$$C_{ht} = c(X_h, I_h, b_t, a_h, e_{ht}) \quad (2)$$

where  $X_h$  represents a bundle of observable household characteristics;  $I_h$  is the set of observable, available risk management instruments;  $b_t$  is a vector of parameters describing the state of the economy at time  $t$ , where  $b_t$  evolves according to some stochastic process; and  $a_h$  and  $e_{ht}$  represent, respectively, an unobserved time-invariant household level effect, and any idiosyncratic factors (shocks) to households that are otherwise observationally equivalent. Based on this simple model, heterogeneity across households and a distinction between the cross-section and intertemporal dimensions of vulnerability can be introduced and models for empirical implementation can be derived (see Chaudhuri [2000]).

Such a measurable definition of vulnerability will hopefully provide insights into how different household characteristics, macroeconomic aggregates, and risk management instruments influence vulnerability. Results from the latter may help to assess their relative effectiveness and, perhaps, efficiency.

Yet in order to examine fully the interaction between risk management instruments, household characteristics, and macroeconomic aggregates, and to gain a better understanding about the underlying choice of risk management instruments, it will be necessary to have a more explicit model of SRM and vulnerability. This is still missing. One promising approach would be to determine a model in which individuals or households have the possibility to reduce their vulnerability through access to and application of a given set of risk management instruments, with opportunity costs determining the choice of strategies and arrangements. In such a model, it is the interaction between risk exposure and risk instruments that creates vulnerability (defined as hazard, or the expected damage or loss). Risk exposure is the result of the interaction between risk and characteristics, of which some are exogenous (such as gender), while some are endogenous and can be changed by individuals as a preventive action (such as changing location through migration). The government can enhance the set of risk management instruments against existing resource constraints, opportunity cost

considerations, and trade-offs with other policy objectives. The trade-offs for individuals between the choice of different risk management instruments can, for example, be specified in a simple model as proposed by Gill and Ilahi (2000), based on Ehrlich and Becker (1972).

## **5. Risk and Vulnerability Assessments: A New Entry Point For Analysis and Policy Dialogue**

The view that risks, both their sources and forms, matter for poverty, and that the way out of poverty crucially depends on the availability of appropriate risk management instruments, has important implications. It implies that a necessary starting point is a thorough risk assessment that details, measures, and assesses the crucial risks to which the population at large and the poor in particular are exposed. A second stage involves an assessment of the available instruments to address these risks and identification of gaps in existing instruments. Finally, a plan has to be elaborated that defines the priority and the sequence of actions to close the risk-instrument gap. Such a systematic approach may not only be more effective for poverty reduction, but also more palatable for national governments and the conduct of a policy dialogue with international organizations and bilateral aid providers. This section summarizes current risk assessment efforts in Latin America, and outlines next steps.

### **a. Dimensions of Risk Assessment**

There are two main dimensions for risk assessment: top-down and bottom-up. The top-down approach takes a macro view of the main risks to which a country or region is subject, and includes macroeconomic risks (such as inflation, volatility of GDP, and terms of trade shocks), natural risks (such as earthquake, flooding, or drought), major health risks (such as HIV/AIDs and other communicable diseases leading to large covariant shocks), and security risks (such as war and civil strife). Data for these risks are largely available from national and international databases and the macro-risk profile of a country can be established from a desk operation. The regional social protection sector strategy papers by the World Bank that were developed in parallel to the overall strategy paper include a first approach in this direction (World Bank, 1999a and b, 2000c–f).

Based on these macro-risk profiles of a country, a number of studies can be undertaken to investigate the poverty effects and implications of these risks, and to outline policy actions, many of which will fall outside social protection as a sector.

At the regional level, a study was undertaken to investigate the opportunities and risks in a globalized Latin America and the Caribbean (LAC) (De Ferranti et al., 2000). The study asks whether globalization has increased the macroeconomic risks for the region and how the realized macroeconomic risks in the 1980s and 1990s have impacted the poor. It concludes that while the macroeconomic volatility in LAC is high (at least higher than in industrialized countries), it has not risen in the 1990s; in various countries it has even fallen below that experienced in the 1970s. But as documented by surveys, the perception of insecurity has increased and with it the demand for risk management instruments by workers (most importantly for unemployment income support). To deal with existing risks *ex ante*, it suggests a number of policies, including macroeconomic diversification and liquidity

management and anticyclical budgetary policies. With regard to the impact of crises on the poor, the results based on household panel data for Argentina, Brazil, El Salvador, and Mexico are rather differentiated (De Ferranti et al., 2000: 8, 9):

- Economic contractions differ substantially in their economic effects on poverty and human capital investment. In deep recessions, the poor suffer greater proportional losses in income than the wealthy. In moderate recessions, the opposite appears to happen: in many cases, the greatest proportional income losses are borne by the rich, while groups such as the elderly and single mothers do not appear to be especially badly affected. This finding is not true in every crisis and every setting. For example, conclusions vary by country, and within some countries between rural and urban areas.
- The poor seem to have gained more during growth periods than is generally acknowledged. This does not mean that the poor should not be helped, it merely implies that from the perspective of poverty alleviation, growth policies must be given priority, regardless of concerns about high inequality in the region.
- The poor, like those with more wealth, are reluctant to permanently compromise their family's future during economic crises that are perceived as temporary. This is especially true for parental decisions about children. The poor do not, for example, frequently pull their children out of school during bad times, although they do when the recession is perceived as severe.
- Finally, and unsurprisingly, access to reserves, such as assets and underused family labor, reduces the vulnerability of households to shocks, in the sense of having to adjust through reduced consumption or critical investments such as schooling and health. Assets may be the key factor in households' weathering large versus moderate contractions. In brief or mild contractions, even the limited assets of the poor can help them weather the crisis; in more severe or recurring crises, the poor may eventually exhaust their assets and be forced to suffer drastic declines in their well-being, with adverse long-term effects.

A bottom-up approach to risk and vulnerability assessment asks the poor what they perceive as the most threatening risks for their livelihood. Their assessment may be different from a (distant) government perception or an (even more distant) perception by international institutions and bilateral aid providers. And their assessment may provide more direct guidance for policies and the selection and provision of appropriate risk management instruments.

An example of an ex-post risk assessment is based on the 1994–1995 Ethiopian Rural Household Survey (Dercon and Krishnan, 2000). As highlighted in Table 2, for the rural population, natural risks (e.g., harvest failure) dominate other concerns, and even policy problems, such as resettlement and taxation, are more serious than labor problems, such as illness, death, and divorce. Altogether, agriculture-related risks dominate any other concerns in the rural area, including even war and crime. Introducing period-specific risks into the econometric specification further illustrates the effects of shocks such as rainfall (or the lack thereof) and livestock diseases, and the lack of consumption-smoothing instruments (Dercon and Krishnan, 2000: Table 6).

Qualitative risk assessments derived from participatory assessments and community consultations in other African countries confirm that the main sources of risk are largely perceived to be covariant (HIV/AIDS, war and civil conflicts, rural risks, and macroeconomic shocks), with some idiosyncratic shocks such as illness, widowhood,

**Table 2. Assessed Risk in Ethiopia by Rural Population During the Past 20 Years**

| Type of Risky Event                                   | Percent of Households Reportedly Affected by Type of Event | Mode Year of Most Recent Severe Event |
|---|--|---------------------------------------|
| Harvest Failure (due to drought, flooding, etc.)      | 78   | 1984                                  |
| Policy problems (resettlement, taxation, etc.)        | 42   | 1985                                  |
| Labor problems (illness or death, divorce, etc.)      | 40   | 1993                                  |
| Oxen problem (disease, theft, distress sale, etc.)    | 39   | 1993                                  |
| Other livestock (as above)                            | 35   | 1984                                  |
| Land problem (land reform, transfer to family member) | 17   | 1989                                  |
| Asset losses (fire, theft, villagization, etc.)       | 16   | 1985                                  |
| War   | 07   | 1989                                  |
| Crime/Banditry  | 03   | 1986                                  |

*Source:* Dercon and Krishnan (2000: Table 5), based on data from the 1994–1995 Ethiopian Rural Household Survey.

and old age also of concern.<sup>8</sup> Similar patterns also emerge for other lower and middle-income regions in South and East Asia and the Middle East and Northern Africa.<sup>9</sup> These findings call for public interventions that may not necessarily put traditional social protection programs in the forefront, but rather access to water, health care, and education. The situation in the former communist countries of Europe and Central Asia is somewhat different, since the old system tried to eliminate any kind of risk through public ownership of the means of production and planning, while providing a whole range of social protection programs (World Bank, 2000b). Here, a restructuring of these social programs for a market economy is needed and underway. What all regions and countries need is quantitative evidence of risk and vulnerability and qualitative indicators. Pilots in this direction are underway.

### **b. Country Pilots in Latin America and the Caribbean**

New risk and vulnerability assessments are currently being piloted by the World Bank in Guatemala and Colombia (Arriagada, Lindert, and Rawlings, 2001). The current plan of these assessments is to

- Construct a typology of vulnerable groups in each country,
- Construct a profile of key risks and assess their impact on the poor and key vulnerable groups,
- Examine household and community-level mitigation and coping mechanisms, and

<sup>8</sup> See the African Sector Strategy Paper “Dynamic Risk Management and the Poor: Developing a social protection strategy for Africa” (World Bank, 2000d).

<sup>9</sup> See the strategy papers for East Asia and the Pacific, the South Asian region, and the Middle East and North Africa (World Bank, 2000c–e).

- Review formal risk management and social protection interventions in each country and assess their effectiveness in reaching and protecting key vulnerable groups.

A major practical challenge for these country pilots is to develop a methodology and a set of indicators for assessing risk and vulnerability using limited cross-section and qualitative data. Clearly, panel data would be superior but are not available in either country or many other countries in the region. Even if they were available, they typically would not (yet) contain information about risks, risk instruments, and vulnerability. For this reason, existing cross-section data and newly launched survey data have to be used, including

- Single-cross-section household data resulting from recently fielded household surveys that include specially designed modules on risk, vulnerability, and risk management, in addition to traditional modules that could also lend information to analysis;
- Participatory qualitative vulnerability assessments that gather information on community perceptions of risk, vulnerability, poverty, and the use of SRM strategies; and
- Other information that is potentially relevant in these countries, such as poverty maps, maps of other vulnerability-related phenomena such as natural resources and disasters, conflict maps, food security maps (being tracked by the World Food Program and the Food and Agriculture Organization), other household surveys (such as demographic and health surveys, census data, etc.), and other economic data.

Another approach already piloted in various countries in the LAC region (such as Argentina, Jamaica, Mexico, and Uruguay) consists of using secondary information to identify key risks by age group, help identify possible measures to address these risks, and to clarify the role of social protection policies (including social insurance and social assistance programs) vis-à-vis other sectors. The secondary information draws on work on poverty assessments and budget analysis, voices of the poor surveys, information from NGOs, and other sources. Identifying risks by age groups is a simple but useful way to identify sources of vulnerability. As people move through the age profile with given social programs, a readily available indicator for vulnerability can be established. This short cut in the risk analysis process proves very powerful in complementing traditional poverty assessments and engaging governments in a discussion about appropriate policy responses. Table 3 presents an abbreviated version of such an age-group-related risk-policy response table for Argentina.

### c. Next Steps

The work on risk and vulnerability assessments is just beginning, at both the conceptual and operational levels. The approach undertaken by the World Bank is to move conceptual and operational work in tandem in order to leverage the gains in understanding. Conceptual work guides the next steps for implementation, while operational work and new survey pilots provide the feedback to rethink methodology and the conceptual framework.<sup>10</sup> The success of this approach is likely to be enhanced by

<sup>10</sup> For a first template on risk and vulnerability assessments, see Heitzmann, Canagarajah, and Siegel (2002).

**Table 3. Managing Social Risk in Argentina: Main Risks and Policy Responses**  
(Summary Table)

| Age group/<br>Main Risk                                   | Role for Other<br>Programs                            | Role for Social Protection                    |  | Number of<br>Indigent and<br>Poor Uncovered |
|---|---|---|--|---|
|   |   | Social Insurance                              | Social Assistance                                      |   |
| 0-5<br>Stunted<br>development                             | PHC services<br>Pre-school<br>education               |   | Early Child<br>Development<br>Programs                 | 400,000 ind.<br>1,000,000 poor              |
| 6-14<br>Low education<br>quality                          | Improve primary<br>school quality                     |   | Scholarships/return<br>to school incentive<br>programs |   |
| 15-24<br>Low secondary<br>school completion               | Improve secondary<br>school access/<br>quality        |   |  | 100,000 ind.<br>400,000 poor                |
| 25-64<br>Low income<br>(unemployment/<br>underemployment) | Labor-intensive<br>growth and labor<br>market reform  | Unemploy-<br>ment insurance                   | Workfare/income<br>transfers                           | 800,000 ind.<br>3,750,000 poor              |
| 65 and Over<br>Low income                                 |   | Social security<br>(contributory<br>pensions) | Noncontributory<br>pensions (income<br>transfer)       | 24,000 ind.<br>200,000 poor                 |
| <b>General Population</b>                                 |   |   |  |   |
| Low access to/quality<br>of health care                   | Provision of<br>health services                       | Health insurance                              |  | 1,700,000 ind.<br>6,000,000 poor            |
| Low housing quality                                       | Mortgage facilities,<br>infrastructure<br>development |   | Housing subsidies                                      | 200,000 hh. ind.<br>800,000 hh. poor        |

*Notes:* Blank cells = not applicable; hh = households; ind. = indigent; PHC = public health care.  
*Source:* World Bank (2000).

- Information sharing among regions, international institutions, bilateral aid providers, and others involved in this new approach. This is more easily said than done (even within one institution), but conferences like the Asian and Pacific Forum on Poverty are an important step.
- Supporting academic research at the analytical and empirical level, such as the use of panel data to derive vulnerability indicators that allow the use of cross-section data to signal vulnerability.
- Working very closely with governments to gain their support for the new approach and to disseminate the new thinking and methodology. Within the World Bank, this is being done through the World Bank Institute, and a new seminar and training module has been piloted with the African region in 2002.

## 6. Economic Crisis Management: What have We Learned For Social Protection?

Addressing major financial and economic crises, such as the debt crisis in Latin America in the 1980s and mid-1990s and the recent financial crisis in East Asia, presents a major challenge for SRM. Such crises stem from large covariant shocks to individuals and households that, if deep and protracted, are likely to exhaust their risk management capacity and their use of informal and market-based arrangements, as well as the risk management capacity of governments. Family and community risk-sharing arrangements are less effective in the face of covariant shocks; they tend to break down, and are

typically less effective, for the poorest of the poor. Governments are typically not prepared, either in administrative or budget terms, to handle a rising number of needy individuals; quite often programs not only cannot be expanded, they do not even exist. Lacking or having exhausted available risk management instruments, households will have to use short-term coping mechanisms such as taking children out of school and increasing time spent in the labor market by children and women, selling of productive assets, and reducing nutritional intake, all of which have long-term negative consequences for productive capacity and poverty reduction.

This background has motivated the Asia Pacific Economic Cooperation (APEC) finance ministers to ask the World Bank, the IMF, ADB, and IADB to prepare a paper that takes stock of the experience in Latin America and East Asia, and that distills good practices for the region and the world (World Bank et al., 2001). The report of this working group is based on responses to a questionnaire administered to six APEC countries (Chile, Indonesia, the Republic of Korea, Mexico, Peru, and Thailand) and follow-up missions to these countries during July–August 2000. The report provides a good first review of issues and recommendations, and the main findings include

- The availability of timely and reliable information on poor and vulnerable groups is critical for the design and implementation of social safety net programs.
- Pre-crisis planning can contribute to the design of effective safety nets. Planning will include an assessment of risks and target populations, together with identification of program instruments, financing, and a strategy for reducing or phasing out programs after the crisis.
- Ideally, safety net instruments should be in place before a crisis occurs. It is essential that the programs be targeted, provide adequate protection to the poor, avoid creating a culture of dependency among beneficiaries, and be consistent with economic incentives and overall targets of macroeconomic and fiscal policy.
- Social safety nets should build on existing public programs and mechanisms for targeting and delivery. In practice, safety nets will typically comprise a variety of programs and targeting methods. Major social safety net programs include cash or in-kind transfers, price subsidies, public works, fee waivers for social services, supplemental feeding and nutrition programs, targeted human development programs, and microfinance programs, as well as social insurance programs that can reach the poor.
- If adequate pre-crisis planning has not been possible, social safety nets should concentrate on existing programs, employing simple targeting methods that can be adapted quickly to increased utilization during the crisis.
- Transparency and accountability in the design and implementation of programs and in the use of resources are critical to the effectiveness of social safety net programs. Public information on the different programs and eligibility criteria should be made available as well as periodic and independent program evaluations.
- Social safety net programs should be coordinated across implementing ministries and departments as well as different government levels to avoid inefficient overlap and administrative waste.
- The building of adequate administrative capacity at the local level should precede decentralization.
- During crises, proportional cuts in social spending in general and safety nets in particular should be avoided. If possible, spending should be maintained or increased and key programs should be protected.

- The involvement of NGOs, community groups, and religious organizations can be promoted to enhance efficiency and accountability, provided their capacity to implement social safety nets is adequate (World Bank et al., 2001: 18).

Adding support for these conclusions to experiences from other countries, encouraging further technical clarification about design and implementation, disseminating the findings in these countries and beyond, and supporting implementation in these countries would be a major achievement for social protection and lasting poverty reduction.

## **7. Social Sector Expenditure Reviews: A Means to Improve the Efficiency of Public Interventions**

The SRM framework suggests that many effective risk management interventions fall outside the traditional social protection domain but are within the social sectors, such as access to basic health care, education, water supply, and sanitation. This suggests that an integrated view of social expenditure and financing would be beneficial. Furthermore, the Poverty Reduction Strategy Papers and the underlying process call for a review of budgetary expenditure in order to increase spending effectiveness. This asks for a review of social expenditures and their efficiency in contributing to poverty/vulnerability reduction.

Reviews of total government expenditure and selected policy areas are undertaken by a number of institutions to serve a variety of purposes. The IMF produces the Government Finance Statistics annually, with the key objective of making the fiscal accounts consistent with other accounts in the real and monetary sectors to facilitate detection, analysis, and reaction to sources of macroeconomic instability.<sup>11</sup> The World Bank produces public expenditure reviews, which examine the structure of expenditures and provide a broad-brush analysis of expenditure problems (including institutional weaknesses). The International Labour Organisation (ILO) produces social protection expenditure reviews and uses the European System of Integrated Social Protection Statistics as a starting point (Hagemeyer, 2000). Bilateral aid providers, such as DFID, GTZ, the Canadian International Development Agency, the Swedish International Development Cooperation Agency, as well as multilateral organizations, produce other expenditure reviews for loosely defined social subsectors in developing countries, most often on education and health, and sometimes on social safety nets or social protection, however defined. However valuable these different reviews by different actors are, they use different definitions and concepts, often are not linked to the development indicators these expenditures affect, and demonstrate the lack of agreement about the best methods to estimate the effectiveness of these expenditures. In addition, expenditure analyses often fail to take into account (extrabudgetary) spending by bilaterals and NGOs, or large employer-sponsored programs.

The current state of expenditure reviews calls for the development of a systematic methodological framework for social expenditure, financing, and performance reviews in developing countries. A framework is needed that is jointly developed and applied by international organizations, bilateral aid providers, and countries to undertake reviews with comparable results. Such a joint methodology would have at least two main effects: it would enable the development of benchmarks for countries, and it would facilitate

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<sup>11</sup> The new Government Finance Statistics manual enhances the link with the system of National Accounts, inter alia, by moving toward the recording of flows on an accrual basis and by integration of stocks and flows. See IMF (2000).

learning from the experiences of other countries. Moreover, once a methodology is established, institutions, bilaterals, and countries will be able to outsource these reviews to international and local consultants, whose work and results can be much better benchmarked and hence monitored. Finally, a joint framework would provide a better basis for partnership among international organizations as well as bilateral aid providers, and should contribute to institution building in the joint client countries.

The Social Protection Sector of the World Bank has developed a draft framework that will form the basis of dialogue with the ILO, IMF, and other partners, and several bilateral aid providers have expressed their interest in joining the effort (for the template, see Canagarajah, Heitzmann, and Holzmann, 2001).

The currently proposed approach to conduct a comprehensive social sector review is three-layered:

- Identify the scope and structure of a country's social sector;
- Monitor the necessity, appropriateness, and capability of social sector programs/interventions to reduce poverty; and
- Evaluate the economic effectiveness of social sector programs and interventions provided or financed by the public sector.

First, it is necessary to identify all expenditures related to a country's social sector by gathering information on relevant programs or interventions provided or financed by the government or the private sector.<sup>12</sup> The successful conduct of this exercise will enhance knowledge of the basic composition and structure of a country's social sector expenditures, as well as the provision and financing systems, and will allow analysts to answer basic expenditure-related questions, e.g., what, how much, by whom, and for whom.

Second, all of a country's social sector interventions and programs need to be reviewed in terms of their potential to reduce poverty/vulnerability. This involves primarily the assessment of whether social sector interventions/programs in a country meet the prioritized needs of the poor and contribute to improved risk management. Furthermore, in-depth analysis of programs or interventions by the public sector need to be carried out. Such an analysis would include the examination of whether public programs or interventions meet the rationale for public intervention and the actual demands of the poor. Moreover, the objective(s), progress and outcome(s) of each program or intervention would be studied to identify successful and unsuccessful projects. The information gathered by this exercise provides grounds for improving the allocation of resources between public programs.

Third, all social sector programs and interventions financed or provided by the public sector need to be evaluated in terms of their economic effectiveness, e.g., by use of cost benefit analysis, benefit incidence analysis, tracer studies, etc. The successful conduct of this exercise will provide information on necessary reforms of social sector programs/interventions in the public sector.

Applying the three-layered methodology proposed here will permit a description of the structure and composition of social sector programs and interventions within a country, as well as an analysis of the appropriateness, capability, and effectiveness of public sector

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<sup>12</sup> For a review of public and private transfers in the East Asia crisis context, see Sumarto, Suryahadi, and Pritchett (2000).

programs and interventions to reduce poverty and provide a rationale for necessary reforms of public programs.<sup>13</sup>

The suggested road map for the development of the framework and its implementation is pragmatic. First, after a reasonable and generally agreed draft is available, it is suggested that a review should be piloted in a few countries in each region to test its feasibility and to learn about its usefulness. Second, a sequential approach is suggested: a review would start with an assessment of the main programs before decisions were made about selective deepening of analysis and follow-ups. Finally, it is suggested that work begin with initial qualitative assessments and memorandum items before decisions are taken about resource-consuming quantitative follow-ups.

## 8. Concluding Remarks

With the new prominence that social protection has achieved in the past 10 years in development and poverty reduction, the aim of this paper has been to put forward and describe a conceptual underpinning for a more dynamic, forward-looking approach to the field. That conceptual underpinning is the SRM framework, based on the notion that social protection should be viewed not just as a series of stopgap measures to clean up after economic shocks, but as a springboard out of poverty.

The SRM framework focuses on vulnerability—the idea that economic stability for individuals and households is based on minimizing the risks that beset everyone, the poor most of all—and the need to offer instruments for managing risk to every person and family, in order to help the poor climb out of poverty and to keep others from falling into poverty. This approach to social protection is likely to be more effective for rapid and permanent poverty reduction. It also can help people cope with the increasing and ever more various risks with which the globalizing world threatens them.

For all its promise, many conceptual and operational issues still need to be addressed. Work in this direction includes, *inter alia*, development of an operational definition of vulnerability, the design and implementation of risk and vulnerability assessments, the design of appropriate safety nets to respond to major economic shocks, and the conduct of reviews of social sector expenditure, financing, and performance in various countries. Successful conclusion of this ground-laying work and implementation of SRM programs and planning in developing countries during the coming years should contribute to achieving the poverty reduction goals set at the Social Summit 2000 in Geneva.

To this end, a coalition is needed among multilateral development institutions (such as the World Bank and ADB) and bilateral aid providers (such as the Australian Agency for International Development, DFID and GTZ), national and international research institutions, and aid provider and client governments. While each will assume a specific role, collaboration to improve the design and implementation of a forward-looking social protection approach is important. Only then can the richness of thought and experience be harvested and applied for the benefit of the vulnerable.

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<sup>13</sup> Linking the assessed risks by age group with budgetary costs per capita also provides a first indication about the potential budgetary costs to cover the gap. For an application to social sector programs in the Mexican context, see Hall and Arriagada (2000: Table 6).

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