INNOVATIONS IN INSURING THE POOR

Social Protection and Risk

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Elements of social protection date back several millennia. Free food distribution was a feature of Egypt in the time of the Pharaohs and of Rome during its Imperial age. England had a succession of "Poor Laws" dating from the 16th century that provided assistance to those unable to work, and Germany inaugurated components of the modern welfare state in the late 19th century. The past 15 years have seen an upsurge in interest in implementing social protection in developing countries. This brief outlines the principal components of social protection, explains how they help households cope with risk, and notes critical design features.

Social protection

As shown in Figure 1, social protection encompasses three broad sets of public action. One is social safety nets. These are targeted noncontributory programs that transfer resources to poor households. Examples include transfers of cash through welfare payments, child allowances, or pensions; in-kind transfers such as food aid; vouchers and food stamps; school feeding programs; subsidies on goods purchased by the poor; and public works or workfare schemes. Recent innovations in safety nets include improvements in targeting; explicit links to asset formation (as in conditional cash transfer [CCT] schemes tied to schooling attendance); and improved delivery mechanisms such as the use of bank cards in Brazil's Bolsa Familia program.

A second component is publicly provided state-contingent insurance. Here, financial assistance is triggered by the realization of an event such as illness, disability, or unemployment. Eligibility and benefit levels are typically based on employment and contribution history rather than, say, current poverty status.

The third component consists of elements of social sector policies. For example, fee waivers for the use of primary healthcare facilities, interventions to prevent malnutrition in preschool children living in poor households, and free primary education not only serve as health and education policies, but also complement social safety-net interventions. Weather insurance products share characteristics of both safety nets (for example, when they are targeted to poor localities or when they are subsidized) and state-contingent insurance, with low rainfall levels acting as the trigger for payment.

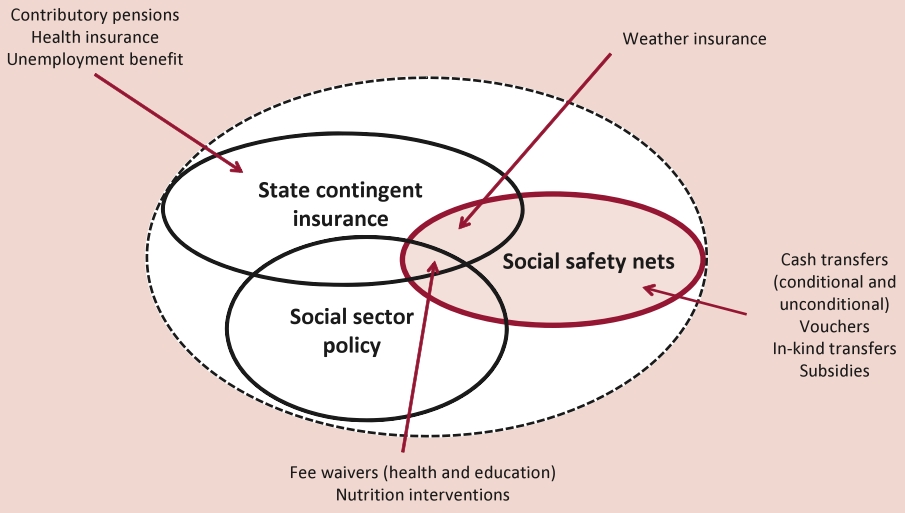
Social protection and risk

In addition to their intrinsic value in creating a fairer society, social protection programs have an instrumental function in reducing ex ante exposure to risk and the ex post consequences of shocks—and thus promoting economic growth—through several channels.

Most risks—potential events that generate welfare losses—emanate from the environment or setting (physical, social, political, legal, and economic) within which individuals reside. The physical setting refers to natural phenomena such as the level and variability of rainfall, exposure to cataclysmic events such as earthquakes and cyclones, the presence of communicable diseases, and the quality of infrastructure. The social setting captures such factors as social cohesion and strife and the existence of certain norms of behavior. The legal setting consists of the formal "rules of the game" that govern exchange, as well as their enforcement. This legal setting is in turn partly a function of the political setting, which includes the mechanisms by which these rules are set. Finally, there is an economic setting that captures policies that affect the level of assets, returns to assets, and the variability of those returns. Households' ability to cope with the realization of risks—that is, shocks—depends on the resources available to them and their ability to allocate, and reallocate, these resources (see also Brief 3, "Risk and the Rural Poor," for more on risk).

Ex ante, social protection may reduce the likelihood of political or social strife brought about by rapid but narrow growth or significant structural economic changes. This motivation drove China's recent expansion of social protection in order to promote a "harmonious society." Reductions in such tensions may increase the security of property rights by reducing the likelihood of confiscation by state actors (as a consequence, say, of a coup) or

Figure 1—Sources of loans for major health events



Source: SKS Microfinance client survey, 2007.
Note: Total number of loans in this category = 8,007.

private actors (where low social cohesion leads to increased crime). Reducing political tensions also reduces the likelihood of radical, unexpected changes in economic policy, which is itself another form of risk faced by households.

Holding assets is a key ex ante risk management mechanism. Social safety nets can facilitate the creation of assets at the individual, household, and community level. In theory, households could borrow money to finance these investments, but many poor households lack access to credit, which would allow them to acquire assets, invest in their children's human capital, or build up the capital needed to enter more profitable activities. Certain types of safety nets create assets of value to the local economy; public works programs that rehabilitate roads, refurbish canal and irrigation facilities, or build structures—such as schools and health clinics—are examples. In addition, local communities are increasingly involved in decisionmaking on the choice of assets to be built, the management of their construction, and the oversight of the finances being used. This community participation not only increases the likelihood that communities will value the assets constructed, but also helps build up social capital and governance capacity in these communities.

Even if shocks do not occur, the threat of shocks discourages innovation and risk taking. Studies from south India and Tanzania show that because poor households deploy their assets more conservatively than wealthy households, they earn lower returns on their assets. Further, the threat of shocks can make households reluctant to participate in credit markets because they fear the consequences of an inability to repay. With the right design and implementation features, social protection can create space for innovation, which, by increasing incomes and assets, reduces vulnerability to future shocks.

Ex post, social protection provides two functions. As a source of income, it replaces the income lost as a result of the shock and thus enables households to maintain consumption levels. It also releases households from having to choose between maintaining consumption but depleting assets on the one hand and preserving assets (and thus future income streams) by reducing consumption on the other. Shocks, even if temporary, can reduce investment in human capital, with long-lasting consequences. In Zimbabwe, children exposed to the civil war preceding independence and the droughts that occurred in the early 1980s were more likely to be stunted as preschoolers, have reduced stature by late adolescence, and complete less formal schooling.

Critical design issues

The mere existence of social protection programs is by no means sufficient to ensure pro-poor growth. Poorly designed or implemented social protection programs, or those with only token funding, are unlikely to meet the intrinsic or instrumental objectives described here. Much depends on correct design. Effective social protection and effective social safety nets have six key characteristics: a clear objective; a feasible means of identifying intended beneficiaries; a means of transferring resources on a timely and reliable basis; a means of scaling up and back in response to transitory events; ongoing monitoring of operations and rigorous evaluation of effectiveness; and transparency in operation to encourage learning, minimize corruption, and ensure that beneficiaries, and the wider population, understand how the program functions.

Transparency, timeliness, and reliability are especially critical. Absent these, social protection can veer dangerously close to being just another source of random income shock. Ethiopia's Productive Safety Nets Programme has led to sizable increases in beneficiary asset holdings, but where payments have been unpredictable, the likelihood of distress sales of assets actually increased.

Social protection can induce moral hazard or disincentives (for example, in terms of risk taking or labor supply); although these risks are worth keeping in mind, the preponderance of evidence suggests that in most cases the magnitudes of such adverse behavioral responses are small or negligible. As the coverage of social protection expands, program designers also need to be mindful of the cumulative effects of these interventions and the extent to which individual components complement or substitute for each other. For example, there is relatively little understanding of the extent to which innovations in social protection, such as weather insurance, intersect with longstanding programs like emergency drought relief. Does it make sense to support both? Or should governments focus on providing a minimum safety net for those in greatest need of assistance while creating space for private market mechanisms to provide additional insurance for those who would like to purchase it or who are unlikely to receive publicly provided assistance?

Caveats and conclusions

Shocks are pervasive in developing countries. Social protection can reduce the likelihood of certain shocks occurring and facilitate asset formation. It can replace lost income and prevent transitory shocks from having permanent consequences. Such outcomes have both intrinsic and instrumental value. But this potential is realized only when social protection is timely, reliable, and transparent. ■

For further reading: M. Grosh, C. del Ninno, E. Tesliuc, and A. Ouerghi, *From Protection to Promotion: The Design and Implementation of Effective Safety Nets* (Washington, D.C.: World Bank, 2009); U. Gentilini and S.W. Omamo, *Unveiling Social Safety Nets* (Rome: World Food Programme, 2009); and H. Alderman and J. Hoddinott, "Growth-Promoting Social Safety Nets," in J. von Braun, R. Vargas-Hill, and R. Pandya-Lorch, eds., *The Poorest and Hungry: Assessments, Analyses, and Actions* (Washington, D.C.: International Food Policy Research Institute, 2009).

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